TEESSIDE PENSION FUND Q4 2022

Quarterly Report
Prepared: 1st March 2023

Fund Objectives

Teesside 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 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

As at 31st December 2022, the portfolio comprised 31 properties located throughout the UK, with a combined value of £378.9m. This reflects an overall Net Initial Yield of 5.21%, and an Equivalent Yield of 5.56%.

The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 89.3% of the portfolio by capital value. There are 86 demises and a total net lettable area of 2,676,364 sq ft.

The portfolio has a current gross passing rent of £19,834,031 per annum against a gross market rent of £20,140,375 per annum, making the portfolio reversionary in nature.

The weighted average unexpired term is 7.2 years to the earlier of the first break or expiry, and 8.4 years to expiry, ignoring break dates.

Fund Summary

Total Pension Fund Value (September 2022)	£4,812m
Real Estate Weighting (target allocation)	7.9% (5-15%)
Direct Portfolio Value (Dec 2022)	£378.9m

Direct Portfolio

Direct portfolio value (Dec 2022)	£378.9m
Number of holdings	31
Average lot size	£12.2m
Number of demises	86
Void rate (% of ERV) (Estimated UK Benchmark)	0.7% (7.0% – 9.0%)
WAULT to expiry (break)	8.4 years (7.2 years)
Current Gross Passing Rent (Per Annum)	£19,834,031
Current Gross Market Rent (Per Annum)	£20,140,375
Net Initial Yield	5.21%
Reversionary Yield	5.49%
Equivalent Yield	5.56%

Portfolio Highlight (Q4 2022) – Iceland, Swindon

The Fund has completed the purchase of a logistics unit located on Symmetry Park in Swindon. The Property totals 220,994 sq ft and is let to Iceland Foods Ltd, with an unexpired term of 13.2 years.

The property was acquired for £31.1m, reflecting 4.95% NIY.

UK Economic Commentary (As at March 2023)

- UK GDP is estimated to have remained flat in Q4 2022 following a contraction by 0.3% in Q3 2022 quarter-on-quarter, following growth of 0.1% in Q2 2022. GDP in Q3 2022 was 0.8% above its pre-pandemic (Q4 2019) level.

- Inflation fell for a third month in a row to 10.1% in January 2023, from 10.5% in December 2022, 10.7% in November 2022 and 11.1% in October 2022. Declining energy and other commodity prices are the main reasons for the fall. Inflation likely reached its peak in October 2022.

- Retail sales volumes increased by 0.5% in January 2023. They declined by 1.0% in December 2022; retail sales volumes were 1.7% below their pre-pandemic February 2020 levels.

- The proportion of retail sales online declined to 25.4% in December 2022 from 25.9% in November. It remains higher than pre-pandemic (19.8% in February 2020) but continues a downward trend since its peak in February 2021 (37.5% of sales).

- The UK unemployment rate increased by 0.1 percentage point to 3.7% in the three months to December 2022. Economic inactivity decreased by 0.1 percentage points to 21.5% on the quarter in September-November 2022. The decrease in inactivity was driven by decreasing numbers of students, long-term sick, or retired.

- The number of job vacancies in October to December 2022 decreased by 75,000 to 1,161,000. The fall in the number of vacancies reflects uncertainty across industries, as survey respondents continue to cite economic pressures as a factor in holding back on recruitment, but vacancies are still above pre-pandemic levels (823,000).

- Both average total pay (including bonuses) and regular pay grew by 6.4% year-on-year in September-November 2022. In real terms (adjusted for inflation), total and regular pay both fell by 2.6%. Even though inflation has been falling for two months in a row, nominal wage growth has been unable keep up with it.

- Looking forward, CBRE forecast UK GDP contracting by -0.8% in 2023, and then growing by 1.7% in 2023 and 2.8% in 2024. The biggest risks to the outlook is an escalation in Ukraine, which might cause another price shock in energy and food. An overreaction to inflation by central banks might also slow down the economy through excessively high borrowing costs.

- The Bank of England increased the Base Rate by 0.5% in February 2023, bringing it to 4.0%. CBRE's base case is that the Bank Rate will peak at c.4.5% in Q3 and Q4 of 2023. After that, the Bank Rate is expected to gradually decline to 3% by early 2025.

UK Real Estate Market Commentary (As at December 2022)

- In H2, UK investment sales of £23.6bn occurred. Together with revisions to volumes for H1, this resulted in a full year total for 2022 of £60.9bn, only marginally lower than the £62.3bn that transacted in 2021.

- The office sector accounted for £18.2bn, or 30% of the full year total, with the industrial and residential sectors commanding a 22% and 19% share of total volume respectively.

- The proportion of purchases accounted for by domestic investors stayed relatively stable over the year, with a roughly 40/60 split between domestic and foreign acquisitions in 2022.

- North American and Asian investors were again the dominant sources of international capital in H2, with nearly three quarters of international capital sourced from these two regions.

- 2022 total returns for All UK Property were -9.1% (-13.3%* capital return, 4.8%* income return)**. All sectors reported negative total returns for 2022, with Industrial recording the lowest total return of -18.1%, driven by -21.0% capital return.

- The quarterly total return for All UK Property for Q4 2022 was -13.5% (-14.6% capital return, 1.2% income return). Industrial total returns were -20.2% (-21.1% capital return, 1.0% income return), retail total returns were -9.8% (-11.3% capital return, 1.6% income return) and office total returns were 2.5% (-12.1% capital return, 1.1% income return).

- Rental values for All UK Property increased by 4.7% throughout 2022, and 1.0% in Q4. This figure reflects another record year for Industrial rental value growth with 10.3%, annual rental growth in the office and retail sectors was 2.0% and 0.5%.

- Capital value movements have been yield driven, with UK All-Property yields moving out 84bps throughout Q4. This brings the annual yield shift to 98bps. The Q4 decline in values bringing the UK All-Property annual result to -13.3%, effectively nullified the 13.8% post-pandemic bounce back in capital values recorded in 2021

* Return figures will not always sum due to the use of compounding calculations over an annual horizon

** Based on CBRE Monthly Index, all property total returns to December 2022

Direct Real Estate Investments

Sales

No sales this period.

Acquisitions

The Fund has completed the purchase of two new assets in Q4 2022. Firstly, a Retail Park located in Tonbridge, an affluent south-east commuter town, let to multiple national retailers including M&S, Halfords and Home Bargains. The Property totals 60,528 sq ft and is let for an average unexpired term of 9.5 years. Acquired for £22.0m reflecting 5.23% NIY.

Secondly, a logistics unit located on Symmetry Park in Swindon. The Property totals 220,994 sq ft and is let to Iceland Foods Ltd with an unexpired term of 13.2 years. Acquired for £31.1m reflecting 4.95% NIY.

Direct Portfolio Analysis

Top Ten Holdings (by Capital Value)

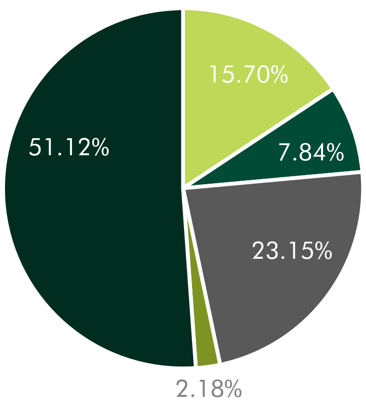
No.	Asset	Sector	Value	% of Direct Portfolio
1	THORNE - Capitol Park	Industrial	£31,200,000	8.2%
2	SWINDON - Symmetry Park	Industrial	£31,100,000	8.2%
3	LONDON - Long Acre	High Street Retail	£31,000,000	8.2%
4	BIRMINGHAM - Bromford Central	Industrial	£20,200,000	5.3%
5	TONBRIDGE - Tonbridge Retail Park	Retail Warehouse	£20,050,000	5.3%
6	PARK ROYAL - Minerva Road	Industrial	£19,500,000	5.1%
7	GATESHEAD - Team Valley	Industrial	£18,900,000	5.0%
8	RUGBY - Valley Park	Industrial	£18,300,000	4.8%
9	PARK ROYAL - Coronation Road	Industrial	£16,300,000	4.3%
10	SWADLINCOTE - William Nadin Way	Supermarket	£15,400,000	4.1%
		Total	£221,950,000	58.6%

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

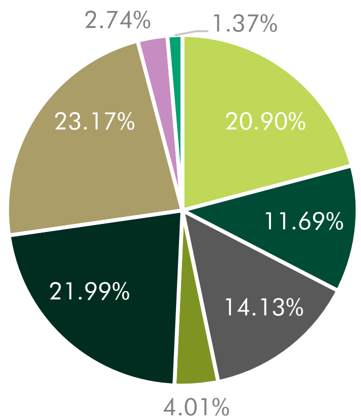
In addition to recommendations on industrial purchases, we may also recommend alternative and long-let investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure, supermarkets and student housing.

Set against a backdrop of low economic growth, we will seek to make purchases where both occupational and investment supply and demand conditions are positive. This should 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 86 different demises let to 66 tenants. The largest tenant is Iceland Food Limited which accounts for 8.2% of the annual contracted income. Experian currently lists Iceland as representing a "Very Low Risk" of business failure.

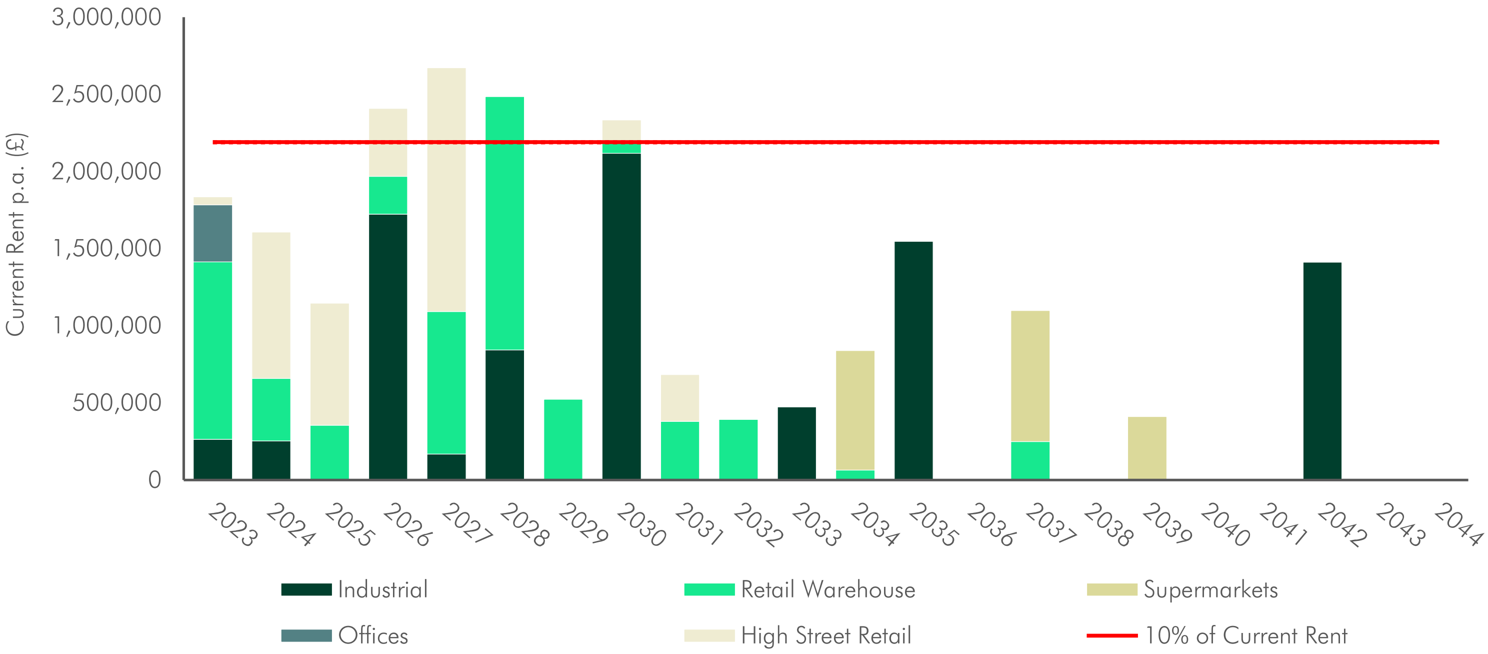
As a significant portion of the portfolio income will be from the top ten tenants, we will monitor their covenant strength and flag any potential issues. Our most recent assessment shows a large majority of these tenants are classed as having a "Very Low Risk" of business failure.

Top Ten Tenants (by Contracted Rent)

#	Tenant	Sector	Number of Leases	Contracted Rent p.a.	% of Portfolio Rent	Risk Rating (Experian)
1	Iceland Food Limited	Industrial / Retail	2	£1,798,211	8.2%	Very Low Risk
2	Zara UK Limited	Retail	2	£1,580,000	7.2%	Very Low Risk
3	Omega Plc	Industrial	1	£1,413,690	6.5%	Very Low Risk
4	Unipart Logistics Limited	Industrial	1	£1,077,000	4.9%	Very Low Risk
5	B&Q plc	Retail	2	£997,000	4.6%	Very Low Risk
6	H&M	Retail	1	£918,123	4.2%	Below Average Risk
7	Royal Mail Group Limited	Industrial	1	£899,162	4.1%	Very Low Risk
8	B&M Retail Limited	Retail	3	£863,400	3.9%	Very Low Risk
9	Libra Textiles	Retail	1	£850,000	3.9%	Very Low Risk
10	Brunel Healthcare	Industrial	1	£843,761	3.9%	Very Low Risk
			Total	£11,240,347	51.3%	

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. A number of the 2023 lease expiries are in negotiations or in solicitor's hands.



Property Portfolio Returns

The below table demonstrates the Portfolio's return compared to a reference index over the past 1, 3 and 5 years. The CBRE Property Index* is provided for illustrative purposes only:

	1 Year Dec 21 - Dec 22			3 Year (p.a.) Dec 19 - Dec 22			5 Year (p.a.) Dec 17 - Dec 22		
	TPF	Index	Variance	TPF	Index	Variance	TPF	Index	Variance
Income Return	5.1%	4.8%	+0.3%	5.4%	5.3%	+0.1%	5.5%	5.4%	+0.1%
Capital Return	-4.3%	-13.3%	+9.0%	1.7%	-3.0%	+4.7%	0.1%	-2.3%	+2.4%
Total Return	0.82%	-9.1%	+9.9%	7.3%	2.1%	+5.2%	5.7%	2.9%	+2.8%

* Note that the CBRE Property Index is not the performance benchmark for the Portfolio.

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. 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

Unipart, Rugby – February 2023

The Fund has completed the October 2021 rent review with Unipart, increasing the passing rent by 24%.

Royal Mail, Gateshead – February 2023

The outstanding rent review has been determined by an Independent Expert. The settlement figure reflects a 19% uplift on the current passing rent.

Toni & Guy, Gloucester Road – February 2023

The Fund has completed a Lease renewal with Toni & Guy for a term of 10 years reflecting £87 Zone A, a 5% increase on the existing passing rent of the unit. The tenant will benefit from a break on the 5th anniversary of the Lease commencement date.

H&M, Exeter – November 2022

The Fund has completed the June 2022 inflation-linked rent review with H&M, increasing the passing rent by 24%, in line with the RPI provision within the Lease.

Rentokil, Bromford Central – November 2022

The Fund has completed a Lease renewal with Rentokil for a term of 10-years reflecting £7.65 psf, a 23% increase on the existing passing rent of the unit. The tenant will benefit from 4-months rent-free and a break on the 5th anniversary of the Lease commencement date.

Regatta Furniture, Ipswich – September 2022

The Fund has completed a new Lease with Regatta Furniture for a term of 10-years reflecting £17.25 psf, a 6% increase on the existing passing rent, the tenant will benefit from a rent-free period of 4-weeks.

Portfolio Arrears Update – 23rd February 2023

	Rent Due 25 December	Collectable Rent	Quarter Date up to and including 25/12/2022	Week 1 up to and including 01/01/2023	Week 2 up to and including 08/01/2023	Week 3 up to and including 15/01/2023	Week 4 up to and including 22/01/2023	Payment after 22/01/2023	Difference
	4,489,102.29	4,489,102.29	3,092,278.57	272,983.75	639,675.70	107,194.00	5,678.82	255,657.30	115,634.15
Non Collectable Total		0.00							
Collections Including non collectables			68.88%	74.97%	89.21%	91.60%	91.73%	97.42%	
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The rent collection across the entire portfolio over the previous three quarters has reflected the following:
December 2022 – 97.4%
September 2022 – 99.5%
June 2022 – 100%

The total Collectable Arrears on the entire portfolio is £256,995 as at 23rd February 2023.

The Collectable Arrears exclude the following:

- Tenants that have overall credit balances on their accounts
- Tenants with recent charges raised within the last month

Below, is a summary of the tenants that have arrears in excess of £10,000. These six tenants account for 66.6% (£171,307) of the total collectable arrears:

Royal Mail Group Limited (Gateshead) – Total arrears of £49,316 (19.2% of the collectable arrears). This relates solely to insurance. This is being reviewed due to a query with the reinstatement value and whether this should include tenant's fixtures. An amended RCA has now been completed and provided to the insurers to review the overall premium.

B&Q plc (Arbroath) – Total arrears of £39,383 (15.3% of the collectable arrears). This relates mainly to service charge arrears. B&Q have service charge queries and we are working with them to resolve. A Measured Survey is being considered to resolve issues over disagreed floor arears.

Nuffield Health (Guildford) – Total arrears of £30,494 (11.9% of the collectable arrears). This relates mainly to the third monthly instalment of the December 2022 quarter's rent. Once received, they will be in an overall credit position.

Pizza Hut (UK) Limited (Ipswich) – Total arrears of £21,120 (8.2% 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.

Shoe Zone Retail Limited (Congleton) – Total arrears of £18,967 (7.4% of the collectable arrears). This relates to the December 2022 quarter's ret and service charge, which have not been paid. The tenant is disputing the sums charged and this is being reviewed.

American Dry Cleaning Company Limited (17/23 Gloucester Road) – Total arrears of £12,027 (4.7% of the collectable arrears). These arrears relate to many charges including part of the December 2022 quarter's rent, insurance and superior landlord's service charges. We are working with the tenant to get these cleared.

The remaining £85,688,688 (33.3% of the collectable arrears) of arrears is spread across 27 tenants, ranging from £9,556 to 29p.

Real Estate Lending

Debt Investment Portfolio	Sector	Loan Limit	Drawn Balance	Interest Rate	Fully Drawn Income p.a.	Maturity	LTV	ICR
Chester Greyhound	Retail	£20.0m	£20.0m	3.70%	£0.74m	Nov-2025	61.5%	2.38x
St Arthur Homes	Affordable Housing	£16.0m	£4.5m	4.50%	£0.72m	Nov-2026	54.0%	1.35x
TOTAL CURRENT		£36.0m	£24.5m	4.06%	£1.46m		58.4%[1]	2.02x[1]

[1] Portfolio LTV and ICR assume the St Arthur Loan is fully drawn at 55.0% LTV (maximum permissible gearing)

The Fund currently has two committed loans totalling £36.0m, of which £24.5m is drawn. These loans will produce a blended return of 4.06% once St Arthur is fully drawn.

We are continuing to target good quality investment lending opportunities for the Fund across all sectors and UK geographies. Rising interest rates have created an opportunity to target loans at the lowest risk end of the market. This was previously bank-dominated territory where the Fund could not compete on pricing, typically around 2-2.5% at an all-in interest rate level.

The Fund's strategy is to target returns in excess of 5% per annum on the strongest assets, with rates above 6% now achievable on 'Core Plus' opportunities (e.g. another Chester Greyhound), without taking additional risk.

The Fund's target ticket size is £10m to £30m, with loan to value ratios of 45-60% and an expectation that most opportunities will be presented around 50-57.5% LTV.

Existing Loan Portfolio

- All existing loans are performing in line with the loan agreements. All are covenant compliant and all interest and amortisation payments have been made on time.
- Chester Greyhound: A £20.0m senior loan to refinance Aprirose's existing holding of Greyhound Retail Park, Chester. The loan is levered at 61.5% loan to value, with quarterly amortisation payments now commencing to take the loan to 57.5% LTV at maturity. In the period, Boots has signed up to a new 7 year lease from August 2021 (previously holding over) at £165k p.a.
- St Arthur Homes: A £16.0m loan to support the refinance of a 178-unit shared ownership portfolio. The loan closed with an initial drawdown of £4.5m in November 2022. The second drawdown (c.£3.7m) is likely to be requested for late March 2023. St Arthur have 15 months from closing (i.e. to February 2024) to draw the full loan, with any undrawn headroom to be cancelled at that time.

Greyhound Retail Park, Chester

St Arthur Homes - Chapel Riverside, Southampton (24 units)

Responsible Investment Initiatives

Environmental, Social and Governance (ESG) criteria are increasingly prominent in investment decision making and will influence the attractiveness of real estate 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 relevance 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.

Existing Teesside Portfolio

CBRE is implementing a three-stage ESG review process for the existing Portfolio. The first stage will focus on data collection to ensure all data is present and any gaps are filled to create a consistent foundation. Action plans will then be created for specific assets that are in need of improvement to meet regulation and market requirements. The final stage of the process will explore value add initiatives such as electric car charging points, across the portfolio, in order to drive additional revenues and further improve the ESG credentials of these assets.

To date, a significant focus has been on existing EPC ratings, across the Portfolio, and this is the current workstream. Upon conclusion, individual asset plans, where required, will be recommended to the Fund in order to improve those individual ratings ahead of the legislative deadlines.

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