

TEESSIDE PENSION FUND

Quarterly Portfolio Strategy Report

1st JULY – 30th SEPTEMBER 2020

Prepared 18th November 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 September 2020, the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £267.35m. This reflects an overall Net Initial Yield of 5.59%, and an Equivalent Yield of 5.90%.
- 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 7.6 years to the earlier of first break or expiry, and 8.8 years to expiry, ignoring break dates.
- The portfolio also has the following characteristics:
 - The vacancy rate is currently 2.45% of Estimated Rental Value. By comparison, the ‘MSCI Quarterly Index Q3 2020 Void Rate’ is 7.4%.
 - The top ten tenants constitute 53.4% of the total gross annual income of the portfolio, while the top twenty tenants constitute 87.7%.
 - Current gross passing rent is £16,218,173 per annum, against a gross current market rent of £16,619,463 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 10th November 2020

The total Collectable Arrears on the entire portfolio is £1,274,711 as at 10th November. 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 also tenants that have overall credit balances on their accounts.

Below, is a summary of the top ten tenants with the greatest arrears, which account for 80.4% (£1,024,832) of the total arrears:

- **River Island Clothing Co. Limited (Lincoln)** – Total arrears of £206,250 (16.2% 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 30th November (8 months). We understand that River Island may enter a CVA and they are negotiating with landlords over rent reductions. We are in negotiations with the tenant. On 7th October we received their first payment of £13,750, being 50% of one month's rent.
- **P&O Ferrymasters Limited (Lutterworth)** – Total arrears of £202,261 (15.9% of the collectable arrears). This relates mainly to the September quarter rent plus some historic insurance charges. We are continuing to chase for payment. This lease expires on 24th December and the tenant is not in occupation (the unit is sub-let to ASDA). A new lease to ASDA is being finalised with an early surrender from P&O. All sums due will be collected upon completion.
- **Nuffield Health (Guildford)** – Total arrears of £149,026 (11.7% of the collectable arrears). This relates mainly to the June and September quarter 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 (25 July) within any balance prior to opening deferred to December. We have received no payment towards their June rent but they have begun to pay their September quarter monthly and we have received their first two instalments.
- **Peacocks Stores Limited (Cirencester)** – Total arrears of £90,579 (7.1% of the collectable arrears). This tenant has not yet been granted any rent concession and the arrears relate to their monthly rent from 28th March through to 27th November (8 months), plus service charge and insurance premium, which we are continuing to chase for payment. No payments have been received.
- **Unipart Logistics Limited (Rugby)** – Total arrears of £86,863 (6.8% of the collectable arrears). They are now paying their rent monthly and have paid their first two instalments. This sum is the final instalment of their September quarter rent.

- **Boots UK Limited (Congleton)** – Total arrears of £85,829 (6.7% of the collectable arrears). This tenant has not yet been granted any rent concession and the arrears relate mainly to their monthly rents from 1st April to 31st November (8 months). Payments towards service charge are being made monthly.
- **Sportsdirect.com Retail Limited (Cirencester)** – Total arrears of £84,504 (6.6% of the collectable arrears). This tenant has not yet been granted any rent concession and the arrears relates to their monthly rent from 28th March through to 27th November (eight-months), plus service charge and insurance premium, which we are continuing to chase for payment. No payments have been received.
- **Pizza Hut (UK) Limited (Ipswich)** – Total arrears of £50,461 (4.0% of the collectable arrears). This tenant has not paid their June or September quarter rents and have insurance and service charge also outstanding. The tenant entered a CVA in September and we are in negotiations regarding a continued re-occupation.
- **Marks & Spencer Simply Food Ltd (Congleton)** – Total arrears of £38,558 (3.0% of the collectable arrears). This tenant is now paying their quarterly rent in monthly instalments but is not paying service charge. These arrears relate to their third rent instalment for the September quarter (£21,375) with the remaining balance being service charges.
- **Aurum Group Limited (Newcastle upon Tyne)** – Total arrears of £30,500 (2.4% of the collectable arrears). This relates solely to one third of their September quarter rent. This tenant has reliably paid it's rent on a monthly basis since 2012.

The remaining £249,879 (19.6% of the collectable arrears) of arrears is spread across 60 tenants, ranging from £30,105 to £32.24.

EXECUTIVE SUMMARY

Quarterly Rent Collection Statistics

Quarterly Rent Collection Statistics at 10th November 2020

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 29 September	Collectable Rent	Quarter Date up to and including 29/09/2020	Week 1 up to and including 06/10/2020	Week 2 up to and including 13/10/2020	Week 3 up to and including 20/10/2020	Week 4 up to and including 27/10/2020	Payment after 27/10/2020	Difference
	4,050,152.71	4,050,152.71	2,179,602.90	419,391.50	60,469.69	285,367.36	151,903.42	325,977.93	627,439.91
Non Collectable Total		0.00							
Collections Including non collectables			53.82%	64.17%	65.66%	72.71%	76.46%	84.51%	
Collections Excluding non collectables			53.82%	64.17%	65.66%	72.71%	76.46%	84.51%	

These figures relate to rents that only became due on the September English Quarter Day (29th September 2020).

The difference of £627,439.91 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 September quarter include River Island Clothing Co. Limited (£206,250), P&O Ferrymasters Limited (£202,261), Nuffield Health (£149,026), Peacocks Stores Limited (£90,579), Unipart Logistics Limited (£86,863) and Boots UK Limited (£85,829).

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 85% of collectable rent (to 10th November 2020). By comparison, the total collected within the same timeframe in 2019 was 97% of the collectable rent.

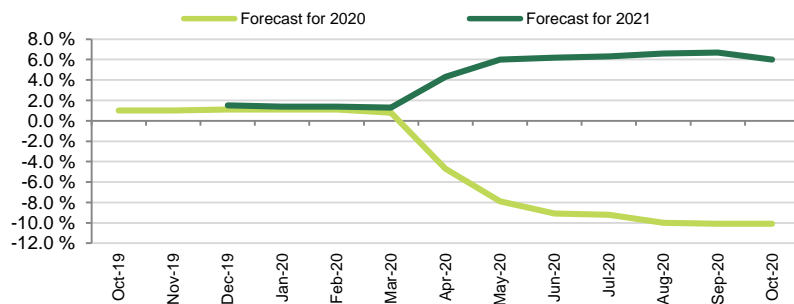
2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

PROPERTY MARKET & SECTOR FORECASTS

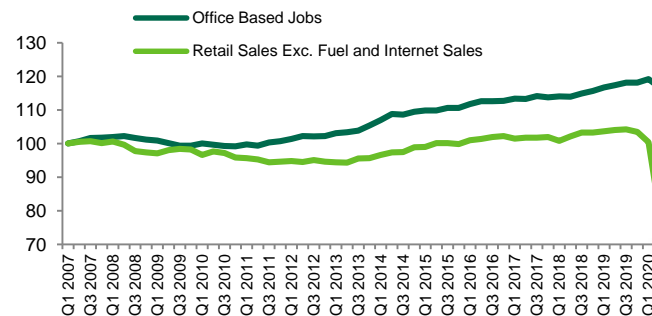
Economic Performance Q3 2020

- The UK economy grew by 1% in September, and had recovered a large part of the output lost during the spring lockdown. Taking the whole of the third quarter (Jul-Sep) the UK economy grew by 15.5% QoQ, compared with the previous quarter. The rate of growth has slowed in recent months, and in September the economy was still around 8% smaller than in February (and this was before the latest set of restrictions came in to place).
- Looking at the sectors, the service sector remained around 9% below February levels. In September, the hospitality sector fell back after a strong performance in August. Manufacturing is down around 8% on February levels. Car and other transport equipment remains one of the weakest performing industries, down over 20% on February.
- While household consumption bounced back in Q3, business investment remains 20% below pre-pandemic levels.
- CBRE are forecasting GDP growth of 5.6% in 2021, following an 11.6% fall in 2020. Implicit in our base case is that we reach an FTA with the European Union by the January 2021 deadline and that a vaccine becomes available at the end of the first quarter of 2021 (the end of the Winter).

Evolution of UK GDP Growth Forecast



Economic Drivers of Commercial Property Demand

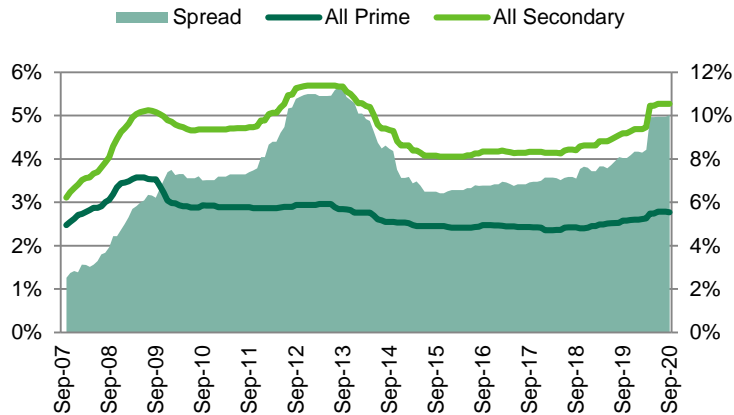


PROPERTY MARKET & SECTOR FORECASTS

Property Market Q3 2020

- Year on year total returns for All UK Property fell by -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 significantly lower than the 5-year average as the down draught of the pandemic hits performance, especially the Retail sector.
- Quarterly total returns for All UK Property for Q2 recorded -1.9% (-3.0% capital return, 1.0% income return).
- Industrials total returns were flat over Q2 2020 (-1.0% capital return, 1.0% income return).
- Rental values for All UK Property fell by -1.1% over the second quarter of 2020. This figure was largely pulled down by a fall of -3.0% in the Retail sector, plus marginal falls in the office and industrial.

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

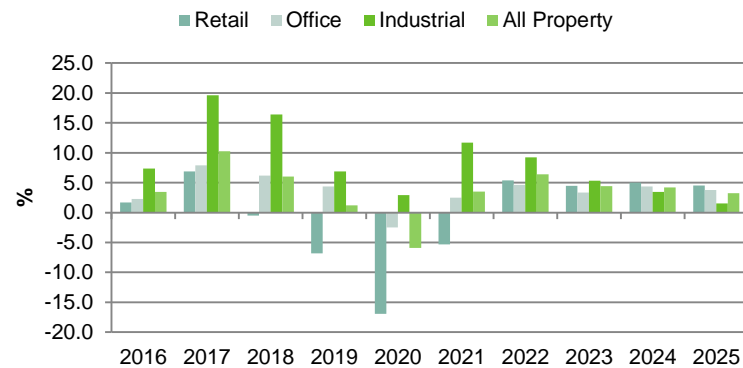


Source: CBRE Monthly Yields, Sept 2020

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

** Based on CBRE Monthly Index, all property total returns Sept 2019

Property Total Returns



Source: MSCI, CBRE, August 2020

PROPERTY MARKET & SECTOR FORECASTS

Property Market Q3 2020 Transactions

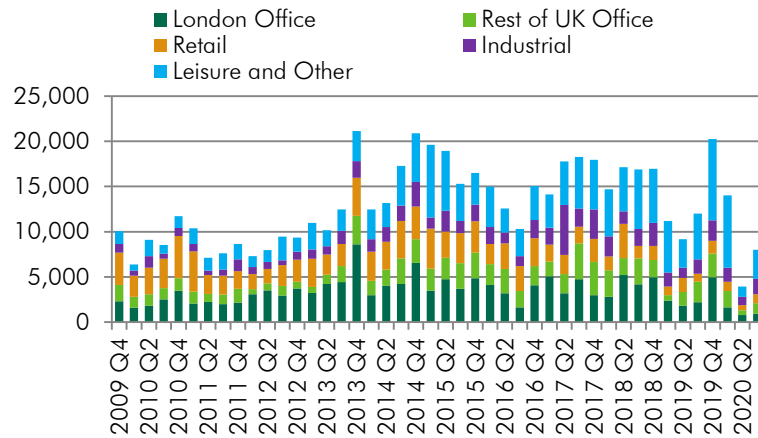
- Total UK investment reached £8.0bn in Q3 2020. This was double the investment seen in Q2 (£3.9bn) due to the easing of the UK's restrictions in the face of the COVID-19 pandemic. However, it was almost half the 5-year quarterly average of £15.0bn, as market uncertainty deterred investors. YTD volumes for 2020 reached £25.9bn, which was 20% down on the same period last year (£32.4bn).
- Global travel restrictions hindered international investment in Q3, as overseas investors were responsible for 34% of capital invested into UK commercial real estate. This performance is below the 10-year quarterly average of 43%.
- Investment transactions for 'All Offices' totalled £2.1bn in Q3 2020. Investment volumes in Central London offices were £904m in Q3, a slight rise on Q2 (£780m) but significantly below the 5-year quarterly average of £3.3bn. The largest investment during this quarter was 25 Cabot Square in London Docklands, purchased for £380m.

PROPERTY MARKET & SECTOR FORECASTS

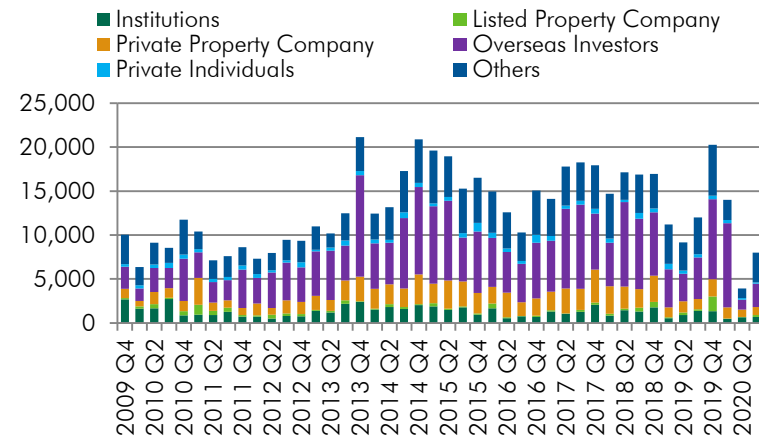
Property Market Q3 2020 Transactions

- The Industrial sector saw £1.7bn in transaction activity in Q3 2020. This included three deals over £150m.
- Retail transactions totalled £1.0bn for the quarter, with the largest transaction being the £157m sale of the RDI REIT retail park portfolio.

Commercial Property Investment Transactions (£millions)



Source: : CBRE, Property Data, October 2019



Source: : CBRE, Property Data, October 2019

PROPERTY MARKET & SECTOR FORECASTS

UK Returns Forecast Q3 2020

	2018	2019	2020	Forecast					Annualised 2021- 2025
				2021	2022	2023	2024	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	2.9	11.7	9.2	5.3	3.5	1.5	6.2
All Property	6.0	1.2	-5.9	3.5	6.4	4.4	4.2	3.3	4.4
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	-1.3	7.1	4.9	1.2	-0.6	-2.5	2.0
All Property	1.4	-3.3	-10.0	-0.9	2.0	0.1	-0.1	-1.0	0.0
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	1.3	1.8	2.1	0.7	0.7	0.5	1.2
All Property	0.5	-0.6	-3.6	-2.5	0.0	0.6	1.1	1.1	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	4.8	4.9	5.0	-0.3
All Property	5.5	5.6	5.8	5.7	5.5	5.5	5.5	5.6	-0.2

*Forecast figures based on Q2 2020 quarterly valuations

In 2020 the spread in performance between the sectors will be wide with the sector performance divergence persisting over time. The covid-19 pandemic has hastened the structural shifts in consumer spending habits and brought about fears around the outlook for the office sector.

The All Property Total Returns for the 2019 outturn was 1.2%, and further losses are expected at the aggregate level in 2020 (forecasted at -5.9%). Retail is forecast to post losses of -16.9% in 2020 with significant falls in values, particularly in shopping centres. Supermarkets have performed comparatively well. The industrial sector will continue to outperform other sectors. The demand for logistics space, enhanced by the shift to higher levels of online shopping, have supported the industrial sector. Continued demand from investors has pushed industrial yields down. We expect All Property Returns to recovery marginally in 2021 with a stronger Return expect in 2022. On the whole, the outlook is driven by the rate of economic recovery. The 5-year annualised total return for 2021-2025 is 4.4% per annum.

Rental falls are forecast in the near term for all sectors except industrial property.



3 PORTFOLIO STRATEGY AND FORECASTING

PORTFOLIO STRATEGY AND FORECASTING

Portfolio Strategy

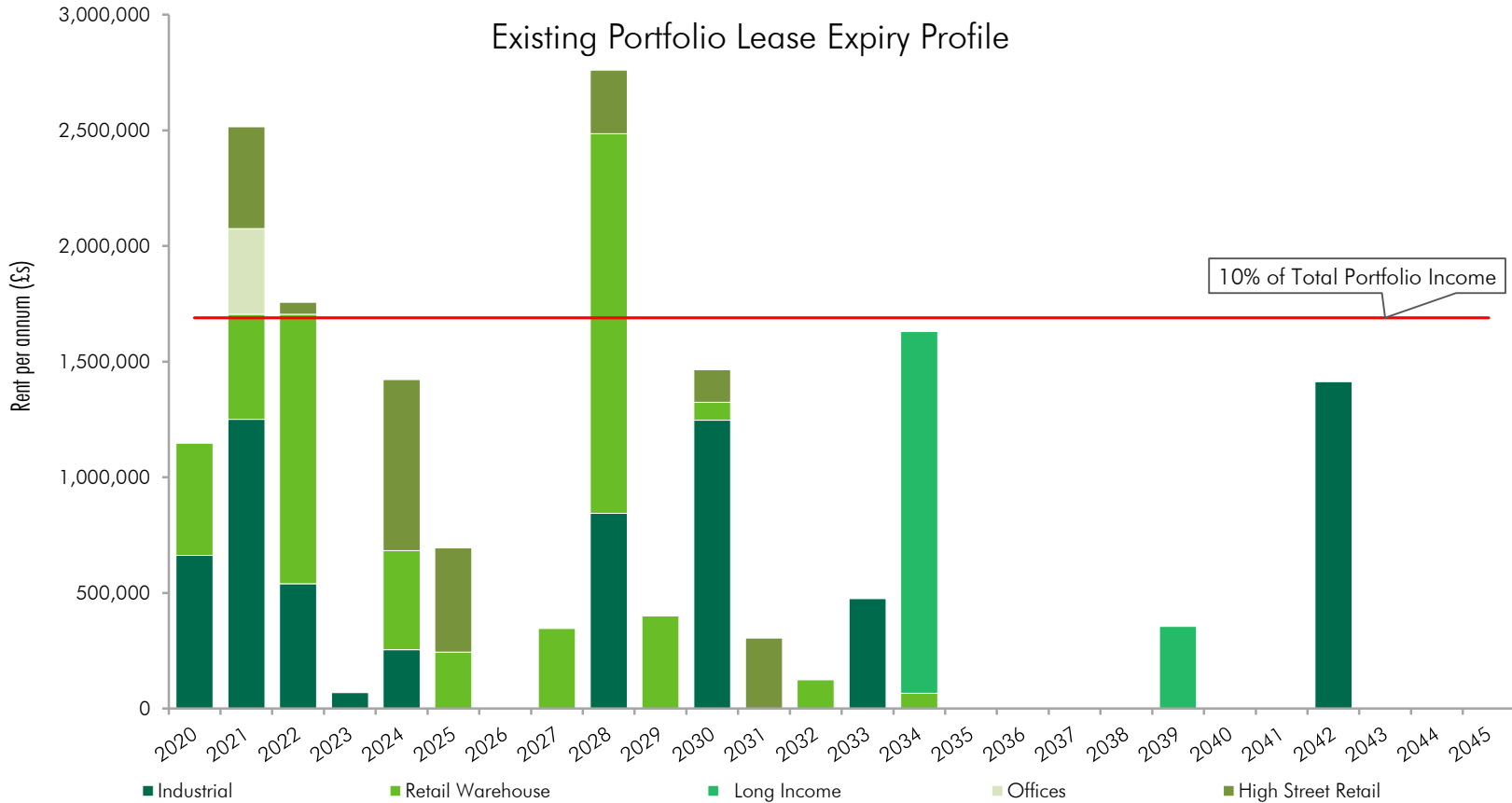
Top Down Strategy

- The Teesside Pension Fund was valued at £4.150bn in June 2020. The Direct Property Portfolio held by the Fund was valued at £267.35m (September 2020), equating to 6.4% 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 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.
- 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

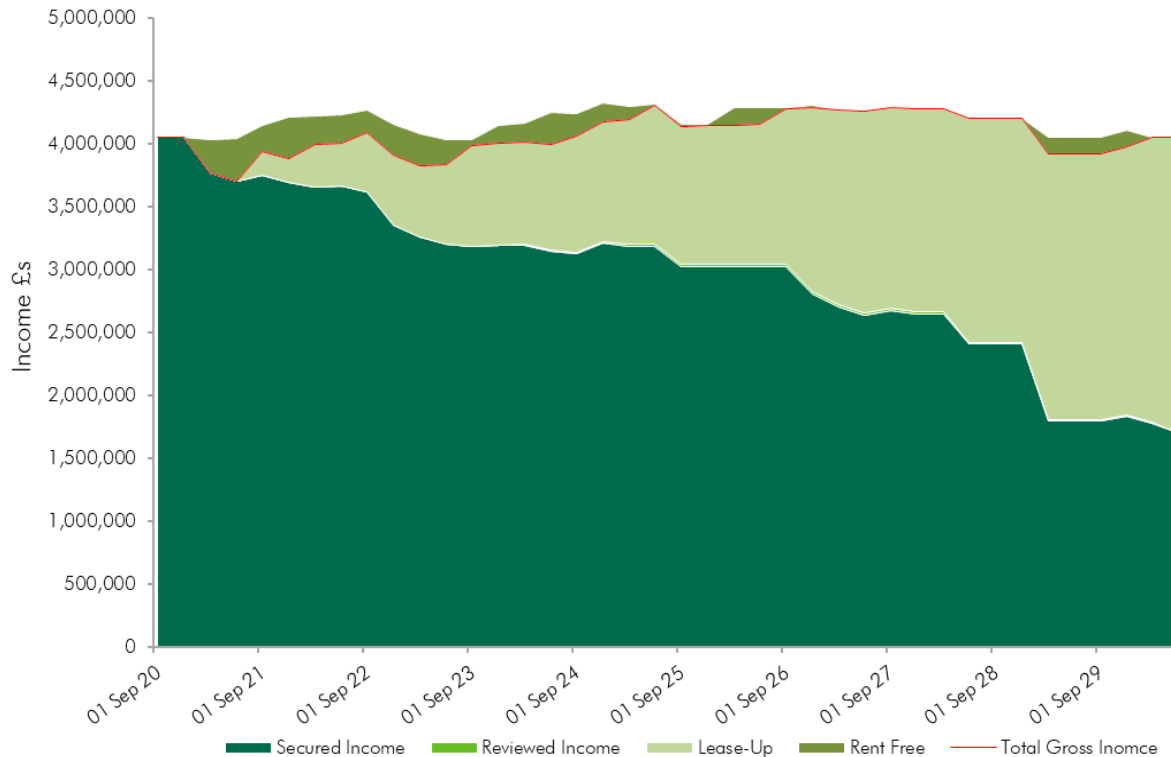
Lease Expiry Profile



PORTFOLIO POSITIONING AND FORECASTING

Portfolio Analysis

Existing Portfolio Income Profile



The income forecast includes our current rental growth projections. These have been 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	9.4%
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	40.0%
Retail Warehouse	32.1%
Long Income	11.4%
Offices	2.3%
High Street Retail	14.2%
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 2024
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



LUTTERWORTH, MAGNA PARK

November 2020

A new 10-year reversionary lease has been agreed with ASDA at a rent of £755,000 pax, an increase of 14%. The deal is currently in solicitors hands and is due to complete imminently.



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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