Agenda Item 11

TEESSIDE PENSION FUND Q4 2021

CBRE

Quarterly Report
Prepared: 2nd March 2022

Fund Objectives

Teesside's Pension Fund's primary objective is to create a sustainable income stream to match its long term pension liabilities. This is achieved through investing into a wide range of asset classes, of which Real Estate is one.

The objective of the direct property allocation is to create a portfolio which produces a consistent total return, over the long term, to meet Teesside Pension Fund's liabilities.

Portfolio Strategy

The portfolio will hold core/core plus properties, over the long term, diversifying the portfolio through different property types, unit sizes, occupier businesses, income expiry and geographical regions.

Stock selection will be favoured over a default asset allocation bias, with a focus on maintaining a long term overweighted position in industrial and retail, alongside an under weight position in offices.

We will seek to extend the weighted average unexpired lease term (WAULT) of the portfolio, as well as diversifying the lease expiry profile.

Individual assets will be well suited to the current occupational market, whilst offering future flexibility. Properties will be leased to good quality businesses on institutional lease terms together with some index-linked assets.

Responsible Investment

In line with Teesside's Pension Fund's Responsible Investment Policy, CBRE considers Environmental, Social and Governance issues (otherwise known as ESG criteria) as part of its decision making process.

Executive Summary (Valuation)

At 31st December 2021, the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £313.8m. This reflects an overall Net Initial Yield of 4.81%, and an Equivalent Yield of 5.17%.

The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 90.9% of the portfolio by capital value. There are 75 demises and a total net lettable area of 1,949,442 sq ft.

The portfolio has a current gross passing rent of £16,616,448 per annum against a gross market rent of £17,100,545 per annum, making the portfolio slightly reversionary in nature.

The weighted average unexpired term is 7.6 years to the earlier of first break or expiry, and 8.6 years to expiry, ignoring break dates.

teesside pension fund

Fund Summary

Total Pension Fund Value (December 2021)	**£4,871m**
Real Estate Weighting (allocation)	6.4% (9%)
Direct Portfolio Value	£313.80m

Direct Portfolio

Direct portfolio value (December 2021)	**£313.80m**
Number of holdings	28
Average lot size	£11.21m
Number of demises	75
Void rate (% of ERV) (Estimated UK Benchmark)	1.59% (7.0% – 9.0%)
WAULT to expiry (break)	8.6 years (7.6 years)
Current Gross Passing Rent (Per Annum)	£16,616,448
Current Gross Market Rent (Per Annum)	£17,100,545
Net Initial Yield	4.81%
Reversionary Yield	5.11%
Equivalent Yield	5.17%

Portfolio Highlight (Q4 2021) – Bromford Central, Birmingham

The Fund has agreed terms for a lease renewal at Bromford Central to Harrow Green Ltd. This leasing transaction maintains a fully let Estate and increases the rent on Unit 4 by 23% (+£31,455 p.a). This is part of the wider estate asset management plan, whereby a number of leasing negotiations will take place in 2022.

UK Economic Commentary (Prepared before the Ukraine Crisis)

- UK GDP is estimated to have increased by 1.0% in Q4 2021, following a downwardly revised 1.0% increase in Q3 2021. This takes the level of quarterly GDP to 0.4% below its pre-pandemic (Q4 2019) level.

- Retail sales volumes rose by 1.9% in January 2022 following a fall of 4.0% in December 2021; sales volumes were 3.6% above their pre-pandemic February 2020 levels.

- The proportion of retail sales online fell to 25.3% in January 2022, its lowest proportion since March 2020, continuing a broad downward trend since its peak in February 2021 (36.5%); despite its downward trend, the percentage of retail sales made online was still higher than pre-pandemic (19.8% in February 2020).

- The UK Employment Rate increased by 0.1 percentage points to 75.5% in Q4 2021; The Unemployment Rate decreased by 0.2 percentage points to 4.1%.

- The number of job vacancies in the three months to January 2022 rose to a new record of 1,298,300, an increase of 513,700 from its pre-pandemic January to March 2020 level.

- Growth in average total pay (including bonuses) was 4.3% and growth in regular pay (excluding bonuses) was 3.7% among employees in the three months to December 2021. In real terms (adjusting for inflation), total and regular pay fell on the year at -0.1% for total pay and -0.8% for regular pay.

- Looking forward, CBRE forecast UK GDP growth of 4.6% in 2022. The biggest risks to outlook are the rising cost of energy prices and the ensuing real income squeeze, which may act as a significant drag on consumer spending; particularly in the second half of the year.

- The Bank of England increased the Base Rate to 0.5% in February 2022. CBRE's base case is that short term interest rates will continue rising throughout 2022 broadly in line with current market pricing. This would see the Base Rate return to 1% by the end of the year.

UK Real Estate Market Commentary

- Year on year total returns for All UK Property grew by 19.9% (13.8%* capital return, 5.4%* income return) for the period Q4 2020 to Q4 2021**. This total returns figure is above the 5 year average and marks a strong bounce back after the negative returns recorded during 2020.

- The quarterly total return for All UK Property for Q4 2021 was recorded at 8.3% (7.0% capital return, 1.2% income return).

- Industrials total returns were 15.0% over Q4 2021 (13.9% capital return, 1.0% income return).

- Rental values for All UK Property increased by 1.6% over the fourth quarter of 2021. This figure was largely pulled up by the 4.1% rise in values in the Industrial sector. Both Office and Retail sector rents rose marginally by 0.2% over the quarter.

- In Q4, the investment transactions in the UK commercial real estate market totalled £22.0bn, the highest ever total for a single quarter in the UK. This brought annual volumes to £61.4bn for 2021.

- Central London Office volumes reached £10.0bn in 2021, up from £7.6bn in 2020. Over the year, two thirds of volumes in this market were attributed to overseas investors, with North American investors responsible for £2.6bn, European investors for £2.3bn and Asian investors for £1.1bn.

- For offices outside of Central London, investment totalled £8.6bn in 2021, the highest total since 2018. 35% of this volume was invested in the London Metropolitan & South East markets, 27% in major regional cities, 25% in other regional offices, and 13% in nationwide office portfolios.

- In 2021, £6.4bn transacted in the Retail real estate market, rising from £4.4bn in 2020. The largest deal in 2021 was the £378m sale of Topshop's former flagship store on Oxford Street to IKEA.

- Industrial volumes reached an all-time high in 2021, with £16.5bn transacting. Since 2020, £100m+ deals accounted for 44% of the total volume in this market, a sharp increase on the 21% of industrial volumes that were attributed to £100m+ between 2010-2019.

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

** Based on CBRE Monthly Index, all property total returns Dec 2021

Investments

Sales

No sales this period.

Acquisitions

No acquisitions this period.

Direct Portfolio Analysis

Top Ten Holdings (by Capital Value)

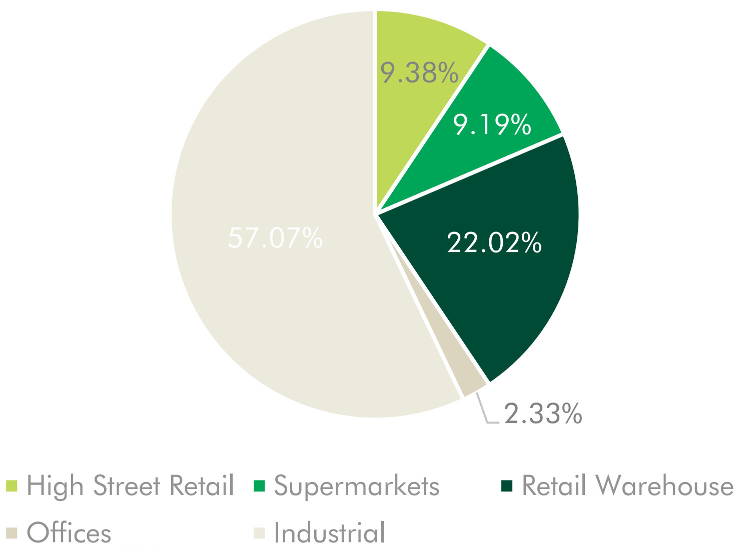
No.	Asset	Sector	Value	% of Direct Portfolio
1	THORNE - Capitol Park	Industrial	£36,400,000	11.6%
2	GATESHEAD - Team Valley	Industrial	£23,600,000	7.5%
3	PARK ROYAL - Minerva Road	Industrial	£20,700,000	6.6%
4	BIRMINGHAM - Bromford Central	Industrial	£20,250,000	6.5%
5	LUTTERWORTH - Magna Park	Industrial	£19,300,000	6.2%
6	RUGBY - Valley Park	Industrial	£18,200,000	5.8%
7	PARK ROYAL - Coronation Road	Industrial	£17,200,000	5.5%
8	STOW-ON-THE-WOLD - Fosse Way	Supermarket	£15,350,000	4.9%
9	SWADLINCOTE - William Nadin Way	Industrial	£14,000,000	4.5%
10	EXETER - H&M High Street	High Street Retail	£13,100,000	4.2%
		Total	**£198,100,000**	**63.1%**

We will seek to extend the weighted average unexpired lease term (WAULT) of the portfolio, as well as diversifying the lease expiry profile.

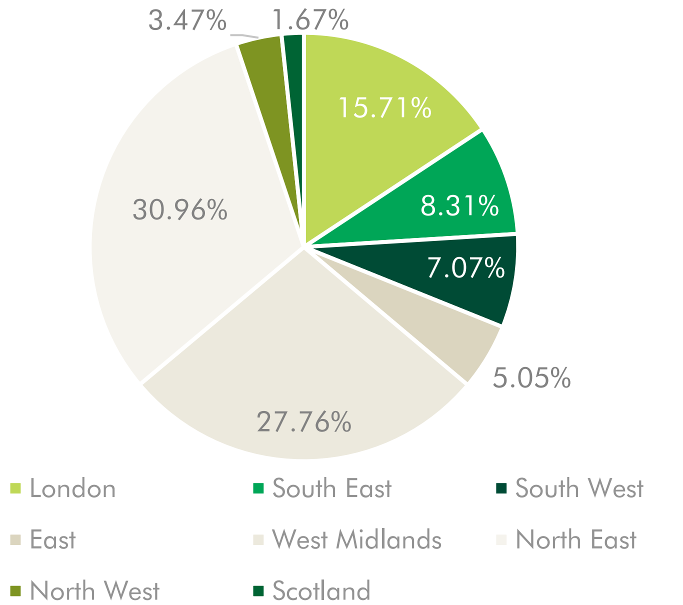
In addition to recommendations on industrial purchases, we may also recommend alternative and long-let investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure, supermarkets and student housing.

Set against a backdrop of low 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.

Sector Allocation (by Capital Value)



Geographical Allocation (by Capital Value)



Direct Portfolio Analysis (continued)

Top Ten Tenants (by Contracted Income)

The portfolio currently has 75 different demises let to 61 tenants. The largest tenant is Omega Plc which accounts for c.8.3% of the annual contracted income. Experian currently lists Omega as representing a “Very Low Risk” of business failure.

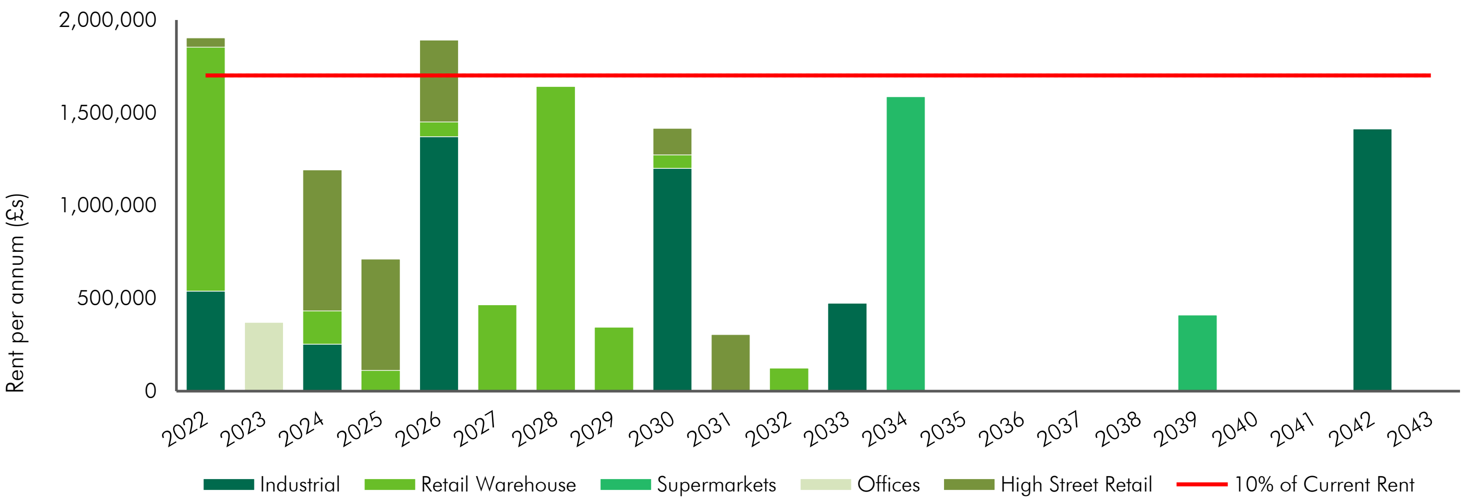
As a significant portion of the portfolio income will be from the top ten tenants, we will monitor their covenant strength and flag any potential issues. This is particularly relevant at the current time as the Covid-19 pandemic is putting increased pressure on all businesses. Our most recent assessment shows that all of these tenants are classed as having a “low risk” of business failure.

Top Ten Tenants (by Contracted Rent)

#	Tenant	Sector	Number of Leases	Contracted Rent p.a.	% of Portfolio Rent	Risk Rating (Experian)
1	Omega Plc	Industrial	1	£1,413,690	8.3%	Very Low Risk
2	Royal Mail Group Limited	Industrial	1	£1,040,000	5.9%	Very Low Risk
3	B&Q plc	Retail	2	£997,000	5.9%	Very Low Risk
4	Unipart Logistics Limited	Industrial	1	£868,635	5.1%	Very Low Risk
5	B&M Retail Limited	Retail	3	£863,400	5.1%	Very Low Risk
6	Libra Textiles	Retail	1	£850,000	5.0%	Very Low Risk
7	Brunel Healthcare	Industrial	1	£843,761	5.0%	Very Low Risk
8	ASDA Stores Limited	Industrial	1	£755,000	4.4%	Very Low Risk
9	H&M	Retail	1	£740,000	4.3%	Very Low Risk
10	Tesco Stores Limited	Supermarkets	1	£737,823	4.3%	Very Low Risk
			Total	£9,069,309	53.5%	

Key Lease Expiries / Income Risk

There is a focus to mitigate against lease expiry risk, by either purchasing properties where the lease expiry profile does not match that of the portfolio, or through active asset management. The graph below identifies the years where more than 10% of the portfolio income is due to expire.



Investment Management Update

We continue to seek long-let institutional stock in a range of sectors, primarily industrial, retail warehousing and supermarket sectors to deliver the secure index linked income streams identified within the Fund's strategy. Whilst many of these have not progressed quickly we are optimistic that we may gain traction over the next few weeks as investors begin to consider their post pandemic strategies. TPF's requirement has been articulated to the investment market and we are receiving a substantial number of investment ideas each week.

Asset Management Update

Unit H, Congleton – February 2022

The Fund has agreed terms with Pure Gym for a new 15-year lease reflecting £14.90 psf, a 10% increase on the Retail Unit's estimated rental value.

Harrow Green, Bromford Central – February 2022

The Fund has agreed terms with Harrow Green for a 10-year reversionary lease with 3-months rent-free at £7.25 psf, a 23% rental uplift on the previous passing rent.

Royal Mail, Gateshead – February 2022

The Fund has instructed a rent review surveyor to settle the September 2020 outstanding rent review.

Pets at Home, Arbroath – October 2021

The Fund has agreed terms with Pets at Home for a 5-year reversionary lease reflecting £12.00 psf, a 5% increase in the Retail Park's estimated rental value.

Unipart, Rugby – August 2021

The Fund has instructed a rent review surveyor to settle the October 2021 rent review. An uplift in the passing rent is anticipated to be agreed.

Portfolio Arrears Update – 28th February 2022

	Rent Due 25 December	Collectable Rent	Targets Quarter Date up to and including 25/12/2021	92.00% Week 1 up to and including 01/01/2022	96.00% Week 2 up to and including 08/01/2022	98.00% Week 3 up to and including 15/01/2022	99.00% Week 4 up to and including 22/01/2022	Payment after 22/01/2022	Difference
	4,340,850.23	4,340,850.23	2,930,760.79	17,799.55	299,972.37	55,089.76	300,123.80	489,101.36	248,002.60
Non Collectable Total		0.00							
Collections Including non collectables			67.52%	67.93%	74.84%	76.11%	83.02%	94.29%	
Collections Excluding non collectables			67.52%	67.93%	74.84%	76.11%	83.02%	94.29%	

The rent collection across the entire portfolio in the previous three quarters has reflected the following.
December 2021 – 94.3%
September 2021 – 97.8%
June 2021 – 95.6%

The total Collectable Arrears on the entire portfolio is £1,012,720 as at 28th February 2022 (£1,892,102 as of 22nd November 2021 and £2,066,000 as at September 2021).

The Collectable Arrears exclude the following:

- Tenants that are insolvent (99p Stores Limited and Peacocks Stores Limited at Cirencester, Laura Ashley Ltd and Homestyle Group Operations Ltd at Congleton).
- Tenants that have overall credit balances on their accounts
- Tenants with recent charges raised within the last month

Below, is a summary of the top ten tenants with the greatest arrears, accounting for 79.5% (£804,630) of the total collectable arrears:

Nuffield Health (Guildford) – Total arrears of £243,716 (24.1% of collectable arrears) (£310,000 as at November 2021). Nuffield continue to pay their quarterly rent on a monthly basis but have missed a number of payments. In 2021 they paid one third for September, and two-thirds of the June quarter's rent. In 2020 they paid nothing towards their June rent and only paid one-third of December's rent. They also have service charge and insurance outstanding. Our Accounts Team are in regular dialogue with this tenant.

Saint Gobain Building Distribution Limited (Bromford Central) – Total arrears of £141,120 (13.9% of the collectable arrears). These arrears are spread across their two leases and relate mainly to a backdated rental uplift. We are liaising with the tenant over payment.

Matalan Retail Limited (Northwich) – Total arrears of £87,945 (8.7% of the collectable arrears). These arrears relate mainly to the March 2021 quarter's rent. The tenant has an agreed payment plan of £12,500, which they are meeting, and this will be repaid by 1st September 2022.

Shoe Zone Retail Ltd (Congleton) – Total arrears of £75,598 (7.5% of the collectable arrears). The majority of this tenant's arrears relate to the December 2020, June 2021 and September 2021 quarter's rent and service charge, which the tenant has not yet paid anything towards.

B&Q Plc (Arbroath) - Total arrears of £56,247 (5.6% of the collectable arrears). This relates to service charge arrears. B&Q appear to have queries and we are working to establish what these relate to.

Pizza Hut (Ipswich) - Total arrears of £54,669 (5.4% of the collectable arrears). Current rents are being paid and this relates to the period of insolvency. This account requires a full reconciliation, which will reduce this level of arrears.

Harrow Green Ltd (Bromford Central) – Total arrears of £42,600 (4.2% of the collectable arrears). Most of these arrears relate to their December 2021, which the tenant has not yet paid anything towards.

Portfolio Arrears Update – 28th February 2022

Libra Textiles Limited (Rotherham) – Total arrears of £34,800 (3.4% of the collectable arrears). This relates to a payment plan for the June 2021 quarters' rent. They are keeping to the plan and the final instalment is due on 25th March 2022.

Wickes Building Supplies Limited (Colchester) – Total arrears of £34,131 (3.3% of the collectable arrears). Mainly related to final instalment of the December quarter's rent.

Toughglaze (UK) Ltd (Park Royal) – Total arrears of £33,805 (3.3% of the collectable arrears). Mainly related to the final instalment of the December quarter's rent

The remaining £208,080 (20.5%) of the collectable arrears is spread across 51 tenants, ranging from £32,479 to £25.

Responsible Investment Initiatives

Environmental, Social and Governance (ESG) criteria are having an increasingly prominent role in investment decision making and will influence the attractiveness of investments going forward. CBRE will ensure that responsible investment is put at the forefront of the strategy and that ESG factors are considered within each investment and asset management initiative. This will help ensure that the investment portfolio remains resilient over the long term.

We have summarised the relevant of each of the ESG factors below. These will be expanded upon with portfolio level principles and asset specific initiatives as the importance of ESG grows.

Environmental – sustainable factors will continue to play a part in the definition of 'prime' real estate, and buildings that don't meet the increasingly competitive standards are likely to become obsolete faster. Occupiers will demand their buildings adhere to the highest environmental standards.

Social - real estate's impact on the local community and on a company's workforce are becoming equally important. Buildings that contribute positively to the world are therefore likely to be more resilient than those that do not, and as such are likely to benefit from increased occupier demand, leading to future rental and capital growth.

Governance - market participants will increasingly question the governance and management practices of their partners and supply chain. Rigorous standards will mean businesses will need to become more transparent and engage with their stakeholders to ensure access to the best opportunities.

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