

TEESSIDE PENSION FUND

Quarterly Portfolio Strategy Report

1st JANUARY – 31st MARCH 2020

Prepared 26th May 2020

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	46.0%	40.2%
Retail Warehouse	26.1%	30.0%
Long Income	11.4%	18.5%
Offices	2.7%	2.5%
High Street Retail	13.8%	8.8%
	100%	100%

EXECUTIVE SUMMARY

Portfolio Profile

- At 31st March 2020, the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £278.5m. This reflects an overall Net Initial Yield of 5.56%, and an Equivalent Yield of 5.79%.
- 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 6.7 years to the earlier of first break or expiry, and 8.3 years to expiry, ignoring break dates.
- The portfolio also has the following characteristics:
 - The vacancy rate is currently 2.0% of Estimated Rental Value. By comparison, the ‘MSCI Quarterly Index Q1 2020 Void Rate’ stands 6.8%.
 - The top ten tenants constitute 49.75% of the total gross annual income of the portfolio, while the top twenty tenants constitute 72.4%.
 - Current gross passing rent is £17,045,841 per annum, against a gross current market rent of £17,208,187 per annum, making the portfolio slightly 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 18th May 2020

The total Collectable Arrears on the entire portfolio is £898,535.94 as at 18th May 2020. The Collectable Arrears exclude the following:

Tenants that are insolvent (99p Stores Limited at Cirencester), charges that have been raised within the last month and tenants that have overall credit balances on their accounts

All tenants granted Covid-related monthly payment instalments are included in these figures. Of the Collectable Arrears, the top ten tenants make up 58.8% (£526,475.23) of the total arrears, all percentages are based on the total collectable arrears figure:

- Rentokil Initial UK Ltd (Bromford Central) – Total arrears of £93,251.13 (10.4%), comprising March Rent, Service & Insurance charges.
- Wickes Building Supplies Ltd (Colchester) – Total arrears of £79,350.00 (8.9%). They have paid one-month's rent towards the March quarter leaving two-months outstanding.
- AKW Global Logistics Birmingham Limited (Bromford Central) – Total arrears of £67,339.37 (7.5%). This comprises the March quarter rent, service and insurance charges. They have not made a payment towards the March quarter.
- Royal Mail Group Limited (Gateshead) – Total arrears of £66,631.08 (7.4%). This relates solely to their annual insurance premium.
- River Island Clothing Co. Ltd (Lincoln) – Total arrears of £55,000.00 (6.1%). Tenant is charged rent monthly and these arrears relate solely to the rent due on 1st April and 1st May.
- DSG Retail Limited (Ipswich) – Total arrears of £39,324.98 (4.4%). They have paid two-month's rent towards the March quarter leaving one-month outstanding. This arrear relates mainly to their third instalment.
- B&M Retail Limited (Ipswich) – Total arrears of £38,657.73 (4.3%). They have paid two-month's rent towards the March quarter leaving one-month outstanding. This arrear relates mainly to their third instalment.
- Harrow Green Ltd (Bromford Central) – Total arrears of £30,105.02 (3.4%). They have paid one-month's rent towards the March quarter leaving two-months outstanding.
- Omega plc (Doncaster) – Total arrears of £29,797.92 (3.3%). This relates solely to their annual insurance premium.
- Halcyon Fine Art Group Holdings Limited (Park Royal) – Total arrears of £27,000.00 (3.3%). Halcyon have been granted a 50% rent free for the March quarter and paid the sum of £18,000. The balance of £27,000 has been agreed to be paid on 25th June.

EXECUTIVE SUMMARY

Rent Collection Statistics

Rent Collection Statistics at 19th May 2020

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 25 March	Collectable Rent	Quarter Date up to and including 25/03/2020	Week 1 up to and including 01/04/2020	Week 2 up to and including 08/04/2020	Week 3 up to and including 15/04/2020	Week 4 up to and including 22/04/2020	Payment after 22/04/2020	Difference
	3,065,143.65	3,065,143.65	1,923,412.82	319,090.40	61,340.00	0.00	0.00	242,096.98	519,203.45
Non Collectable Total		0.00							
Collections Including non collectables			62.75%	73.16%	75.16%	75.16%	75.16%	83.06%	
Collections Excluding non collectables			62.75%	73.16%	75.16%	75.16%	75.16%	83.06%	

These figures relate to rents that only became due on the March English Quarter Day (25th March 2020).

The difference of £519,203.45 relates to a number of Tenants and is due to varying situations across the portfolio, on a Tenant specific basis. The 5 largest debtors include Rentokil Initial UK Ltd (£82,500), Wickes Building Supplies Limited (£79,350), AKW Global Logistics Birmingham Limited (£58,500), B&M Retail Limited (£37,500 and Harrow Green Limited (£27,465).

All tenants are either being chased or have paid, with payment receipt pending bank transfer completion. A number of Tenants are subject to varying temporary arrangements with regards to their rental payments as a result of the ongoing Covid-19 pandemic. These are being handled on a tenant specific basis, with each request and agreement being considering in isolation.

CBRE have collected 83% of collectable rent (to 20th May 2020). By comparison, the total collected within the same timeframe in 2019 was 100%.

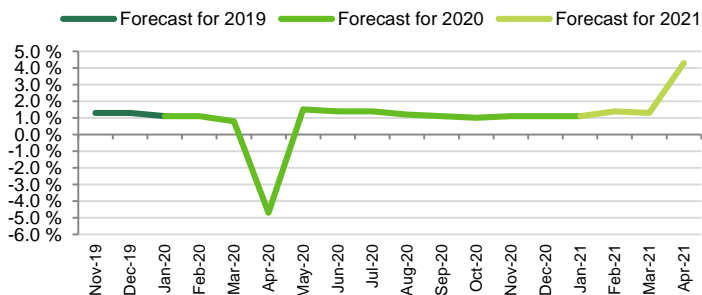
2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

PROPERTY MARKET & SECTOR FORECASTS

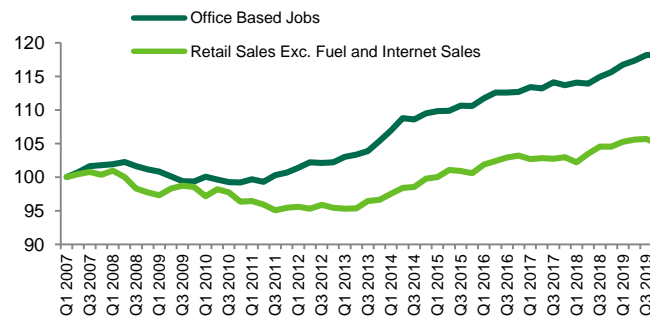
Economic Performance Q1 2020

- European economies have progressively been disrupted by impact of the Covid-19 pandemic. The response has been significant, with governments introducing public health measures in terms of closing businesses and keeping people at home.
- The UK Government has also introduced support measures for businesses to try and limit business losses and prevent job cuts.
- In February, the unemployment rate was 4.0% and average weekly earnings grew above inflation at 2.8%. These numbers will likely look very different over the coming months with many employees having to take pay cuts. The unemployment rate will rise but this will be limited for now as those on the government furlough scheme remain as employees.
- The Bank of England Base Rate was cut from 0.75% to 0.1% and the size and pace of its asset purchase facility (QE) increased by another £200bn, bringing the total to £635bn, or close to 40% of UK nominal GDP.
- The UK economy will not be able to avoid a severe drop in output in 2020. Just how severe the hit to the UK economy will be depends, to a large extent, on the length of the lockdown. The longer it goes on, the bigger the impact on company balance sheets and revenue targets, and therefore overall growth.

Evolution of UK GDP Growth Forecast



Economic Drivers of Commercial Property Demand



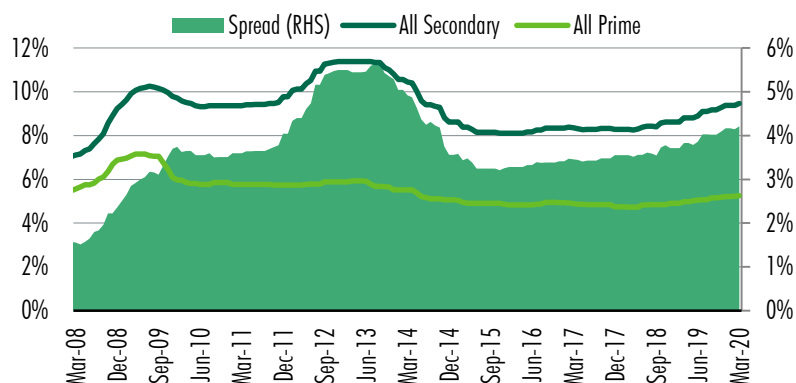
Source: HM Treasury
Consensus

PROPERTY MARKET & SECTOR FORECASTS

Property Market Q1 2020

- Year on year total returns for All UK Property were -0.6% (-4.9%* capital return, 4.6%* income return) for the period Q1 2019 to Q1 2020**. Year on year returns at this level sit below the 5 year average, as the retail sector's woes continue to impact upon All Property level results.
- Quarterly total returns for All UK Property for Q1 2020 stood at -1.4%, comprising of -2.4% capital return and 1.1% income return).
- The industrial sector again recorded strong performance, with the quarterly total return in this sector equating to 0.4% (-0.7% capital return, 1.1% income return)
- Rental values for All UK Property fell by -0.9% in the first quarter of 2020. This figure was largely impacted by reduction of -5.6% in the Retail sector, compared with an increase of 1.3% in the Office sector.

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

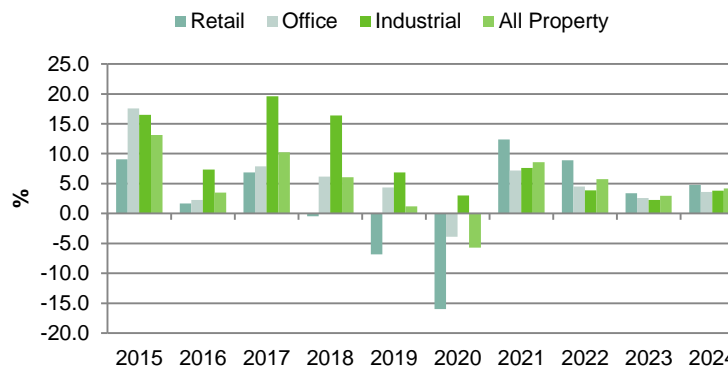


Source: CBRE Monthly Yields, Mar 2020

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

** Based on CBRE Monthly Index, all property total returns Mar 2020

Property Total Returns



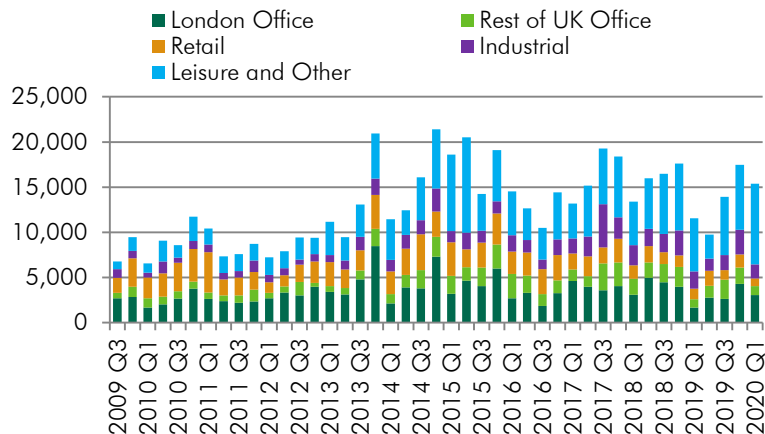
Source: MSCI, CBRE, March 2020

PROPERTY MARKET & SECTOR FORECASTS

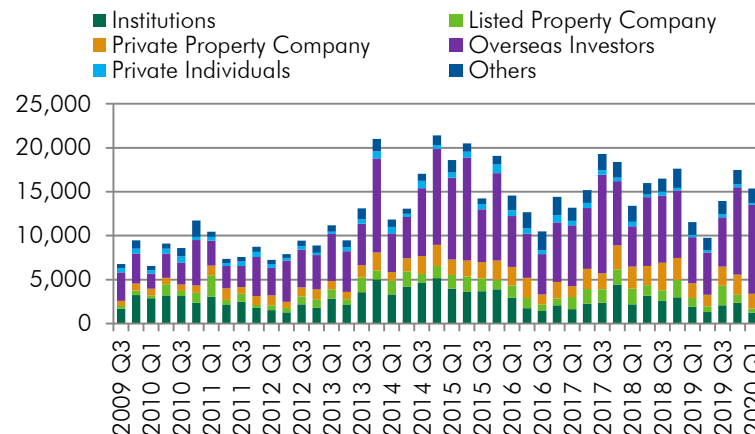
Property Market Q1 2020 Transactions

- In Q1 2020, total transaction volumes for 'All Property' stood at £15.4bn. This is a decrease from the £17.5bn reported in Q4 2019 and includes the largest ever UK real estate transaction – the £4.7bn sale of IQ Student Accommodation.
- 66% of capital invested in Q1 2020 was from overseas investors. This was boosted by Blackstone's acquisition of IQ – as reported above – but even without this record deal the influx of international capital accounted for more than half the market.
- Office investment reached £4.0bn in Q1 2020 with five transactions over £200m. This is lower than the five-year sector average of £5.5bn.
- The Alternative sector continued to gain traction, accounting for the two largest deals of the quarter and c. 60% of transaction volumes. As well as the IQ transaction, the £700m acquisition of The Ritz by a Middle Eastern buyer was the most expensive single-asset hotel deal ever seen in the UK.

Commercial Property Investment Transactions (£millions)



Source: : CBRE, Property Data, March 2020



Source: : CBRE, Property Data, March 2020

PROPERTY MARKET & SECTOR FORECASTS

UK Returns Forecast Q1 2020

	2017	2018	2019	Forecast					Annualised 2020-2024
				2020	2021	2022	2023	2024	
Total return: % per year									
Retail	6.9	-0.5	-6.8	-16.0	12.4	8.9	3.4	4.8	2.2
Office	7.9	6.2	4.4	-3.9	7.2	4.5	2.6	3.6	2.7
Industrial	19.6	16.4	6.9	3.0	7.6	3.9	2.3	3.8	4.1
All Property	10.2	6.0	1.2	-5.7	8.6	5.7	3.0	4.2	3.0
Income return: % per year									
Retail	5.1	5.1	5.3	5.9	6.0	5.6	5.5	5.6	5.7
Office	4.1	4.0	4.1	4.0	4.0	3.9	4.0	4.1	4.0
Industrial	5.1	4.5	4.4	4.3	4.3	4.4	4.5	4.6	4.4
All Property	4.8	4.6	4.6	4.5	4.5	4.4	4.4	4.5	4.4
Capital growth: % per year									
Retail	1.7	-5.3	-11.6	-20.7	6.0	3.2	-2.0	-0.8	-3.3
Office	3.6	2.1	0.3	-7.5	3.0	0.6	-1.3	-0.5	-1.2
Industrial	13.9	11.4	2.4	-1.2	3.1	-0.5	-2.1	-0.7	-0.3
All Property	5.2	1.4	-3.3	-9.7	3.9	1.3	-1.4	-0.3	-1.3
Nominal rental value growth: % per year									
Retail	1.1	-2.2	-4.9	-8.8	-2.4	0.0	0.8	1.4	-1.9
Office	1.5	0.8	1.5	-2.4	-0.6	2.5	3.1	2.7	1.1
Industrial	5.3	4.6	2.9	2.8	-0.1	1.1	1.2	1.9	1.4
All Property	2.2	0.5	-0.6	-3.5	-0.6	1.5	1.7	1.9	0.2
Equivalent Yields - % at end year									
Retail	5.5	5.7	6.1	7.0	6.3	6.1	6.2	6.3	0.2
Office	5.8	5.6	5.6	5.8	5.6	5.6	5.8	5.9	0.3
Industrial	5.7	5.3	5.3	5.4	5.2	5.3	5.4	5.5	0.2
All Property	5.6	5.5	5.6	5.8	5.5	5.5	5.6	5.7	0.1

*Forecast figures based on Q4 2019 quarterly valuations

The spread of performance across sectors was wide in 2019. After a promising start to 2020, in the office and industrial sectors, the arrival of Covid-19 has brought an unexpected halt to transactional activity. The severity of the hit to the UK economy will largely be dependant on the length of the lockdown.

All Property Total Returns for 2019 stood at 1.2%, which was down on 2018. This lower return is primarily due to an outward shift in retail yields. In 2019 the industrial sector outperformed the other key sectors with a Total Return of 6.9%, it is expected that this trend will continue as we move in to H2 2020.

It is expected that all property total returns will fall back in this year as a result of the continued uncertainty around the Government's lockdown measures. By 2021, it is hoped that the economy will be on a recovery path with increased activity feeding into robust income return and a recovery in capital values. The 5-year annualised total return for 2020-2024 is 3.0% per annum.

Rental value reductions are predicted in the office (-2.4%) and retail (-8.8%) sectors over the course of 2020, with the industrial sector seeing moderate rental growth. As we move into 2021, and beyond, rental growth is expected to recover. It will be important to monitor ongoing structural changes across the logistics and offices sectors as employees being to return to work under what is currently termed the 'new normal', However, it is yet to be seen what from this will take.



3 PORTFOLIO STRATEGY AND FORECASTING

PORTFOLIO STRATEGY AND FORECASTING

Portfolio Strategy

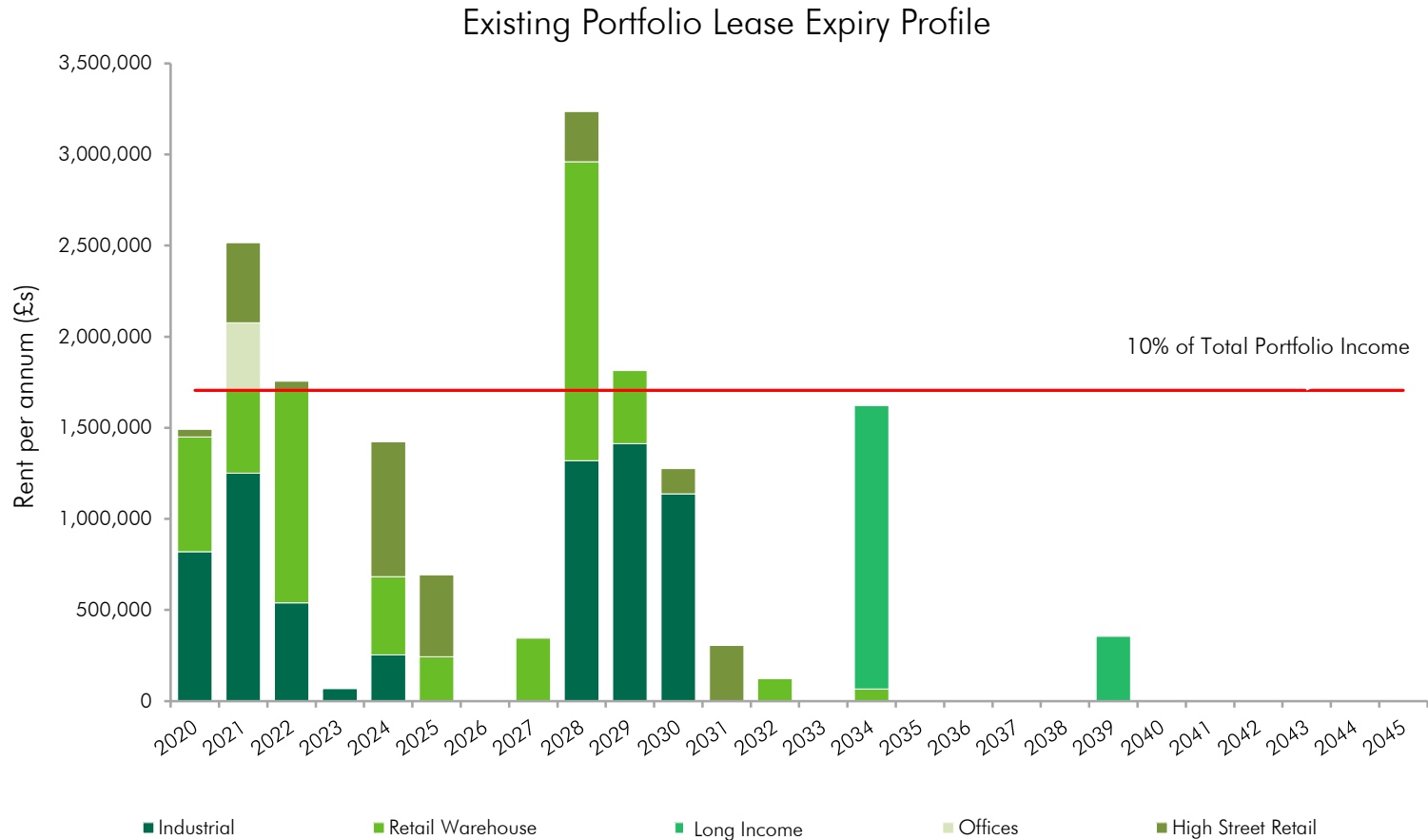
Top Down Strategy

- The Teesside Pension Fund was valued at £4.288bn in December 2019. The Direct Property Portfolio held by the Fund was valued at £278.5m (March 2020), equating to 6.5% 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 and long-let investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure, supermarkets 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

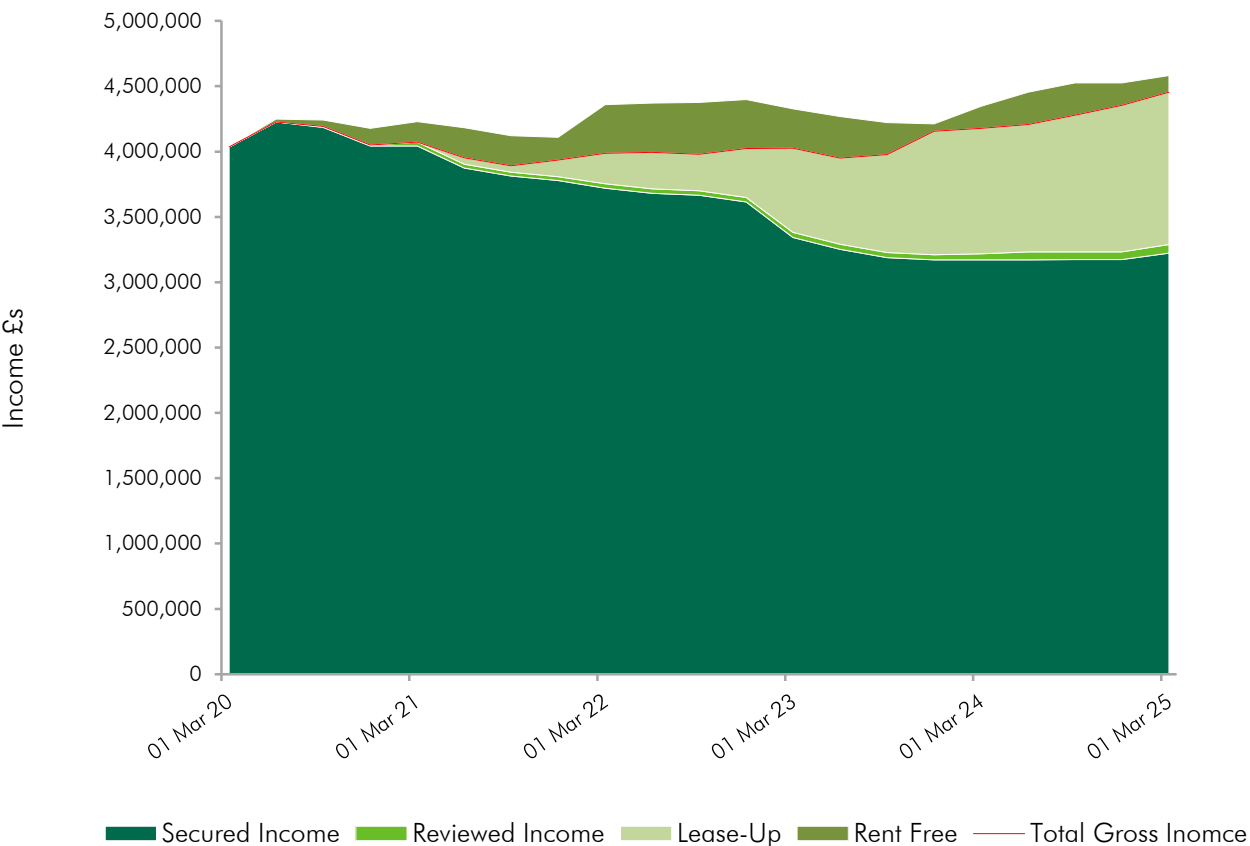
Expiry Risk



PORTFOLIO POSITIONING AND FORECASTING

Portfolio Analysis

Existing 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	12.3%
South East	9.5%
South West	9.8%
East	6.4%
West Midlands	25.8%
North East	30.4%
North West	4.1%
Scotland	1.8%
Total	100%

SECTOR	% OF PORTFOLIO (Rental Value)
Industrial	41.7%
Retail Warehouse	31.4%
Long Income	10.2%
Offices	2.3%
High Street Retail	14.4%
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	8.29%	1	09 September 2029
2	B&Q plc	107,068	£997,000	£1,025,000	5.85%	2	31 January 2027
3	Royal Mail Group Limited	207,572	£899,162	£1,000,000	5.27%	1	23 September 2030
4	DHL Supply Chain Ltd.	146,138	£868,635	£875,000	5.10%	1	28 September 2021
5	Libra Textiles	129,952	£850,000	£850,000	4.99%	1	01 August 2034
6	Brunel Healthcare	136,342	£843,761	£650,000	4.95%	1	10 April 2028
7	H&M	32,501	£740,000	£740,000	4.34%	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	3.88%	1	25 December 2020
10	Matalan Retail Limited	51,753	£500,000	£500,000	2.93%	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	2.64%	1	23 June 2025
13	HSBC Bank Plc	2,016	£440,000	£460,000	2.58%	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 2021
18	Nuffield Health	26,458	£354,715	£331,000	2.08%	1	04 April 2039
19	Pets at Home Ltd	15,577	£325,825	£282,500	1.91%	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	72.4%	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%.



LUTTERWORTH, MAGNA PARK

December 2019

Terms for a new reversionary lease have been 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.



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.



CIRENCESTER

January 2020

Terms have been agreed to let the sole vacant unit at Cirencester Retail Park to PureGym. 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. Agreeing the lease is currently on hold as result of the Covid-19 lockdown.



LONDON, GLOUCESTER ROAD

August – December 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. Discussions are ongoing with JF Stone with regards to a lease regear.



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

March 2020

A lease renewal has been agreed with ESP. Terms are agreed for a further 10 years at a rent of £203,649 pax, an increase of 30%, with 12 months' rent free. Lease completion is subject to roof repairs to be agreed between the Landlord and Tenant.



CONGLETON RETAIL PARK

May 2020

A lease renewal has been completed at Congleton Retail Park to Jollyes. The lease adds 10 years to the term certain at the unit and provides rental evidence for the outstanding Lease Renewals.

CBRE

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