

CBRE

TEESSIDE PENSION FUND

Quarterly Portfolio Strategy Report

1st APRIL – 30th JUNE 2020

Prepared 26th August 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	47.9%	40.2%
Retail Warehouse	25.1%	30.0%
Long Income	11.0%	18.5%
Offices	2.7%	2.5%
High Street Retail	13.3%	8.8%
	100%	100%

EXECUTIVE SUMMARY

Portfolio Profile

- At 30th June 2020, the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £269.1m. This reflects an overall Net Initial Yield of 5.74%, and an Equivalent Yield of 5.96%.
- The portfolio comprises principally prime and good secondary assets. High street retail, retail warehouse and industrial comprise 86.3% 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 6.6 years to the earlier of first break or expiry, and 8.2 years to expiry, ignoring break dates.
- The portfolio also has the following characteristics:
 - The vacancy rate is currently 2.1% of Estimated Rental Value. By comparison, the ‘MSCI Quarterly Index Q2 2020 Void Rate’ stands at 7.5%.
 - The top ten tenants constitute 50.7% of the total gross annual income of the portfolio, while the top twenty tenants constitute 73.8%.
 - Current gross passing rent is £16,736,821 per annum, against a gross current market rent of £17,083,687 per annum, making the portfolio slightly reversionary in nature.

EXECUTIVE SUMMARY

Portfolio Activity

Investments

Sales

- No sales this period.

Acquisitions

- The Fund has agreed terms to purchase a highly regarded long-let supermarket for £20,700,000, reflecting a NIY of 4.48% and providing an income upon acquisition of £914,587 pa. The unexpired term is approximately 18.5 years. The Lease is subject to 5 yearly RPI linked rent reviews with a collar and cap of 1%–4% pa compounded.

EXECUTIVE SUMMARY

Portfolio Activity & Strategy

Total Portfolio Arrears at 20th August 2020

The total Collectable Arrears on the entire portfolio is £2,206,396 as at 20th August 2020. The Collectable Arrears exclude the following:

- Tenants that are insolvent (99p Stores Limited at Cirencester, Laura Ashley Ltd at Congleton, Homestyle Group Operations Ltd at Congleton) and Tenants that have overall credit balances on their accounts, and;
- Omega PLC (Thorne) and P&O Ferrymasters (Lutterworth) who are in arrears of £611,305 and £202,261, respectively. At Doncaster a lease regear is close to completion and at Lutterworth a lease renewal is also close to being agreed. Completion of these agreements will be conditional on the arrears being cleared.

Below is a summary – excluding Omega Plc and P&O Ferrymasters – of the tenants with the greatest arrears, which account for 35.3% (£778,313) of the total portfolio arrears:

River Island Clothing Co. Limited (Lincoln) – Total arrears of £137,500 (6.2% of the collectable arrears). This tenant has not yet been granted any rent concession and the arrears relate solely to their monthly rents from 1st April to 1st August. We are continuing to chase for payment.

Halcyon Fine Art Group Holdings Limited (Park Royal) – Total arrears of £117,000 (5.3% of collectable rents). This relates to their June quarter rent and the 40% balance of the March rent which was agreed to be paid at the end of June. A reversionary lease is being negotiated in exchange for a further rent concession and the tenant has suggested that a further payment will be made towards the end of August.

AKW Global Logistics Birmingham Limited (Bromford Central) – Total arrears of £115,135 (5.2% of the collectable arrears). This mainly related to the March and June quarters rent. Discussions are ongoing with AKW over a payment plan, rent free period and lease extension.

Nuffield Health (Guildford) – Total arrears of £113,665 (5.2% of the collectable arrears). This relates mainly to the June quarter's rent but also includes insurance and head landlord service charges. The tenant advised that they would begin to pay rent monthly from their date of reopening (25th July) within any balance prior to opening deferred to December. We are continuing to chase now that they have reopened.

Unipart Logistics Limited (Rugby) – Total arrears of £86,863 (3.9% of the collectable arrears). This relates solely to one third of their June quarter rent. They are now paying rent monthly and have paid their first two instalments. The final instalment is expected towards the end of August.

Wickes Building Supplies Ltd (Colchester) – Total arrears of £79,350 (3.6% of the collectable arrears). This relates solely to two thirds of their June quarter's rent. They are now paying rent monthly in arrears and have paid their first instalment.

Toughglaze (UK) Limited (Park Royal) – Total arrears of £70,751 (3.2% of the collectable arrears). This relates mainly to the June quarter's rent and annual insurance premium, which we are continuing to chase for payment.

Peacocks Stores Limited (Cirencester) – Total arrears of £58,049 (2.6% of the collectable arrears). This tenant has not been granted any rent concession and the arrears relates to the monthly rent from 28th March to 27th August, plus service charge and insurance premium, which are both being chased for payment.

EXECUTIVE SUMMARY

Quarterly Rent Collection Statistics

Quarterly Rent Collection Statistics at 20th August 2020

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 24 June	Collectable Rent	Quarter Date up to and including 24/06/2020	Week 1 up to and including 01/07/2020	Week 2 up to and including 08/07/2020	Week 3 up to and including 15/07/2020	Week 4 up to and including 22/07/2020	Payment after 22/07/2020	Difference
	4,368,300.08	4,368,300.08	1,797,163.87	282,020.01	123,670.50	70,346.10	0.00	575,724.51	1,519,375.09
Non Collectable Total		0.00							
Collections Including non collectables			41.14%	47.60%	50.43%	52.04%	52.04%	65.22%	
Collections Excluding non collectables			41.14%	47.60%	50.43%	52.04%	52.04%	65.22%	

These figures relate to rents that only became due on the June English Quarter Day (24th June 2020).

The difference of £1,519,375.09 relates to a number of Tenants and is due to varying situations across the portfolio, on a Tenant specific basis. The 5 largest debtors for the June quarter include; Omega Plc (£375,000), P&O Ferrymasters (£198,600), H&M Hennes & Mauritz UK Ltd (£111,000), Nuffield Health (£106,415) and Halcyon Fine Art Group Holdings Limited (£90,000).

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 65% of collectable rent (to 20th August 2020). By comparison, the total collected within the same timeframe in 2019 was 97% of the collectable rent.

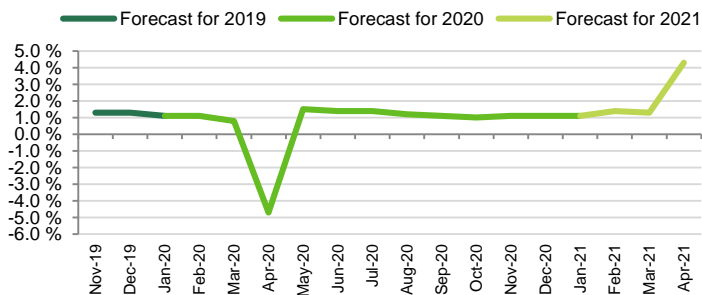
2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

PROPERTY MARKET & SECTOR FORECASTS

Economic Performance Q2 2020

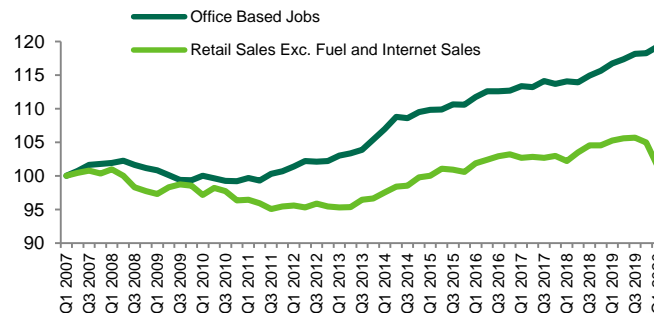
- The coronavirus (COVID-19) pandemic continues to disrupt economic activity, although there are signs that we may be past the worst point and on a tentative road to recovery. Official GDP data only date up to April providing information on the lowest point of the curve – detailing a 20.4% fall, following a 5.9% fall in March 2020. The effect of the lockdown was wide ranging impacting all sectors of the economy.
- The Labour market remains a concern. Headline figures for employment, unemployment and inactivity are only available up to April 2020 and, as such, remain largely unchanged. However, this is in part due to the support measures, including the Job Retention Scheme, introduced by HM Treasury to protect businesses and employment. As of June 14, approximately 9.1 million jobs from 1.1 million different employers were benefitting from the furlough scheme.
- Inflation remains low. The consumer price index including owner-occupied housing services (CPIH) was 0.7% in May, down from 0.9% in April and far below the Bank of England's 2% medium-run inflation target. The BOE Base Rate remains at 0.1% and the asset purchase facility (QE) has been increased by another £100bn, taking the stock of gilts and investment-grade corporate bonds held by the central bank to £745bn, or c.35% of 2019 nominal GDP.
- Looking ahead, 2020 will continue to be dominated by the evolution of the Covid-19 crisis and the economy's reaction to it. The CBRE house view assumes that the peak impact on the economy will be in Q2 with a gradual recovery over the next three-to-four quarters. This is conditional on both the virus starting to wane and the provision of adequate fiscal response to the crisis as we move into Q3.
- CBRE's base case is that the UK economy will contract by 10.3% in 2020 which is behind the house view regarding the eurozone, with a forecast fall of -8.1%. CBRE still expect a relatively strong recovery in 2021, with the UK forecast to grow 9.6% and the eurozone 6.4%. However, there remains significant uncertainty across the markets and time will tell if such forecasts come to fruition.

Evolution of UK GDP Growth Forecast



Source: CBRE, Oxford Economics, ONS

Economic Drivers of Commercial Property Demand



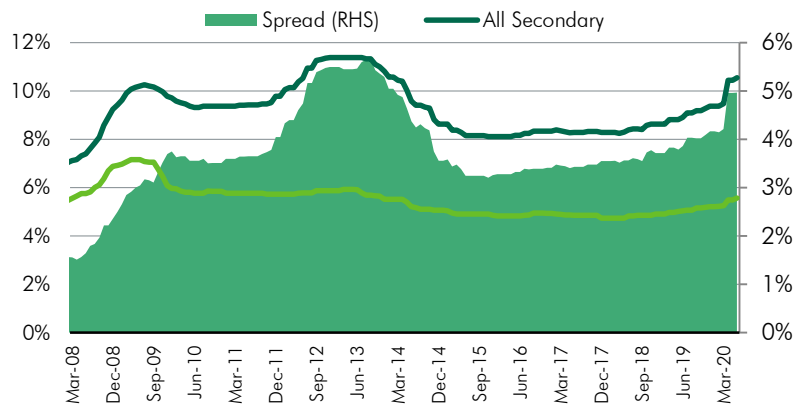
Source: HM Treasury Consensus

PROPERTY MARKET & SECTOR FORECASTS

Property Market Q2 2020

- Year on year total returns for All UK Property were -2.9% (-7.2%* capital return, 4.6%* income return) for the period Q2 2019 to Q2 2020**. Year on year returns at this level are lower than the 5 year average as all three sectors suffer from the Covid-19 shutdown.
- Quarterly total returns for All UK Property for Q2 recorded -1.9% (-3.0% capital return, 1.1% income return).
- Industrials, although slightly tempered when compared to recent returns, again underpinned the wider property market's performance when considered alongside the other traditional investment sectors in Q2 2020. Total returns in this sector were recorded at 0.1% (-1.0% capital return, 1.1% income return).
- Rental values for All UK Property fell by -1.1% in the second quarter of 2020. This figure was largely pulled down by a sharp fall in all three key sectors. This broke down into a fall of -3.0% in the Retail sector compared with -0.3% in the Office sector, and nominal growth of 0.3% in the industrial sector.

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

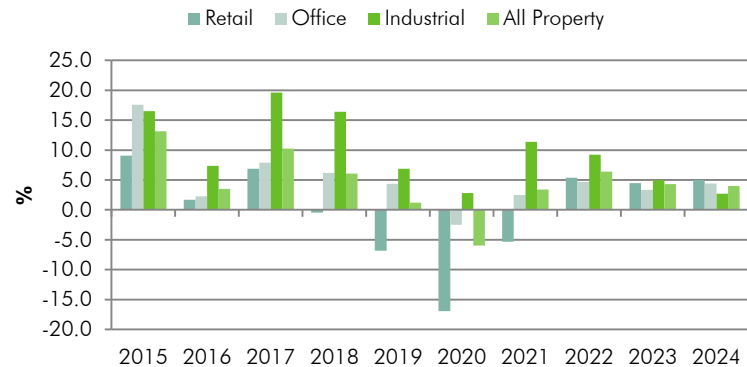


Source: CBRE Monthly Yields, Aug 2020

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

** Based on CBRE Monthly Index, All Property Total Returns Aug 2020

Property Total Returns



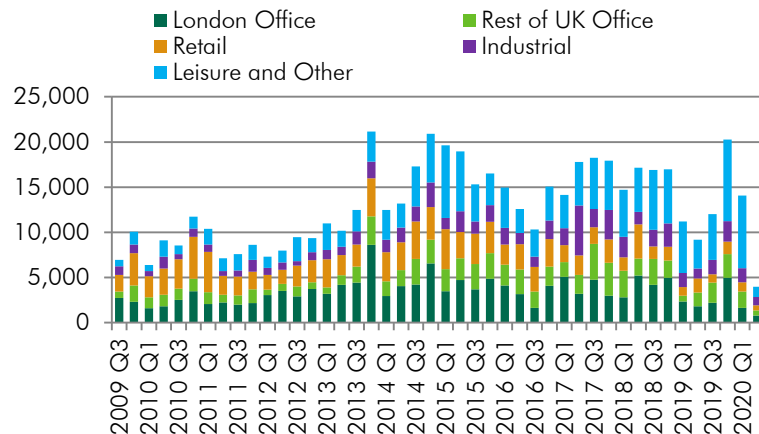
Source: MSCI, CBRE, Aug 2020

PROPERTY MARKET & SECTOR FORECASTS

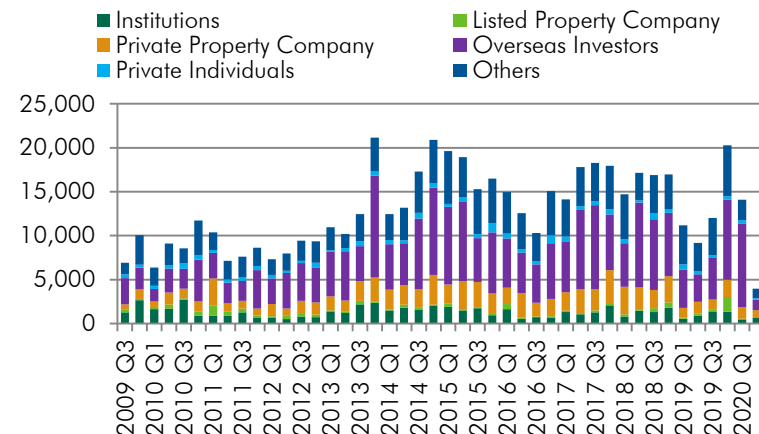
Property Market Q2 2020 Transactions

- In Q2 2020, UK investment volumes reached £3.98bn. This was a dramatic fall from Q1 levels (£14.1bn) due to the market uncertainty and complications brought about by the UK's lockdown in the face of the COVID-19 pandemic. Q2 2020 saw the lowest quarterly investment volumes for the UK since our records began in 2003, even lower than Q1 2009 (£4.3bn). This brought the half-year total for 2020 to £18.1bn – the weakest since H1 2012 (£15.3bn).
- In Q2 2020, only £1.2bn came from overseas investors, which was 30% of total UK investment, and was drastically lower than the £9.6bn of foreign capital invested in UK real estate in Q1 2020.
- Office investment reached £1.3bn in Q2 2020, with three transactions over £100m. In Central London, £780m of office deals completed, which was the lowest since Q1 2020 (£690m).
- The Industrial market saw the largest deal of the quarter – SEGRO's £203m purchase of Perivale Park, which brought quarterly volumes to £0.9bn, around half the 5-year average (£2.0bn).

Commercial Property Investment Transactions (£millions)



Source: : CBRE, Property Data, August 2020



Source: : CBRE, Property Data, August 2020

PROPERTY MARKET & SECTOR FORECASTS

UK Returns Forecast Q2 2020

	2018	2019	Forecast					Annualised	
			2020	2021	2022	2023	2024	2025	2021-2025
Total return: % per year									
Retail	-0.5	-6.8	-16.9	-5.3	5.4	4.5	5.0	4.5	2.7
Office	6.2	4.4	-2.5	2.5	4.6	3.3	4.4	3.8	3.7
Industrial	16.4	6.9	2.8	11.4	9.2	4.9	2.7	0.8	5.7
All Property	6.0	1.2	-6.0	3.4	6.4	4.3	4.0	3.0	4.2
Income return: % per year									
Retail	5.1	5.3	5.5	6.1	6.1	5.9	5.9	5.9	6.0
Office	4.0	4.1	3.9	4.0	3.9	3.9	3.9	3.9	3.9
Industrial	4.5	4.4	4.3	4.2	4.1	4.0	4.0	4.1	4.1
All Property	4.6	4.6	4.5	4.5	4.4	4.3	4.3	4.3	4.3
Capital growth: % per year									
Retail	-5.3	-11.6	-21.3	-10.8	-0.7	-1.4	-0.9	-1.3	-3.1
Office	2.1	0.3	-6.2	-1.4	0.7	-0.5	0.5	-0.1	-0.2
Industrial	11.4	2.4	-1.4	6.8	4.9	0.8	-1.3	-3.2	1.5
All Property	1.4	-3.3	-10.0	-1.0	1.9	0.0	-0.3	-1.2	-0.1
Nominal rental value growth: % per year									
Retail	-2.2	-4.9	-9.8	-8.7	-3.6	-1.2	-0.2	0.1	-2.8
Office	0.8	1.5	-1.4	-3.0	-0.1	1.7	2.8	2.5	0.8
Industrial	4.6	2.9	1.2	1.6	2.1	0.3	0.1	0.0	0.8
All Property	0.5	-0.6	-3.7	-2.7	0.0	0.4	0.9	0.9	-0.1
Equivalent Yields - % at end year									
Retail	5.7	6.1	7.0	7.1	6.9	6.8	6.8	6.8	-0.2
Office	5.6	5.6	5.7	5.6	5.5	5.6	5.7	5.7	0.0
Industrial	5.3	5.3	5.4	5.1	4.9	4.9	4.9	5.1	-0.3
All Property	5.5	5.6	5.8	5.7	5.5	5.5	5.5	5.6	-0.2

The spread of performance across sectors was wide in 2019. After a good start to 2020, the arrival of Covid-19 brought an unexpected halt to market activity. The severity of impact on the UK economy is yet to be seen, and although there are shoots of recovery, it is expected that such improvement is likely to be due to pent-up demand as opposed to any sustained recovery.

All Property Total Returns for 2019 posted 1.2%, down on 2018's 6.0%. This lower return is primarily due to an outward shift in retail yields. The industrial sector outperformed last year with a total return of 6.9% and is expected to continue this trend. The structural shift in logistic supply chains has helped to maintain demand for this asset class. CBRE expect further losses in 2020 with a -6.0% drop for All Property on the back of uncertainty around the economy – and the UK Government's handling of the pandemic – pushing yields up and consequently values down in all sectors. By 2021, it is hoped the economy will be on a recovery path with strong activity feeding into more solid income return and values regaining some of their 2020 losses. The 5-year annualised total return for 2021-2025 is 4.2% per annum.

CBRE predict rental falls in 2020 for the office (-1.4%) and retail (-9.8%) sectors, with the industrial sector seeing only nominal rental growth (1.2%). As we move into 2021 and beyond, rental growth is expected to recover strongly. Rental movements follow our real economy outlook, with downward pressure in 2020 followed by a rebound. However, underlying structural factors will still play a part longer term: office utilisation, density and e-commerce.



3 PORTFOLIO STRATEGY AND FORECASTING

PORTFOLIO STRATEGY AND FORECASTING

Portfolio Strategy

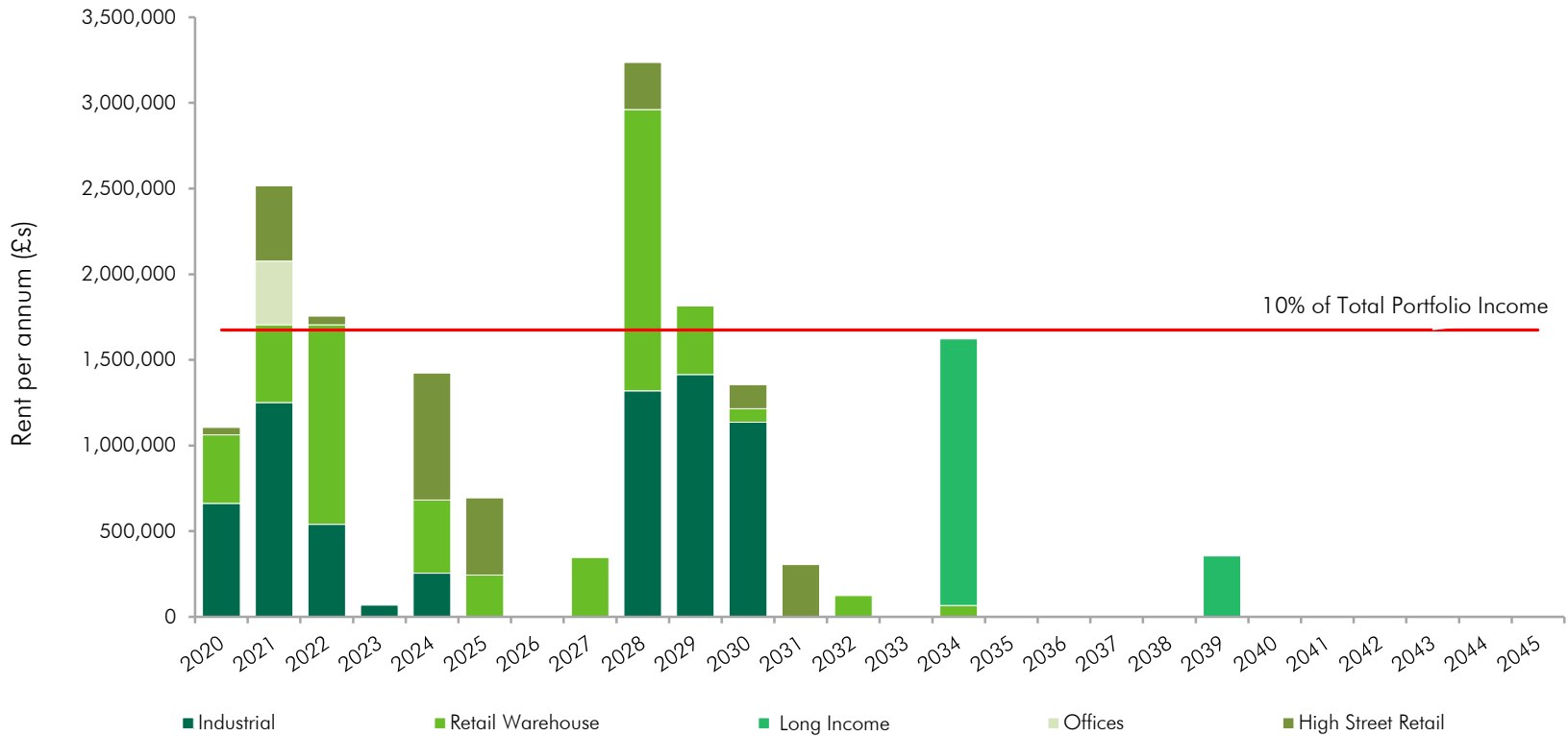
Top Down Strategy

- The Teesside Pension Fund was valued at £4.288bn in December 2019. The Direct Property Portfolio held by the Fund was valued at £269.1m (June 2020), equating to 6.3% 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

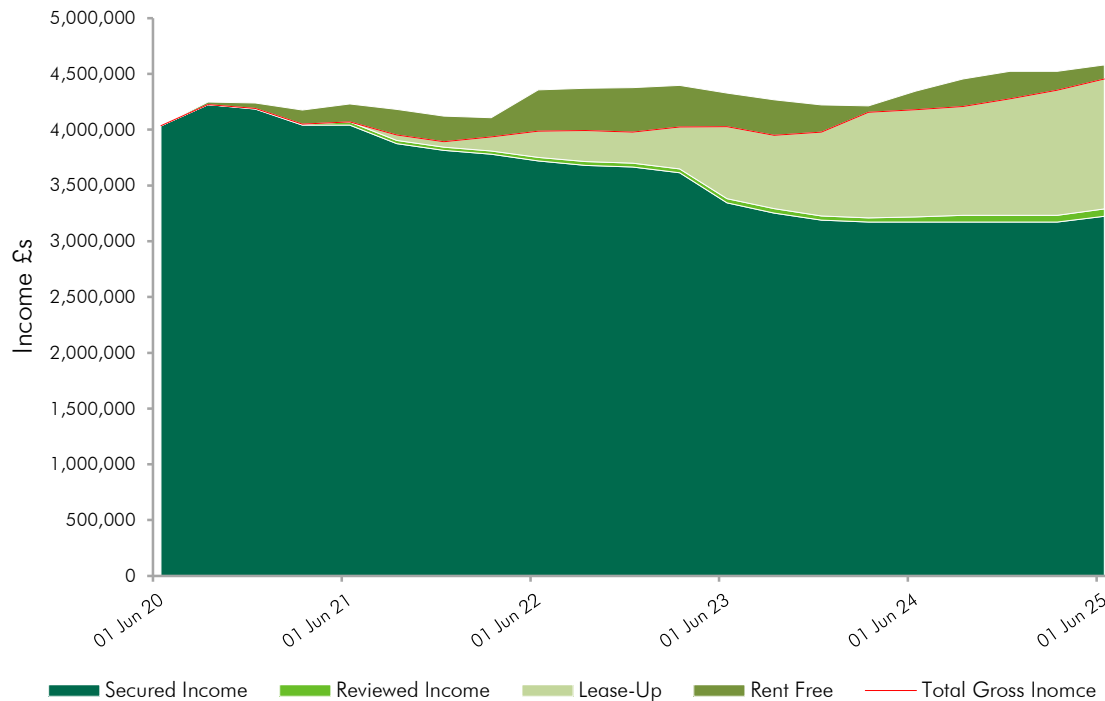
Lease Expiry Profile



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	12.5%
South East	9.2%
South West	6.4%
East	6.2%
West Midlands	26.8%
North East	30.2%
North West	4.0%
Scotland	1.7%
Total	100%

SECTOR	% OF PORTFOLIO (Rental Value)
Industrial	42.0%
Retail Warehouse	31.1%
Long Income	10.2%
Offices	2.3%
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	8.45%	1	09 September 2029
2	B&Q plc	107,068	£997,000	£1,025,000	5.96%	2	31 January 2027
3	Royal Mail Group Limited	207,572	£899,162	£1,000,000	5.37%	1	23 September 2030
4	DHL Supply Chain Ltd.	146,138	£868,635	£875,000	5.19%	1	28 September 2021
5	Libra Textiles	129,952	£850,000	£850,000	5.08%	1	01 August 2034
6	Brunel Healthcare	136,342	£843,761	£650,000	5.04%	1	10 April 2028
7	H&M	32,501	£740,000	£740,000	4.42%	1	23 June 2024
8	Tesco Stores Limited	25,084	£706,785	£570,000	4.22%	1	28 July 2034
9	P&O Ferrymasters Limited	122,157	£662,000	£735,000	3.96%	1	25 December 2020
10	Matalan Retail Limited	51,753	£500,000	£465,000	2.99%	1	27 November 2028
11	Halycon Fine Art Ltd	38,722	£475,000	£500,000	2.84%	1	22 December 2028
12	Barclays	18,833	£450,000	£450,000	2.69%	1	23 June 2025
13	HSBC Bank Plc	2,016	£440,000	£460,000	2.63%	1	18 October 2021
14	Wickes Building Supplies Limited	28,338	£396,750	£396,750	2.37%	1	29 September 2028
15	DSG Retail Limited (t/a Currys/PC World)	25,000	£375,000	£350,000	2.24%	1	28 September 2022
16	B&M Retail Limited (t/a B&M Homestore)	25,000	£375,000	£350,000	2.24%	1	28 September 2022
17	Institute of Cancer Research	9,502	£371,420	£371,420	2.22%	1	17 February 2021
18	Nuffield Health	26,458	£354,715	£331,000	2.12%	1	04 April 2039
19	Pets at Home Ltd	15,577	£325,825	£265,000	1.95%	2	05 January 2024
20	Aurum Group Limited	1,440	£305,000	£305,000	1.82%	1	01 March 2031
	TOTAL	1,470,268	£12,349,627	£12,102,744	73.8%	22	

4 PORTFOLIO ACTIVITY



PORTFOLIO ACTIVITY

ASSET MANAGEMENT COMMENTARY



READING, 5 ACRE ROAD

June 2020

A new 10-year reversionary lease has been agreed with ESP Global Services at a rent of £203,649 pax, an increase of 30%. The deal is subject to the completion of roof repair works. The works are due to complete by September 2020.



STOW-ON-THE-WOLD, TESCO STORE

August 2020

The property is subject to a rental increase in September 2020 inline with the annual RPI uplifts as stipulated within the lease. The uplift will achieve a 2% rental increase for the Fund to a new annual rent of £720,921 pax.



OMEGA, THORNE

August 2020

A new reversionary lease with Omega at Capitol Park, Thorne, has recently completed. The reversionary lease extends the term for a further 8-years providing the Fund index linked income until 2042.



LONDON, GLOUCESTER ROAD

June 2020

Terms have been agreed for a new 10-year lease to American Dry Cleaners Limited with the tenant benefit of a break at the expiry of 3.5 years. A stepped rent has been agreed up to and including the lease's 5th anniversary.

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