

TEESSIDE PENSION FUND Q1 2022

Quarterly Report
Prepared: 8th June 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 March 2022, the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £331.1m. This reflects an overall Net Initial Yield of 4.85%, and an Equivalent Yield of 4.95%.

The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 88.6% 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 £17,271,310 per annum against a gross market rent of £17,247,045 per annum, making the portfolio broadly rack-rented in nature.

The weighted average unexpired term is 7.3 years to the earlier of first break or expiry, and 8.4 years to expiry, ignoring break dates.

Fund Summary

Total Pension Fund Value (December 2021)	£5,040m
Real Estate Weighting (target allocation)	6.6% (9%)
Direct Portfolio Value (March 2022)	£331.1m

Direct Portfolio

Direct portfolio value (March 2022)	£331.1m
Number of holdings	28
Average lot size	£11.83m
Number of demises	75
Void rate (% of ERV) (Estimated UK Benchmark)	0.70% (7.0% – 9.0%)
WAULT to expiry (break)	8.4 years (7.3 years)
Current Gross Passing Rent (Per Annum)	£17,271,310
Current Gross Market Rent (Per Annum)	£17,247,045
Net Initial Yield	4.85%
Reversionary Yield	4.88%
Equivalent Yield	4.95%

Portfolio Highlight (Q1 2022) – Leonardo, Yeovil



In Q2 2021, the Fund completed the purchase of an income strip to forward fund the development of a 210,000 sq ft industrial unit. A year on, the development is coming to fruition with ground works being complete and the recent assembly of the steel frame.

UK Economic Commentary

- UK GDP is estimated to have increased by 0.8% in Q1 2022, following growth of 1.3% in Q4 2021. The level of quarterly GDP in Quarter 1 2022 is now 0.8% above its pre-pandemic (Q4 2019) level.
- Retail sales volumes rose by 1.4% in April 2022 following a fall of 1.2% in March 2022; sales volumes were 4.1% above their pre-pandemic February 2020 levels.
- The proportion of retail sales online rose to 27.0% in April 2022 from 25.9% in March and remains substantially higher than pre-pandemic (19.9% in February 2020).
- The UK unemployment rate fell by 0.2 percentage points in the three months to February 2022. Economic inactivity increased by 0.2 percentage points to 21.4%. This increase was driven by those who are economically inactive because they are looking after family, retired or long-term sick.
- The number of job vacancies in January to March 2022 rose to a new record of 1,288,000. However, the rate of growth in vacancies continued to slow down. Over the quarter the number of vacancies increased by 50,200 with the largest increase in human health and social work.
- Growth in average total pay (including bonuses) was 5.4% and growth in regular pay (excluding bonuses) was 4.0% in December 2021 to February 2022. In real terms (adjusted for inflation), growth in total pay was 0.4% and regular pay fell on the year at negative 1.0%; strong bonus payments over the past six months have kept recent real total pay growth positive. Previous months' strong growth rates were affected upwards by base and compositional effects.
- Looking forward, CBRE forecast UK GDP growth of 3.3% in 2022. The biggest risks to outlook are the rising cost of energy and fuel 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 Bank Rate to 1.0% in May 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 Bank Rate return to 2% by the end of the year.

UK Real Estate Market Commentary

- Year on year total returns for All UK Property grew by 23.5% (17.5%* capital return, 5.2%* income return) for the period Q1 2021 to Q1 2022**. This total returns figure is above the 5 year average and year on year total returns for Q4 2020 to Q4 2021. The quarterly total return for All UK Property for Q1 2022 was recorded at 5.1% (3.9% capital return, 1.2% income return).
- Industrials total returns were 7.5% over Q1 2022 (3.4% capital return, 0.9% income return).
- Rental values for All UK Property increased by 1.1% over the first quarter of 2022. This figure was largely pulled up by the 3.4% rise in values in the Industrial sector. In Q1 2022, both Office and Retail sector rents rose by 0.4%.
- In the first quarter of 2022, investment volumes reached £17.3bn. The rolling 12-month total for UK investment was £68.2bn, the highest since 2018 Q1.
- Central London Office volumes reached £5.5bn in Q1, the highest start to the year ever for this market. The five largest deals accounted for £3.4bn. In particular, the sale of 5 Broadgate to Korean pension fund NPS for £1.2bn was of note as it is the largest transaction in the market since 2017.
- For offices outside of Central London, investment totalled £1.8bn in the first quarter of the year. This included four transactions over £100m, all of which were bought by overseas investors.
- £1.5bn was invested in the Retail market in 2022 Q1, including the £600m sale of two designer outlet parks to LaSalle IM. This was the largest deal in this market since the sale of Westfield in 2018.
- Industrial volumes were £4.1bn in Q1, another strong quarter. This pushed the rolling 12-month total to a new all-time high of £17.1bn.

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

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

Investments

Sales

No sales this period.

Acquisitions

No acquisitions this period.

The Fund has agreed terms in respect of two new assets.

Direct Portfolio Analysis

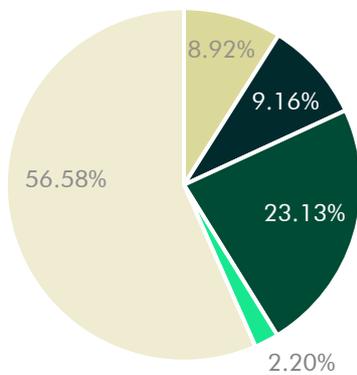
Top Ten Holdings (by Capital Value)

No.	Asset	Sector	Value	% of Direct Portfolio
1	THORNE - Capitol Park	Industrial	£37,800,000	11.4%
2	BIRMINGHAM - Bromford Central	Industrial	£23,950,000	7.2%
3	GATESHEAD - Team Valley	Industrial	£23,600,000	7.1%
4	PARK ROYAL - Minerva Road	Industrial	£21,600,000	6.5%
5	LUTTERWORTH - Magna Park	Industrial	£19,700,000	5.9%
6	RUGBY - Valley Park	Industrial	£18,200,000	5.5%
7	PARK ROYAL - Coronation Road	Industrial	£18,000,000	5.4%
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			£207,100,000	62.5%

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.

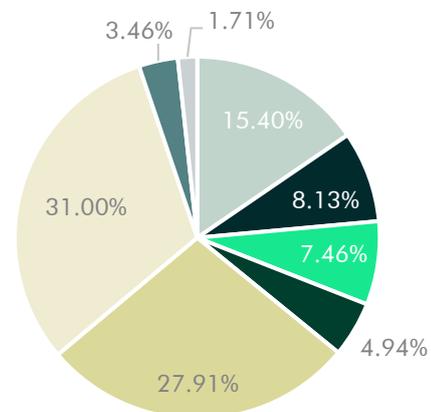
Set against a backdrop of low economic growth, we will seek to make purchases where both occupational and investment supply and demand conditions are strong. This will ensure that purchases are accretive to the portfolio's performance.

Sector Allocation (by Capital Value)



■ High Street Retail
 ■ Supermarkets
 ■ Retail Warehouse
■ Offices
 ■ Industrial

Geographical Allocation (by Capital Value)



■ London
 ■ South East
 ■ South West
■ East
 ■ West Midlands
 ■ North East
■ North West
 ■ Scotland

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.8.2% 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. 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	8.2%	Very Low Risk
2	B&Q plc	Retail	2	£997,000	5.8%	Very Low Risk
3	Royal Mail Group Limited	Industrial	1	£899,162	5.2%	Very Low Risk
4	Unipart Logistics Limited	Industrial	1	£868,635	5.0%	Very Low Risk
5	B&M Retail Limited	Retail	3	£863,400	5.0%	Very Low Risk
6	Libra Textiles	Retail	1	£850,000	4.9%	Very Low Risk
7	Brunel Healthcare	Industrial	1	£843,761	4.9%	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				£8,968,471	51.9%	

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 remain optimistic. The Fund's requirement has been articulated to the investment market and we are receiving a substantial number of investment opportunities each week.

Asset Management Update

Nuffield Health, Guildford – June 2022

The Fund has successfully cleared all Nuffield Health arrears. At its height, arrears totalled £310,000, representing one of the Fund's biggest debtors.

Harrow Green, Bromford Central – February 2022

The Fund has completed a lease renewal with Harrow Green for a 10-year term with 3-months rent-free at £7.25 psf, a 23% rental uplift on the previous passing rent. The tenant benefits from a break on the 5th anniversary of the lease commencement.

Royal Mail, Gateshead – February 2022

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

Portfolio Arrears Update – 8th June 2022

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 25 March	Collectable Rent	Quarter Date up to and including 25/03/2022	Week 1 up to and including 01/04/2022	Week 2 up to and including 08/04/2022	Week 3 up to and including 15/04/2022	Week 4 up to and including 22/04/2022	Payment after 22/04/2022	Difference
	4,651,599.15	4,651,599.15	3,137,584.54	1,064,953.65	18,517.50	25,581.36	56,575.00	300,431.72	47,955.38
Non Collectable Total Collections Including non collectables		0.00							
Collections Excluding non collectables			67.45%	90.35%	90.74%	91.29%	92.51%	98.97%	
			67.45%	90.35%	90.74%	91.29%	92.51%	98.97%	

The rent collection across the entire portfolio in the previous three quarters has reflected the following.

March 2022 – 99.0%

December 2021 – 99.1%

September 2021 – 98.8%

The total Collectable Arrears on the entire portfolio is £451,552 as at 8th June 2022 (£1,012,720 as of 28th February 2022 and £1,892,102 as of 22nd November 2021). It should be noted that the annual insurance premium was charged to all tenants on 4th April. Although these charges are now 2-months old, there are still a number outstanding, which we are continuing to chase.

The Collectable Arrears exclude the following:

- Tenants that are insolvent (99p Stores Limited and Peacocks Stores Limited at Cirencester, Laura Ashley 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 81.2% (£366,698) of the total collectable arrears:

Shoe Zone Retail Ltd (Congleton) – Total arrears of £75,598 (16.7% of the collectable arrears). The majority of this tenant's arrears relates to the December 2020, June 2021 and September 2021 quarter's rent and service charge, which the tenant has not yet paid anything towards. Our Accounts Team are in regular dialogue with this tenant.

B&Q plc (Arbroath) – Total arrears of £56,247 (12.5% of the collectable arrears). This relates to service charge arrears and the latest insurance premium. B&Q have service charge queries and we are working with them to resolve.

Royal Mail Group Limited (Gateshead) – Total arrears of £49,316 (10.9% of the collectable arrears). This relates solely to insurance.

Omega plc (Doncaster) – Total arrears of £43,420 (9.6% of the collectable arrears). This relates solely to insurance.

Pizza Hut (UK) Limited (Ipswich) – Total arrears of £40,891 (9.1% of the collectable arrears). Current rents are being paid and this relates to the period of insolvency. We are working with Pizza Hut to justify these arrears in line with their CVA and Deed of Variation to the lease.

Matalan Retail Limited (Northwich) – Total arrears of £37,945 (8.4% 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.

Asda Stores Limited (Lutterworth) – Total arrears of £17,242 (3.8% of the collectable arrears). This relates solely to insurance.

Portfolio Arrears Update – 8th June 2022

Toni & Guy (South) Limited (Gloucester Road) – Total arrears of £16,601 (3.7% of the collectable arrears). This relates mainly to the March 2021 quarter's rent and we are trying to establish why this has not been paid.

American Dry Cleaning Company Limited (Gloucester Road) – Total arrears of £16,125 (3.6% of the collectable arrears). This relates to a range of charges but the majority is the December 2021 and March 2022 rents to which the tenant has made no payments towards.

Knight Frank (Old Brompton Road) – Total arrears of £13,313 (2.9% of the collectable arrears). This relates solely to insurance.

The remaining £84,855 (18.8% of the collectable arrears) of arrears is spread across 35 tenants, ranging from £10,781 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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