

CBRE

TEESSIDE PENSION FUND

Quarterly Portfolio Strategy Report

1ST JULY 2019 TO 30TH SEPTEMBER 2019

PREPARED FOR



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1 EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

Portfolio Strategy

You have advised us that your objective is to increase the property portfolio to £350m in a risk controlled manner.

CBRE Recommended Strategy

- To diversify the portfolio through different property types, unit sizes, occupier businesses, quality, income expiry and geographical regions.
- To make acquisitions and disposals that help balance the portfolio's overall lease expiry profile.
- Maintain a long term heavily weighted position in industrial and retail, alongside an under weight position in offices. Acquire prime, well let properties, together with some RPI linked assets.
- Keep the vacancy rate lower than typical institutional investment portfolio levels, whilst reducing income risk in particular years.

SECTOR	CURRENT WEIGHTING	TARGET WEIGHTING
Industrial	43.8%	40.2%
Retail Warehouse	27.8%	30.0%
Long Income	11.2%	18.5%
Offices	2.6%	2.5%
High Street Retail	14.6%	8.8%
	100%	100%

EXECUTIVE SUMMARY

Portfolio Profile

- At 30th September 2019 the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £290.5m. This reflects an overall Net Initial Yield of 5.23%, and an Equivalent Yield of 5.59%.
- The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 86.2% of the portfolio by capital value. There are 75 demises and a total net lettable area of 1,949,442 sq ft.
- The weighted average unexpired term is 7.1 years to the earlier of first break or expiry, and 8.7 years to expiry, ignoring break dates.
- The portfolio also has the following characteristics:
 - The vacancy rate is currently 1.3% of Estimated Rental Value. By comparison, the 'IRIS Digest Q2 2019' confirmed an 'all sectors' average void rate of 7.3%.
 - The top ten tenants constitute 50.1% of the total gross annual income of the portfolio, while the top twenty tenants constitute 72.8%.
 - Current gross passing rent is £16,141,175 per annum, against a gross current market rent of £17,270,292 per annum, making the portfolio reversionary in nature.

EXECUTIVE SUMMARY

Portfolio Activity

Investments

Sales

- No sales this period.

Acquisitions

- CBRE have submitted an offer to acquire 1-8 Broadway, Ealing, on behalf of the Fund. Having been invited to submit a second round offer, as at the date of this report, we are awaiting the outcome.

EXECUTIVE SUMMARY

Portfolio Activity And Strategy

Portfolio arrears at 16th October 2019

The total Collectable Arrears on the entire portfolio is £66,033.36 at 16th October 2019. The Collectable Arrears exclude the following:

- Tenants that are insolvent (99p Stores Limited at Cirencester and HHGL Limited at Bingley).
- Tenants that are charged quarterly and pay monthly and are up-to-date (B&Q plc at Hull, Aurum Group Limited at Newcastle and J.F. Stone Investments Limited at Gloucester Road)
- Tenants that have overall credit balances on their accounts.

Of the Collectable Arrears, 80.7% (£53,264.72) relates to the following three tenants:

- My Realisations Ltd (In Administration) – Total arrears of £40,396.87 (61.2% of the collectable arrears). This is mainly the September quarter rent and service charge and we are continuing to chase for payment.
- B&Q plc (Arbroath) – total arrears of £7,224.39 (10.9% of the collectable arrears). This relates solely to two service charge payments from 28/11/2017 and 28/02/2018 (and a balancing service charge credit) and is due to the service charge being restructured for the whole property. All other sums have been paid in full.
- Pizza Hut (UK) Ltd (Ipswich) – Total arrears of £5,643.46 (8.5% of the collectable arrears). This relates mainly to rent from the settlement of the old rent review, which continues to be chased. All current charges have been paid.

The remaining 19.3% of the Collectable Arrears (£12,768.64) relate to 20 different tenant accounts; all of which are being chased.

EXECUTIVE SUMMARY

Rent Collection Statistics

Rent Collection Statistics at 29th September 2019

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 29 September	Collectable Rent	Quarter Date up to and including 29/09/2019	Week 1 up to and including 06/10/2019	Week 2 up to and including 13/10/2019	Week 3 up to and including 20/10/2019	Week 4 up to and including 27/10/2019	Payment after 27/10/2019	Difference
Non Collectable Total	4,293,565	4,152,014	3,093,814	855,973	4,250	92,855	-	-	105,122
Collections Including non collectables		141,551							
Collections Excluding non collectables			72.1%	92.0%	92.1%	94.3%	94.3%	94.3%	
			74.5%	95.1%	95.2%	97.5%	97.5%	97.5%	

These figures relate to rents that only became due on the December English Quarter Day (29th September 2019).

The total non-collectable sum equates to £141,551. This relates to; B&Q Plc, Hull (£72,051), Aurum Group Ltd (£61,000) and J.F. Stone Investments Ltd (£8,500). All tenants are either being chased or have paid, with payment receipt pending bank transfer completion.

The rent attributed to the unit formerly occupied by Multiyork at Interchange Retail Park is being paid by a guarantor to the lease. Multiyork entered administration on 22nd November 2017.

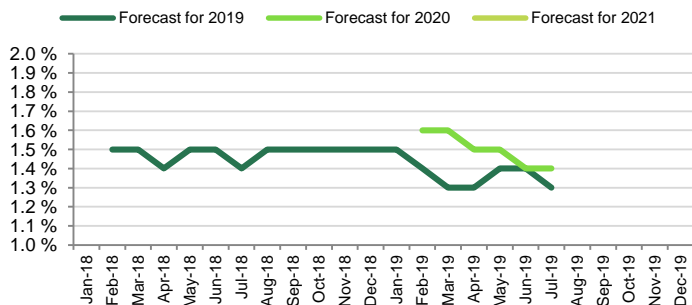
2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

PROPERTY MARKET & SECTOR FORECASTS

Economic Performance Q3 2019

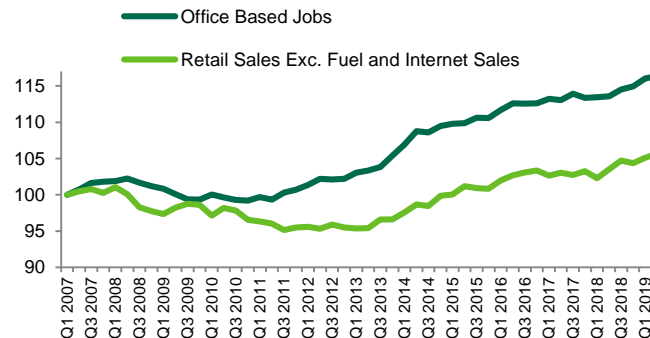
- The UK economy grew moderately at 0.4% over the rolling three month period to the end of August, increasing 0.2% from the previous rolling three months, uplifting GDP expectations in the short term. Supporting this growth, the services sector still remains the main positive contributor, growing 0.4% in the three months to August with construction output also growing marginally by 0.1%. In contrast, the production sector fell by 0.4% in the same period, exacerbated by a sharp decline in car production. This leaves underlying GDP growth at around 1.3% per annum.
- The UK employment rate still remains high at 75.9%, up 0.3 percentage points on the year but 0.2% lower than last quarter. Despite the marginal fall, unemployment rates still remain at record lows of 3.9% which remains the key driver of economic growth in a period of persistently low productivity growth.
- Sustained increases in employment growth and a tight labour market are both having a positive effect on wage growth. Year-on-year average annual weekly earnings increased 4% in July. This represented an increase on the previous month and far exceeding headline CPI inflation – which is running at 1.7%.
- The simultaneous pick-up in wage growth and the fall in inflationary pressures is having a positive effect on real household disposal income, helping to underpin consumer spending.
- CBRE are forecasting GDP growth of 1.2% in 2019 and 1.1% in 2020. It is important to note that these forecasts assume that the UK will agree a deal with the European Union on largely the same terms of that which has currently been proposed and agreed between the Prime Minister and the EU.

Evolution of UK GDP Growth Forecast



Source: CBRE, Oxford Economics, ONS

Economic Drivers of Commercial Property Demand



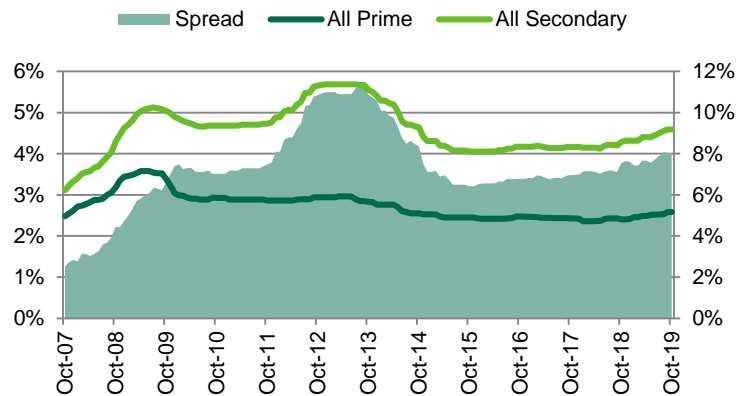
Source: HM Treasury Consensus

PROPERTY MARKET & SECTOR FORECASTS

Property Market Q3 2019

- Year-on-year Total Returns for All UK Property were 2.4% for the period Q3 2018 to Q3 2019**. Reflecting a fall of 3% in Capital Return and, conversely, a 5.5% increase in Income Return.
- Returns at this level are lower than the 5 year average – as the Retail sector’s woes continue to filter through an impact returns at an All Property level.
- Quarterly Total Returns for All UK Property for Q3 recorded 0.5% (-0.9% capital return, 1.4% income return).
- Industrial, once again, recorded strong performance when compared with other sectors in Q3 2019. Total Returns in this sector stood at 2.2% (0.7% capital return, 1.2% income return).
- Rental Values for All UK Property increased 0.1% in the third quarter of 2019. This figure was largely impacted by a fall of -1.2% in the Retail sector, compared with an increase of 1.1% in the Office sector.

Prime Vs Secondary All Property Yields (excl. Central London)

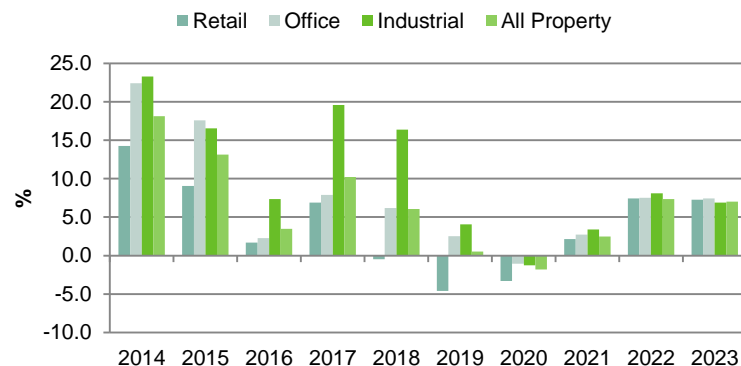


Source: CBRE Monthly Yields, Oct 2019

* Return figures will not always sum due to separate compound calculations

** Based on CBRE Monthly Index, All Property Total Returns, Sept 2019

Property Total Returns



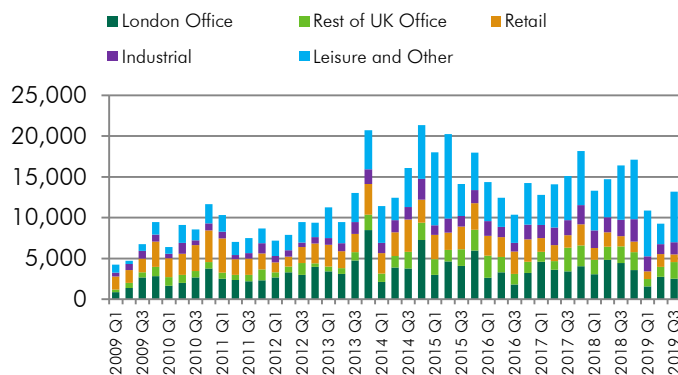
Source: MSCI, CBRE, May 2019

PROPERTY MARKET & SECTOR FORECASTS

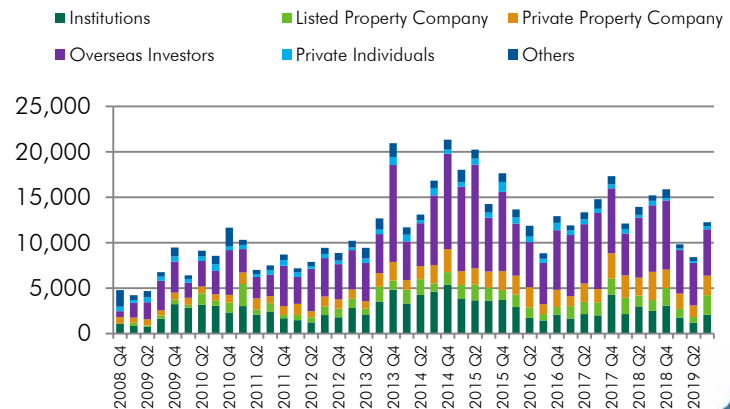
Property Market Q3 2019 Transactions

- In Q3 2019, investors recorded total transaction volumes across 'All Property' at £13.2bn. This is an increase from the £9.3bn reported in Q2 2019, but decrease from the £16.4bn reported in Q3 2018.
- In Q3, 42% of purchasers were overseas investors. The continuation of overseas investor interest has likely been driven in part by the devaluation of Sterling following the continued uncertainty surrounding the UK's future relationship with the European Union.
- UK institutions accounted for 17% of transactions in Q3 2019, amounting to c. £2.0bn of investment. This is a slight increase on the 15% reported in Q2 2019.
- Investment transactions for 'All Offices' totalled £4.6bn in Q3 2019. Central London office investment recorded £2.5bn of capital deployed, accounting for 55% of total office investment for the Quarter. The highest transaction during this quarter was Goldman Sachs purchase of Croyley Business Park for £400m.
- The Industrial sector saw £1.5bn in transaction activity in Q3 2019, reflecting the continued interest in this sector. The biggest deal of Q3 was the sale of Panattoni Park, Northampton for £86.6m.
- Retail transactions totalled £0.9bn for the quarter, with DTZ Investors purchasing The Podium in Bath for £69.8m.

Commercial Property Investment Transactions (£millions)



Source: : CBRE, Property Data, Oct 2019



Source: : CBRE, Property Data, Oct 2019

PROPERTY MARKET & SECTOR FORECASTS

UK Returns Forecast Q3 2019

	2016	2017	2018	Forecast*				2023	Annualised
				2019	2020	2021	2022		2019-2023
Total return: % per year									
Retail	1.7	6.9	-0.5	-4.6	-3.3	2.1	7.4	7.3	1.7
Office	2.3	7.9	6.2	2.5	-1.1	2.7	7.5	7.4	3.8
Industrial	7.3	19.6	16.4	4.1	-1.3	3.4	8.1	6.9	4.2
All Property	3.5	10.2	6.0	0.5	-1.8	2.5	7.3	7.0	3.0

Income return: % per year									
Retail	5.2	5.1	5.1	5.2	5.4	5.5	5.4	5.3	5.4
Office	4.1	4.1	4.0	4.0	4.2	4.4	4.4	4.2	4.2
Industrial	5.3	5.1	4.5	4.4	4.5	4.8	4.7	4.6	4.6
All Property	4.9	4.8	4.6	4.5	4.5	4.7	4.6	4.5	4.6

Capital growth: % per year									
Retail	-3.3	1.7	-5.3	-9.4	-8.2	-3.2	1.9	1.9	-3.5
Office	-1.7	3.6	2.1	-1.5	-5.0	-1.6	3.0	3.1	-0.4
Industrial	2.0	13.9	11.4	-0.3	-5.5	-1.3	3.2	2.2	-0.4
All Property	-1.3	5.2	1.4	-3.8	-6.1	-2.1	2.6	2.4	-1.5

Nominal rental value growth: % per year									
Retail	1.0	1.1	-2.2	-3.1	-1.8	-1.2	-0.3	0.6	-1.2
Office	2.9	1.5	0.8	0.9	0.4	0.5	1.0	1.7	0.9
Industrial	3.5	5.3	4.6	2.8	2.7	1.6	0.5	0.2	1.5
All Property	2.1	2.2	0.5	-0.2	0.2	0.2	0.5	1.0	0.3

Equivalent Yields - % at end year									Change pp
Retail	5.7	5.5	5.7	6.0	6.3	6.3	6.1	5.9	0.3
Office	6.0	5.8	5.6	5.7	5.9	5.9	5.7	5.6	0.0
Industrial	6.3	5.7	5.3	5.4	5.8	5.9	5.7	5.5	0.2
All Property	5.9	5.6	5.5	5.6	5.9	5.9	5.7	5.5	0.1

In 2019 performance across sectors will be wide but narrowing over the forecast horizon. Structural shifts in consumer spending habits are being compounded by Brexit uncertainty and varying supply and demand dynamics.

All Property Total Returns for 2019 are expected to be lower than last year. This is owing primarily to an outward shift in retail yields. The industrial sector will continue to outperform other sectors, with the structural shift toward logistics space combined with a more constrained supply than is seen across other key sectors. We expect All Property Returns to decline before an uptick in growth again in 2021. This is due to yields shifting outward in line with interest rates and a slowing global and UK economy as projected in the CBRE macro-economic house view. A recovery in yields and the economy is forecasted to then follow. The 5-year annualised Total Return for forecast 2019-2023 is 3.0% per annum.

Moderate rental growth is forecast in the office sector while industrial rental growth continues, albeit at a slower pace. Retail rental growth is negative on a five year basis. The general movement in rents highlights our outlook for the UK economy, with market factors such as weak retail spending, slowing employment growth and rising e-commerce giving sectoral variation.



* Forecast figures based on Q2 2019 Quarterly Valuations.

Source: CBRE Sector Forecasts, Q3 2019

3 PORTFOLIO STRATEGY AND FORECASTING

PORTFOLIO STRATEGY AND FORECASTING

Portfolio Strategy

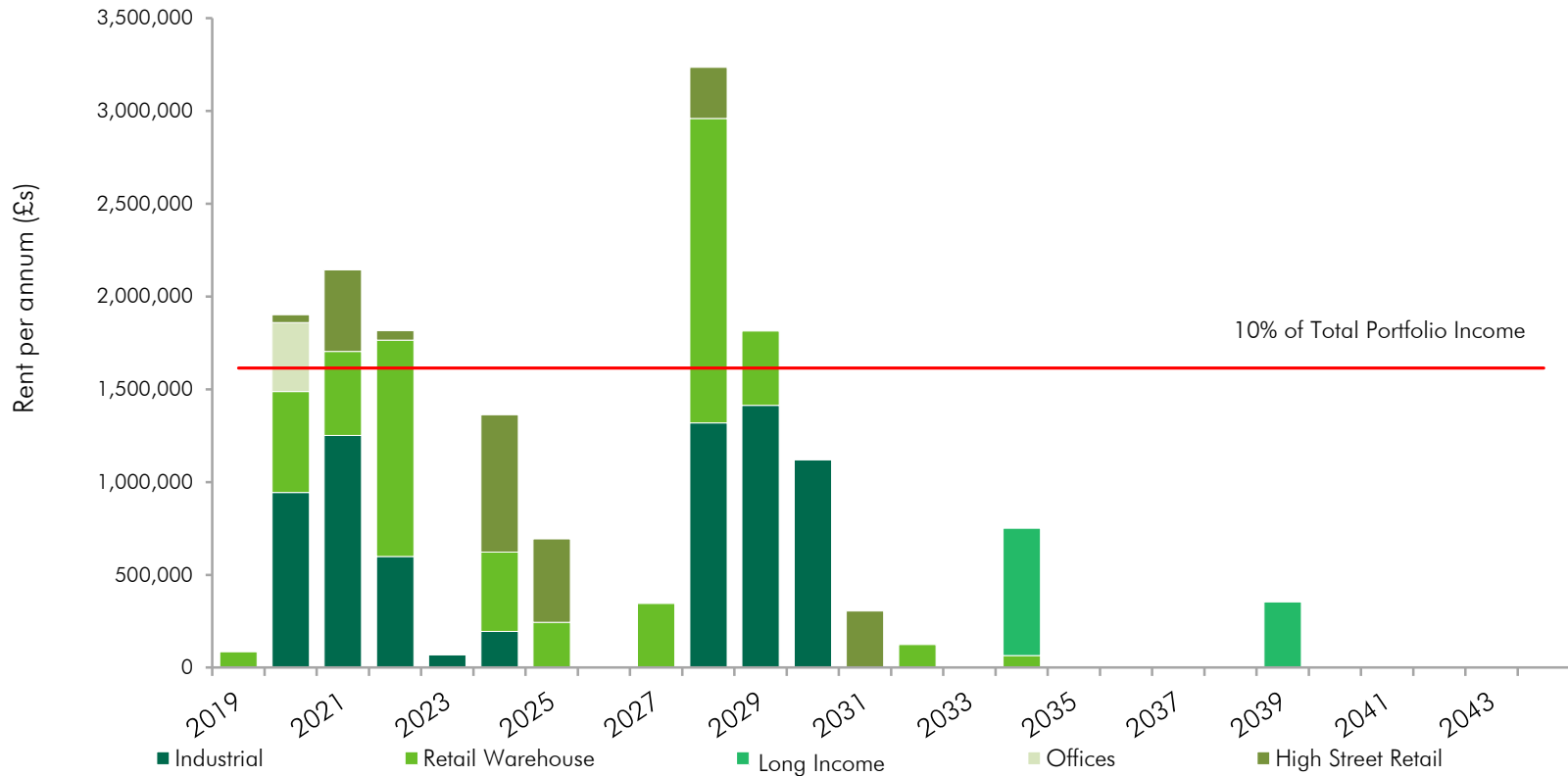
Top Down Strategy

- The Teesside Pension Fund was valued at approximately £4.084bn in March 2019. The Direct Property Portfolio held by the Fund was valued at £290.5m, equating to 7.1% of overall Fund value. The Fund's level of real estate exposure is generally considered underweight, when compared with similar pension funds.
- We will seek to extend the weighted average unexpired lease term (WAULT) of the portfolio, as well as diversifying the lease expiry profile.
- In addition to recommendations on industrial and retail purchases, we may also recommend alternative investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure and student housing.
- Set against a backdrop of mediocre economic growth, we will seek to make purchases where both occupational and investment supply and demand conditions are strong. This will ensure that purchases are accretive to the portfolio's performance.
- As we continually assess all of the properties within the portfolio, we will also consider sales based on asset specific considerations.
- A key driver of the portfolio performance will continue to come from effective asset management of the existing stock to maximise rental income and extend lease lengths.
- A graph showing the expiry profile, per sector, is shown overleaf.

PORTFOLIO STRATEGY AND FORECASTING

Portfolio Strategy

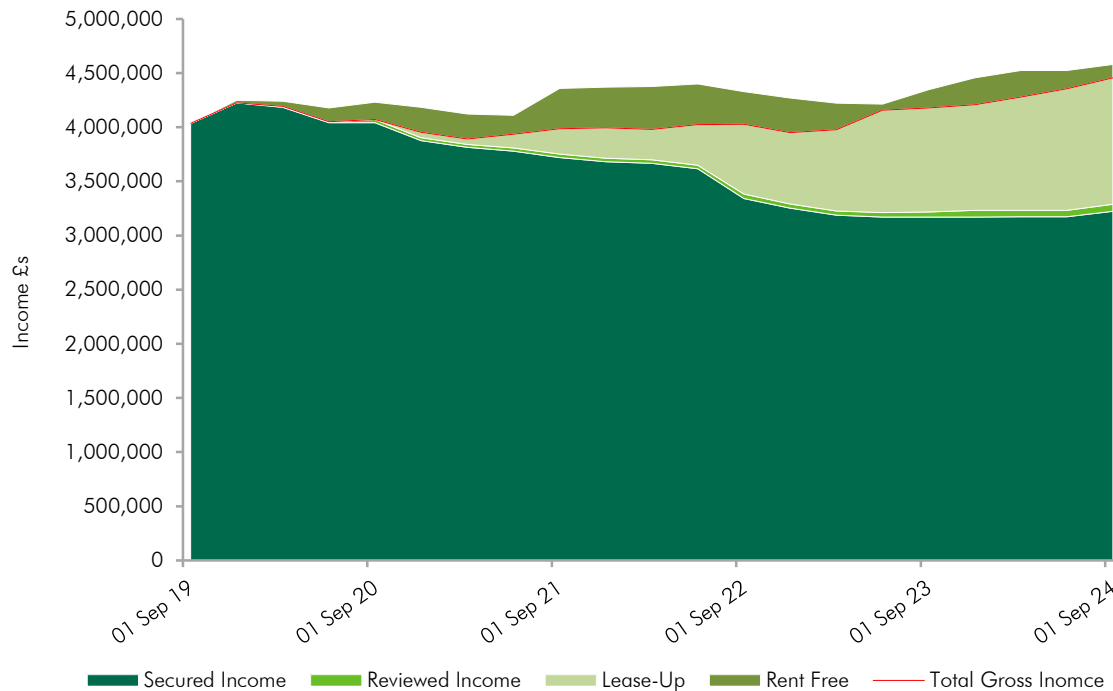
Expiry Risk



PORTFOLIO POSITIONING AND FORECASTING

Portfolio Analysis

Portfolio Income Profile



The income forecast includes our current rental growth projections.

CBRE forecasted rental growth figures have been used and adapted to reflect anticipated rental movement, based on the quality and sub-location of individual assets.

REGION	% OF PORTFOLIO CAPITAL VALUE
London	11.9%
South East	9.6%
South West	10.3%
East	7.1%
West Midlands	24.4%
North East	30.6%
North West	4.1%
Scotland	1.9%
Total	100%

SECTOR	% OF PORTFOLIO (RENTAL VALUE)
Industrial	43.8%
Retail Warehouse	27.8%
Long Income	11.2%
Offices	2.6%
High Street Retail	14.6%
Total	100%



TOP 20 TENANTS (BY CURRENT RENT)

POSITION	TOP 20 TENANTS	TOTAL AREA	CURRENT RENT (£PA)	ERV (£PA)	% OF PORTFOLIO	NO. OF LEASES	FIRST LEASE EVENT
1	Omega Plc	320,815	£1,413,574	£1,413,574	8.76%	1	09 September 2029
2	B&Q plc	107,068	£997,000	£1,025,000	6.18%	2	31 January 2027
3	Royal Mail Group Limited	207,572	£899,162	£1,000,000	5.57%	1	23 September 2030
4	DHL Supply Chain Ltd.	146,138	£868,635	£875,000	5.38%	1	28 September 2021
5	Brunel Healthcare	136,342	£843,761	£650,000	5.23%	1	10 April 2028
6	H&M	32,501	£740,000	£740,000	4.58%	1	23 June 2024
7	Tesco Stores Limited	25,084	£686,011	£570,000	4.25%	1	28 July 2034
8	P&O Ferrymasters Limited	122,157	£662,000	£700,000	4.10%	1	25 December 2020
9	Matalan Retail Limited	51,753	£500,000	£500,000	3.10%	1	27 November 2028
10	Halycon Fine Art Ltd	38,722	£475,000	£500,000	2.94%	1	22 December 2028
11	Barclays	18,833	£450,000	£450,000	2.79%	1	23 June 2025
12	HSBC Bank Plc	2,016	£440,000	£460,000	2.73%	1	18 October 2021
13	Wickes Building Supplies Limited	28,338	£396,750	£396,750	2.46%	1	29 September 2028
14	DSG Retail Limited (t/a Currys/PC World)	25,000	£375,000	£375,000	2.32%	1	28 September 2022
15	B&M Retail Limited (t/a B&M Homestore)	25,000	£375,000	£375,000	2.32%	1	28 September 2022
16	Institute of Cancer Research	9,502	£371,420	£371,420	2.30%	1	17 February 2020
17	Nuffield Health	26,458	£354,715	£331,000	2.20%	1	04 April 2039
18	Pets at Home Ltd	15,577	£325,825	£302,500	2.02%	2	05 January 2024
19	Aurum Group Limited	1,440	£305,000	£305,000	1.89%	1	01 March 2031
20	River Island Clothing Co Ltd	1,270	£275,000	£275,000	1.70%	1	30 November 2028
	TOTAL	1,341,586	£11,753,853	£11,615,244	72.8%	22	

4 PORTFOLIO ACTIVITY

PORTFOLIO ACTIVITY

ASSET MANAGEMENT COMMENTARY

Cirencester Retail Park

- Following its fall into Administration, 99p Stores vacated its unit on the Park. ESH have been engaged to re-let the unit and have advised on occupier interest on both a whole and split unit basis. Following this, negotiations are ongoing with an occupier who have confirmed an interest in taking the unit vacated by 99p Stores.

Bromford Central, Birmingham

- Wolseley UK Ltd have vacated Unit 4. CBRE Building Consultancy have specified and administered the repair works at the property. These have been carried out by Inco Contracts and have recently been completed. A schedule of dilapidations has been served on Wolseley UK Ltd, with negotiations ongoing. The unit was previously under offer, however a change in corporate direction has resulted in the proposed Tenant withdrawing and the unit going back to the market.

Magna Park, Lutterworth

- A 'Wants of Repair' schedule has been served on the under-tenant. The under-tenant is in agreement that repair works need to be carried out at the premises and a timescale for the required works has been agreed. We are in receipt of an offer for a lease extension from the under-tenant, who will be taking sole possession of the unit and are in the process of agreeing Heads of Terms.

17-23 Gloucester Road, London

- A reversionary lease has been agreed with Partridges at Gloucester Road. The terms are largely similar to their current occupation (expiring December 2020). The reversionary lease will ensure an extension of the term certain through until 24th December 2030.

Unit B, 1-3 Acre Road, Reading

- PSCO Ltd / Midwich have vacated Unit B. Sharps Commercial have been engaged to re-let the unit and have advised on a marketing strategy. PSCO Ltd / Midwich are currently carrying out their dilapidations works on the unit, and are due to hand the unit back in February 2020.

Omega, Thorne

- By way of the rent review mechanism contained within the lease of the premises at Thorne, let to Omega Kitchens Plc, the rent has increased in line with the Retail Prices Index from £1,250,000 to £1,413,574 (+13.1%). Effective from 10th September 2019.

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