

CBRE

TEESSIDE PENSION FUND

Quarterly Portfolio Strategy Report

1ST OCTOBER – 31ST DECEMBER 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	44.8%	40.2%
Retail Warehouse	26.8%	30.0%
Long Income	11.5%	18.5%
Offices	2.6%	2.5%
High Street Retail	14.3%	8.8%
	100%	100%

EXECUTIVE SUMMARY

Portfolio Profile

- At 31st December 2019 the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £285.3m. This reflects an overall Net Initial Yield of 5.60%, and an Equivalent Yield of 5.68%.
- The portfolio comprises principally prime and good secondary assets. High street retail, retail warehouse and industrial comprise 85.9% 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 6.9 years to the earlier of first break or expiry, and 8.5 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 Q3 2019' confirmed an 'all sectors' average void rate of 7.1%.
 - The top ten tenants constitute 49.9% of the total gross annual income of the portfolio, while the top twenty tenants constitute 72.6%.
 - Current gross passing rent is £17,011,949 per annum, against a gross current market rent of £17,136,692 per annum, making the portfolio reversionary in nature.

EXECUTIVE SUMMARY

Portfolio Activity

Investments

Sales

- No sales this period.

Acquisitions

- No acquisitions in this period.



EXECUTIVE SUMMARY

Portfolio Activity & Strategy

Portfolio arrears at 21st January 2020

The total Collectable Arrears on the entire portfolio is £55,518.03 at 21st January 2020. 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, 92.1% (£51,119.45) relates to the following three tenants:

- My Realisations Ltd (In Administration) – Total arrears of £39,121.62 (70.5% of the collectable arrears). This primarily relates to the rent and service charge for the December quarter. We continue to chase and Duff & Phelps have advised that payment is on this week's payment run.
- Tesco Stores Ltd (Stow on the Wold) – Total arrears of £6,232.02 (11.2% of the collectable arrears). This relates solely to the backdated increase on the September 2019 rent review, which was raised in Mid-November. We are continuing to chase for payment.
- Pets at Home Limited (Dorchester) – Total arrears of £3,014.87 (5.4% of the collectable arrears). This relates solely to the balancing service charge for the year ending 30 June 2019. The tenant has raised queries and these are being resolved by the Surveyor.
- DSG Retail Ltd (Dorchester) – Total arrears of £2,750.94 (5.0% of the collectable arrears). The majority of these arrears relate to the balancing service charge for the year ending 30 June 2019. No queries have been raised and we are chasing for payment.
-

The remaining 7.9% of the Collectable Arrears (£4,398.58) relate to 15 different tenant accounts, all of which are being chased.

EXECUTIVE SUMMARY

Rent Collection Statistics

Rent Collection Statistics at 28th January 2020

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 25 December	Collectable Rent	Quarter Date up to and including 25/12/2019	Week 1 up to and including 05/01/2020	Week 2 up to and including 12/01/2020	Week 3 up to and including 19/01/2020	Week 4 up to and including 26/01/2020	Payment after 26/01/2020	Difference
	4,394,916.55	4,394,916.55	3,631,091.34	157,752.40	433,850.00	0.00	67,355.00	0.00	104,867.81
Non Collectable Total		0.00							
Collections Including non collectables			82.62%	86.21%	96.08%	96.08%	97.61%	97.61%	
Collections Excluding non collectables			82.62%	86.21%	96.08%	96.08%	97.61%	97.61%	

These figures relate to rents that only became due on the December English Quarter Day (25th December 2019).

The difference of £104,867.81 relates to B&Q Plc, Hull (£72,051), Aurum Group Ltd (£30,500) and J.F. Stone Investments Ltd (£2,317.12). These tenants pay rent on a monthly basis and are currently not in arrears. 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.

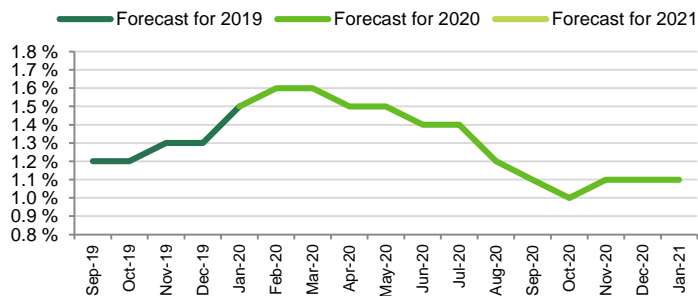
2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

PROPERTY MARKET & SECTOR FORECASTS

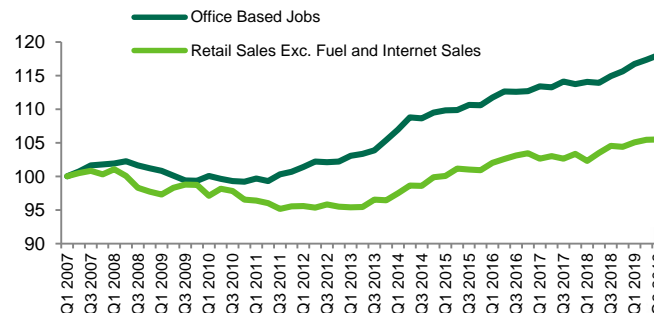
Economic Performance Q4 2019

- The UK economy grew 0.4% in Q3 despite considerable Brexit volatility, increasing from the -0.2% fall in GDP in Q2. Monthly GDP for November – which gives an indication of the pace of Q4 growth – was a modest 0.1%. Retail sales volumes for the combined months of November and December were two of the weakest on record, suggesting that the Q4 estimate for 2019 is also likely to be weak.
- The labour market, by contrast, continued to show strength in December and November. The unemployment rate remains below 4%, with the number of people in employment is at record high. Despite forward looking indicators – such as hiring intention surveys and total vacancies – suggesting that the labour market may be softening, office-based employment continues to outpace the overall total, supported by strong tech sector job creation.
- Job creation and a tight labour market continue to put upward pressure on wages. Total average annual weekly earnings growth increased 3.2% Y-o-Y over the three months to November, and despite a slight levelling off on the previous three months, remains robust. An increase in real household spending power, bolstered by the aforementioned pick-up in wage growth and the fall in inflation, is helping to support consumer spending.
- Looking ahead, Q1 2020 already looks to be considerably stronger than the end of 2019. Markets are citing a 50% chance of an interest rate cut in H1 2020. Additionally, the March budget is likely to show a combination of increases in public sector investment and cuts to National Insurance, with an increased probability that both monetary and fiscal stimulus will be provided to support the UK economy in 2020.
- As such, CBRE is forecasting GDP growth of 1.0% in 2020. Implicit in our forecast is that the UK will agree a Withdrawal Agreement with the EU, exiting on the 31st January 2020. The UK will then target to formalise a Trade Agreement with the EU before the end of the transition period on the 31st December 2020.

Evolution of UK GDP Growth Forecast



Economic Drivers of Commercial Property Demand

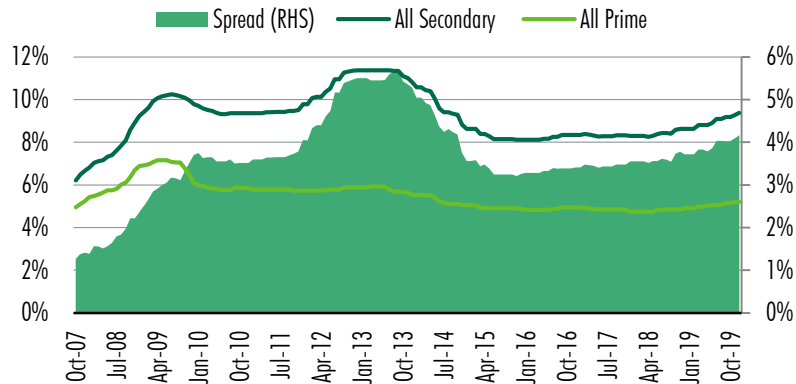


PROPERTY MARKET & SECTOR FORECASTS

Property Market Q4 2019

- Year-on-Year total returns for All UK Property were 1.3% (-3.0%* capital return, 4.6%* income return) for the period Q4 2018 to Q4 2019**. Year-on-Year returns at this level are lower than the 5 year average, mainly due to the Retail sector's woes continuing to feed through to All Property level results.
- Quarterly Total Returns for All UK Property in Q4 recorded 0.2% (-0.9% capital return, 1.1% income return).
- Industrials again recorded a strong performance compared with other sectors in Q4 2019, with Total Returns in this sector recorded at 1.5% (0.4% capital return, 1.1% income return).
- Rental values for All UK Property fell by -0.2% in the fourth quarter of 2019. This figure was largely influenced by a sharp fall of -3.8% in the Retail sector compared with an increase of 1.4% in the Office sector.

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

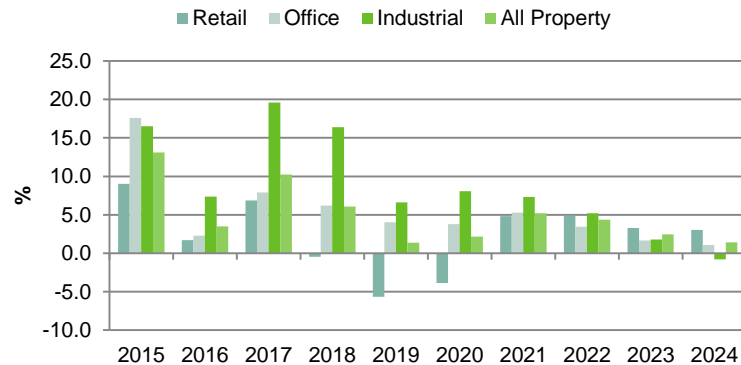


Source: CBRE Monthly Yields, Dec 2019

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

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

Property Total Returns



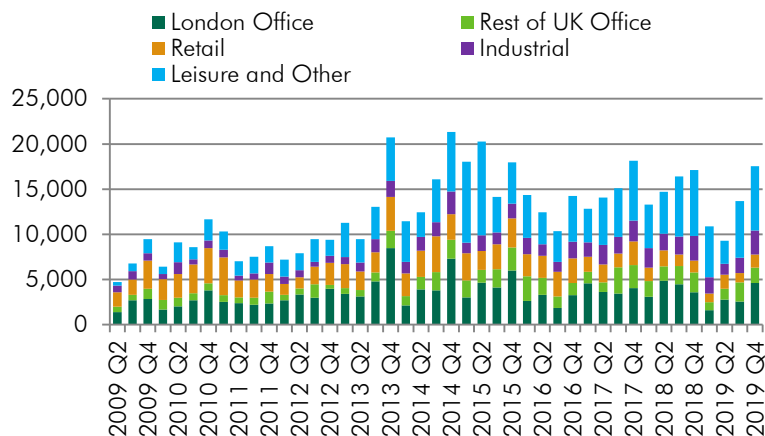
Source: MSCI, CBRE, December 2019

PROPERTY MARKET & SECTOR FORECASTS

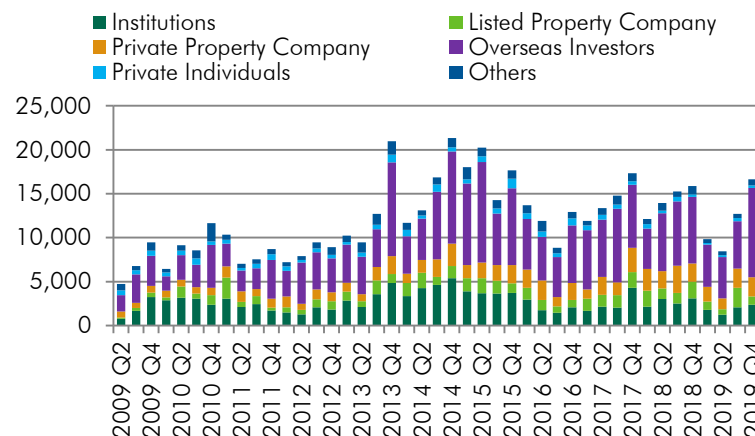
Property Market Q4 2019 Transactions

- In Q4 2019, investors recorded a total transaction volume for 'All Property' of £17.6bn. This is an increase from the £13.7bn reported in Q4 2018. In 2019 £52.1bn was transacted, 17% below 2018.
- In Q4, 61% of investors were from overseas. The rise of overseas investor interest started in early 2018, likely driven, in part, by the devaluation of Sterling following the EU Referendum. In 2019 overseas investors accounted for 43% of total transaction volumes.
- Investment in the office sector stood at £6.3bn in the final quarter of 2019, 35% higher than level recorded in Q4 2018. The biggest Office deal was PonteGadea Inmobiliaria, acquiring the Post Building at Museum Street from Brockton Capital and Oxford Properties Europe for £610m.
- The Industrial sector recorded £2.7bn in transaction activity in Q4 2019, 60% higher than Q4 2018 volumes. The biggest deal was Tudor Portfolio, purchased by Morgan Stanley for £240m.
- In 2019 Offices recorded the highest transaction volume and accounted for 34% of total capital deployed. The biggest deal in 2019 was Medical Properties Trust purchasing the BMI Healthcare Portfolio (£1.5bn).

Commercial Property Investment Transactions (£millions)



Source : : CBRE, Property Data, December 2019



Source : : CBRE, Property Data, December 2019

PROPERTY MARKET & SECTOR FORECASTS

UK Returns Forecast Q4 2019

	2019	2020	2021	Forecast		Annualised	
				2022	2023	2020-2024	
Total return: % per year							
Retail	-5.7	-3.9	4.8	4.9	3.3	3.0	2.4
Office	4.0	3.8	5.3	3.5	1.7	1.1	3.0
Industrial	6.6	8.0	7.3	5.2	1.8	-0.8	4.3
All Property	1.3	2.2	5.2	4.4	2.5	1.4	3.1
Income return: % per year							
Retail	5.3	5.6	5.6	5.5	5.4	5.5	5.5
Office	4.0	4.0	3.9	3.9	3.9	4.0	4.0
Industrial	4.4	4.4	4.3	4.3	4.3	4.4	4.3
All Property	4.6	4.5	4.4	4.3	4.4	4.4	4.4
Capital growth: % per year							
Retail	-10.5	-8.9	-0.7	-0.5	-2.0	-2.3	-3.0
Office	0.0	-0.2	1.3	-0.4	-2.2	-2.9	-0.9
Industrial	2.1	3.5	2.9	0.9	-2.4	-4.9	-0.1
All Property	-3.1	-2.2	0.8	0.0	-1.8	-2.9	-1.2
Nominal rental value growth: % per year							
Retail	-3.8	-3.2	-2.0	-0.9	0.2	1.0	-1.0
Office	1.4	0.8	0.8	1.9	1.9	1.8	1.5
Industrial	3.0	3.7	2.5	0.9	0.0	0.2	1.5
All Property	-0.2	0.0	0.4	0.7	0.8	1.1	0.6
Equivalent Yields - % at end year							
Retail	6.1	6.3	6.1	6.0	6.1	6.2	0.1
Office	5.6	5.6	5.4	5.5	5.6	5.8	0.2
Industrial	5.3	5.2	5.1	5.1	5.2	5.4	0.1
All Property	5.5	5.6	5.4	5.4	5.5	5.6	0.1

*Figures based on Q4 2019 Quarterly Valuations

In 2019 performance across sectors has been wide but is expected to narrow over the forecast period as certainty returns to the market. Structural shifts in consumer spending habits have been compounded by Brexit uncertainty and varying supply and demand dynamics.

Estimated 'All Property Total Return' for 2019, at 1.3%, is lower than 2018. 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 sectors. We expect 2019 to be the weakest year for All Property Returns. The improving economic outlook of over the forecast period feeds into solid income returns, with values forecast to fall less in 2020. The 5-year annualised total return forecast for 2020-2024 is 3.1% per annum.

Moderate rental growth is predicted in the office sector while industrial rental growth remains, albeit at a slower pace. Retail rents fall on a five year basis. The general movement in rents highlights our outlook for the UK economy, nothing market factors such as weak retail spending, slowing employment growth and rising e-commerce highlighting sectoral variation.



3 PORTFOLIO STRATEGY AND FORECASTING

PORTFOLIO STRATEGY AND FORECASTING

Portfolio Strategy

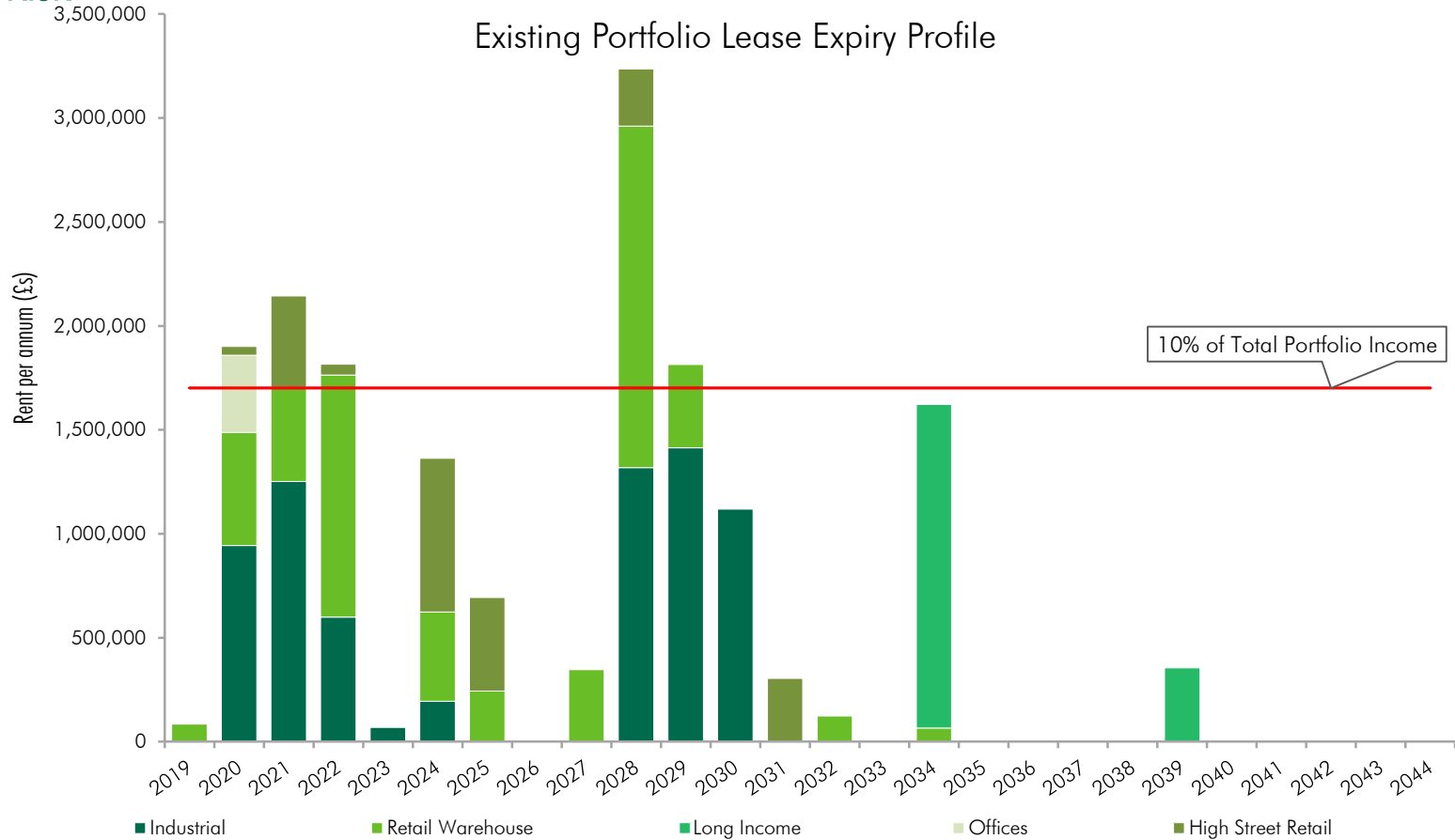
Top Down Strategy

- The Teesside Pension Fund was valued at approximately £4.265bn in September 2019. The Direct Property Portfolio held by the Fund was valued at £285.3m (December 2019), 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 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

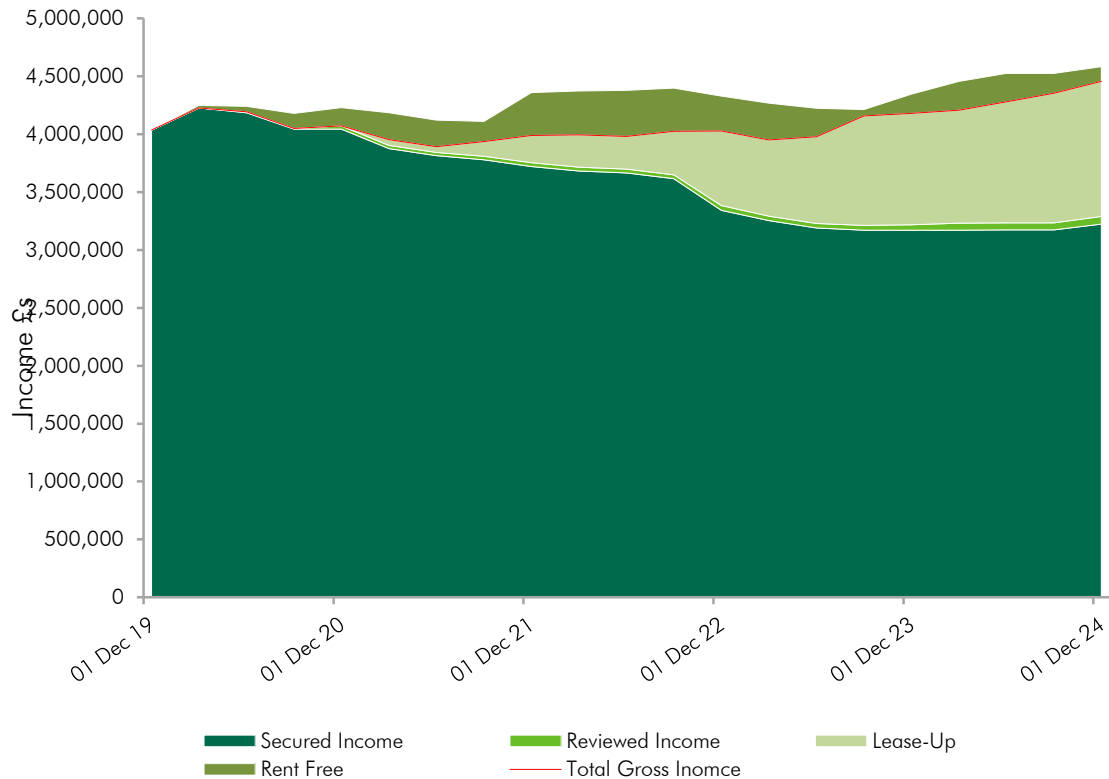
Expiry Risk



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	12.1%
South East	9.4%
South West	10.0%
East	6.7%
West Midlands	25.2%
North East	30.7%
North West	4.2%
Scotland	1.8%
Total	100%

SECTOR	% OF PORTFOLIO (RENTAL VALUE)
Industrial	44.8%
Retail Warehouse	26.8%
Long Income	11.5%
Offices	2.6%
High Street Retail	14.3%
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	8.31%	1	09 September 2029
2	B&Q plc	107,068	£997,000	£1,025,000	5.86%	2	31 January 2027
3	Royal Mail Group Limited	207,572	£899,162	£1,000,000	5.29%	1	23 September 2030
4	DHL Supply Chain Ltd.	146,138	£868,635	£875,000	5.11%	1	28 September 2021
5	Libra Textiles	129,952	£850,000	£850,000	5.00%	1	01 August 2034
6	Brunel Healthcare	136,342	£843,761	£650,000	4.96%	1	10 April 2028
7	H&M	32,501	£740,000	£740,000	4.35%	1	23 June 2024
8	Tesco Stores Limited	25,084	£706,785	£570,000	4.15%	1	28 July 2034
9	P&O Ferrymasters Limited	122,157	£662,000	£735,000	3.89%	1	25 December 2020
10	Matalan Retail Limited	51,753	£500,000	£500,000	2.94%	1	27 November 2028
11	Halycon Fine Art Ltd	38,722	£475,000	£500,000	2.79%	1	22 December 2028
12	Barclays	18,833	£450,000	£450,000	2.65%	1	23 June 2025
13	HSBC Bank Plc	2,016	£440,000	£460,000	2.59%	1	18 October 2021
14	Wickes Building Supplies Limited	28,338	£396,750	£396,750	2.33%	1	29 September 2028
15	DSG Retail Limited (t/a Currys/PC World)	25,000	£375,000	£350,000	2.20%	1	28 September 2022
16	B&M Retail Limited (t/a B&M Homestore)	25,000	£375,000	£350,000	2.20%	1	28 September 2022
17	Institute of Cancer Research	9,502	£371,420	£371,420	2.18%	1	17 February 2020
18	Nuffield Health	26,458	£354,715	£331,000	2.09%	1	04 April 2039
19	Pets at Home Ltd	15,577	£325,825	£282,500	1.92%	2	05 January 2024
20	Aurum Group Limited	1,440	£305,000	£305,000	1.79%	1	01 March 2031
	TOTAL	1,470,268	£12,349,627	£12,155,244	72.6%	22	

4 PORTFOLIO ACTIVITY



PORTFOLIO ACTIVITY

ASSET MANAGEMENT COMMENTARY



READING, 1-3 ACRE ROAD

March – December 2019

An open market rent review was agreed with Active PCB on Unit C. The review increased the passing rent to £68,000 pax an uplift of 15%.



STOW-ON-THE-WOLD, TESCO STORE.

July 2019

A rental increase inline with annual uplifts was agreed for Tesco Stores July 2019 rent review. The uplift achieved a 3% rental increase for the fund to a new passing rent of £706,785 pax.



LONDON, GLOUCESTER ROAD.

August 2019

Partridges agreed a reversionary lease for a term of 10-years from December 2020 at a rent of £140,000 pax. The new lease included an upwards only rent review in 2025 with 6 months rent free from September 2019.



THORNE, CAPITOL PARK.

September 2019

A rental increase was agreed with Omega inline with the 5-yearly rental uplifts. The rent review reflected an uplift of 13% on the passing rent.



LUTTERWORTH, MAGNA PARK.

December 2019

Terms for a new reversionary lease was agreed with the Tenant, ASDA at Magna Park. The lease will reflect an extension of 10-years at a rental of £755,000 pax with 3 months rent free, representing a 14% uplift on the passing rent.



CIRENCESTER

January 2020

Terms have been agreed to let the sole vacant unit at Cirencester Retail Park. Solicitors have been instructed to draft the requisite documentation. Terms are agreed for 15 years, with a 10 year tenant break options at £125,000 pax with 12 months' rent free, and a further 6 months' for fitting out.



SOVEREIGN PARK

January 2020

Terms have been agreed to settle the outstanding 2018 Rent Review at £475,000 pax. Reflecting an increase of 58% on the passing rent. Further to this a minimum uplift to £525,000 pax has been secured at the 2023. In addition, terms have also been agreed for a further 5 year reversionary lease extending the expiry to 2033.



5 ACRE ROAD

January 2020

A lease renewal has been agreed with ESP. Terms are agreed for a further 10 years at a rent of £203,649 pax, with 12 months' rent free. Lease completion is subject to roof repairs to be agreed between the Landlord and Tenant.

CBRE

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