Agenda Item 9

TEESSIDE PENSION FUND
Q2 2023

CBRE

Quarterly Report
Prepared: 13th September 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 30th June 2023, the portfolio comprised 32 mixed-use properties located throughout the UK, with a combined value of £412.4m. This reflects an overall Net Initial Yield of 5.33%, and an Equivalent Yield of 5.49%.

The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 93% of the Portfolio by capital value. There are 90 demises and a total net lettable area of 2,325,239 sq ft.

The portfolio has a current gross passing rent of £23,453,959 per annum against a gross market rent of £23,801,512 per annum, making the portfolio reversionary in nature.

The weighted average unexpired term is 7.5 years to the earlier of the first break or expiry, and 8.1 years to expiry, ignoring break dates.

Fund Summary

Total Pension Fund Value (March 2023)	**£5,060m**
Real Estate Weighting (long term target allocation)	8.2% (10%)
Direct Portfolio Value (June 2023)	£412.4m

Direct Portfolio

Direct Portfolio Value (June 2023)	**£412.4m**
Number of Holdings	32
Average Lot Size	£12.9m
Number of Demises	90
Void rate (% of ERV) (Estimated UK Benchmark)	0.7% (7.0% – 9.0%)
WAULT to Expiry (break)	8.1 years (7.5 years)
Current Gross Passing Rent (Per Annum)	£23,453,959
Current Gross Market Rent (Per Annum)	£23,801,512
Net Initial Yield	5.33%
Reversionary Yield	5.61%
Equivalent Yield	5.49%

Portfolio Highlight (Q2 2023) – St Albans

The Fund has completed the purchase of a Retail Park located in St Albans, an affluent south-east commuter town, let to B&Q, Aldi and Costa. The property totals 67,757 sq ft and is let for an average unexpired term of 15.8 years. Acquired for £30.5m reflecting 5.27% NIY.

teesside pension fund

UK Economic Commentary

- In June monthly GDP grew 0.5%, following a fall of 0.1% in May. The additional bank holiday in May is cited as a key reason for increased output in June.
- Headline inflation fell to 6.8% in July, down from 7.9% in June. Falling gas and electricity prices provided the largest downward contributions to the monthly change.
- We anticipate inflation will continue its downward trajectory, after previous upside surprises, reaching 4.3% by the end of 2023, and returning to the 2% target in mid-2025.
- Unemployment increased to 4.3% from May to July. Vacancies have also been falling for twelve consecutive months. Unemployment is forecast to peak in late 2024 before coming down.
- A slowing UK economy in 2023 will see retail sales decline but are projected to bounce back in 2024 and 2025 as consumers regain purchasing power due to inflation declining.
- A culmination of high inflation and monetary tightening means growth is forecast to be flat in 2023 but will not contract. When inflation subsides and the Bank can loosen monetary policy, we forecast GDP will rebound with projected growth of 0.8% and 1.7% in 2024 and 2025 respectively.
- The Bank of England raised the base rate to 5.25% in August. The Chancellor has announced some support for mortgage holders giving the option to switch to interest only or extend the term for six months with no credit score impact and introduce a minimum 12-month delay on repossession proceedings. However, while this will provide short term respite, households refinancing in 2024 will encounter similarly challenging conditions.
- The main risk to this outlook, is the trajectory of inflation. Core inflation remained unchanged in July at 6.9% but has increased 70bps since March, primarily due to high nominal wage growth this year. Left unaddressed, we could witness the current levels of inflation embedded into the economy. Other risks include a prolonged global economic slowdown and a steeper than anticipated fall in house prices which could collectively prolong the economic slowdown and hinder recovery in 2024 and 2025.

UK Real Estate Market Commentary

- Transaction activity remained at a low level in Q2 2023. Our estimate of the volume traded in Q2, at £9.8bn, is similar to our revised total for Q1 of £10.6bn. Meanwhile, our estimate for H1 2023 of £20.4bn is below the £24.1bn traded in H2 2022 and well below the £38.1bn traded in H1 2022.
- There has been a recovery in foreign investment in Q2. Whereas domestic purchasers dominated in Q1, they only accounted for a 41% share of acquisitions by value in Q2, with North American investors accounting for 33% and European investors for a further 19%.
- Industrial & logistics saw an improvement in transaction activity in Q2 and was the sector commanding the largest share of investment volumes at £2.9bn (29%), followed by residential at £2.4bn (24%) and office at £2.1bn (22%).
- While we anticipate a gradual improvement in volumes through H2 of this year, it is clear that high costs of debt and an uncertain economic outlook continue to weigh upon market activity.
- The quarterly total return for All UK Property in Q2 2023 was 1.4%** This was entirely driven by income return, as capital values remained flat. Industrial total returns were 2.5% (1.2%* capital return, 1.2%* income return), retail total returns were 2.5% (0.7% capital return, 1.8% income return) and office total returns were -1.1% (-2.3% capital return, 1.3% income return).
- Rental values for All UK Property increased by 0.5% in Q2. The industrial sector posted the highest rental growth for the quarter with 1.3%, while office rental values increased by 0.5%. Retail rental value growth was 0.1% for the quarter.
- All property yields increased by 3bps throughout Q2 2023, meaning yields have increased by 10bps through the first half of 2023. While overall, yields appear to have stabilised, movements have been uneven across sectors as office yields have increased by 26bps in H1 2023.

* 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 June 2023

Investments

Sales

No sales this period.

Acquisitions

The Fund has completed the purchase of a Retail Park located in St Albans, an affluent south-east commuter town, let to B&Q, Aldi and Costa. The property totals 67,757 sq ft and is let for an average unexpired term of 15.8 years. Acquired for £30.5m reflecting 5.27% NIY.

The Fund also agreed terms to purchase a 346,465 sq ft industrial unit in north-east England.

Direct Portfolio Analysis

Top Ten Holdings (by Capital Value)

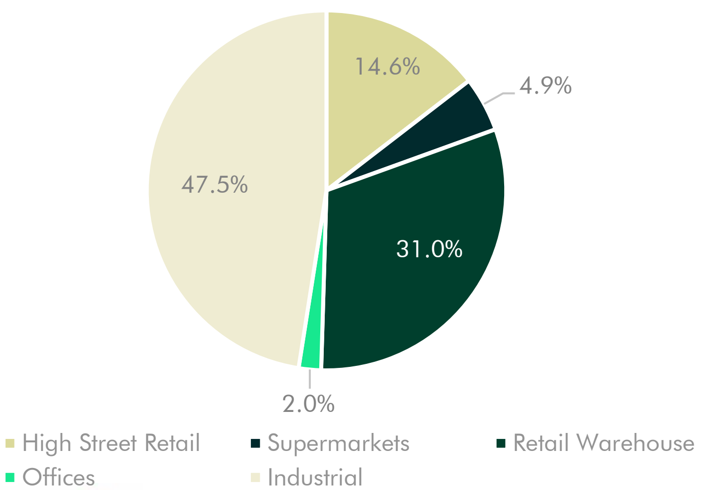
No.	Asset	Sector	Value	% of Direct Portfolio
1	THORNE - Capitol Park	Industrial	£31,300,000	7.6%
2	SWINDON - Symmetry Park	Industrial	£31,150,000	7.6%
3	LONDON - Long Acre	High Street Retail	£31,000,000	7.5%
4	ST ALBANS - Griffiths Retail Park	Retail Warehouse	£30,500,000	7.4%
5	BIRMINGHAM - Bromford Central	Industrial	£21,050,000	5.1%
6	TONBRIDGE - Tonbridge Retail Park	Retail Warehouse	£20,200,000	4.9%
7	GATESHEAD - Team Valley	Industrial	£20,100,000	4.9%
8	PARK ROYAL - Minerva Road	Industrial	£19,500,000	4.7%
9	RUGBY - Valley Park	Industrial	£18,300,000	4.4%
10	PARK ROYAL - Coronation Road	Industrial	£16,300,000	4.0%
		Total	**£239,400,000**	**58.1%**

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

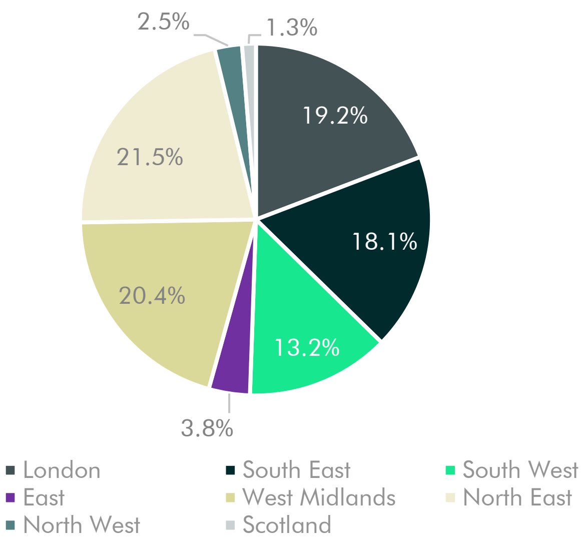
In addition to recommendations on industrial purchases, we may also recommend alternative and long-let investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure, supermarkets and student housing.

Set against a backdrop of low economic growth, we will seek to make purchases where both occupational and investment supply and demand conditions are 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 90 different demises let to 67 tenants. The largest tenant is B&Q Limited which accounts for 8.9% of the annual contracted income. Experian currently lists B&Q as representing a "Very Low Risk" of business failure.

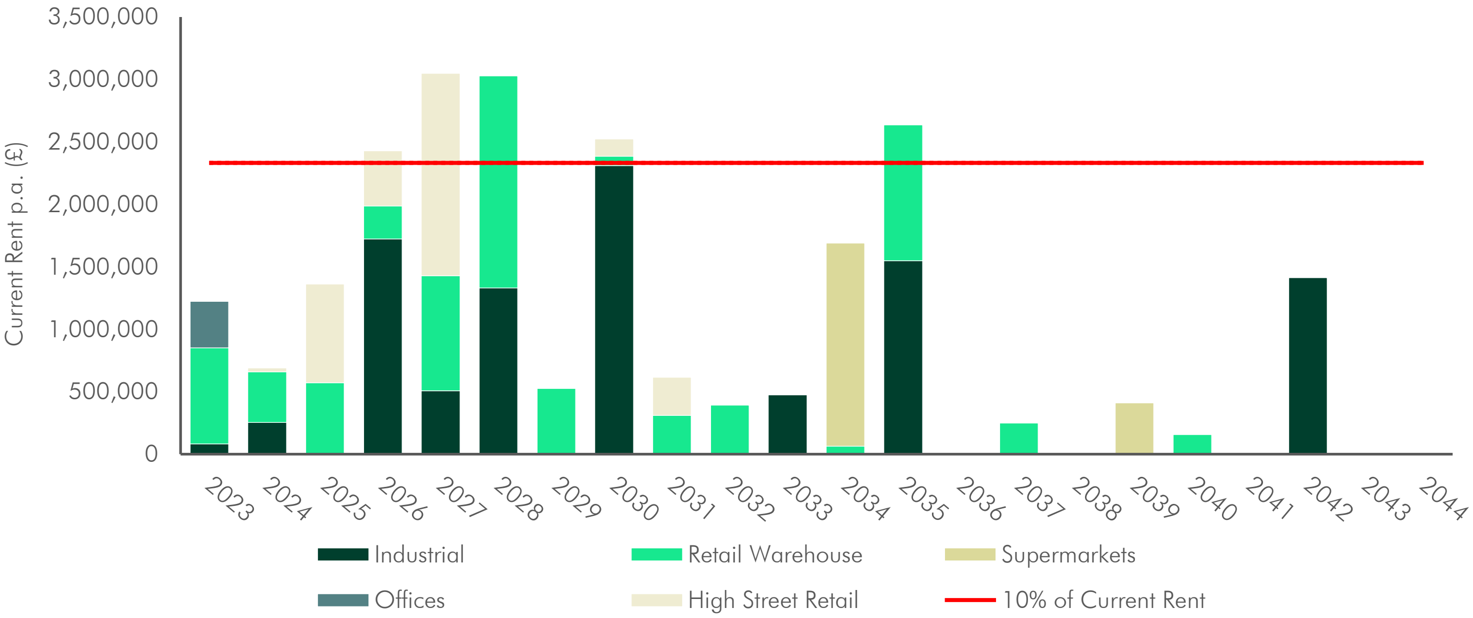
As a significant portion of the portfolio income will be from the top ten tenants, we will monitor their covenant strength and flag any potential issues. Our most recent assessment shows all of these tenants are classed as having a "Very Low Risk" of business failure.

Top Ten Tenants (by Contracted Rent)

#	Tenant	Sector	Number of Leases	Contracted Rent p.a.	% of Portfolio Rent	Risk Rating (Experian)
1	B&Q Limited	Retail	3	£2,084,211	8.9%	Very Low Risk
2	Iceland Food Limited	Industrial / Retail	2	£1,798,211	7.7%	Very Low Risk
3	Zara UK Limited	Retail	2	£1,580,000	6.7%	Very Low Risk
4	Omega Plc	Industrial	1	£1,413,689	6.0%	Very Low Risk
5	Brunel Healthcare	Industrial	1	£1,105,901	4.7%	Very Low Risk
6	Unipart Logistics Limited	Industrial	1	£1,077,000	4.6%	Very Low Risk
7	Royal Mail Group Limited	Industrial	1	£1,074,000	4.6%	Very Low Risk
8	Libra Textiles	Retail	1	£850,000	3.6%	Very Low Risk
9	Tesco Stores Limited	Retail	1	£774,714	3.3%	Very Low Risk
10	ASDA Stores Limited	Industrial	1	£755,000	3.2%	Very Low Risk
			Total	£12,512,726	53.3%	

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 Jun 22 - Jun 23			3 Year (p.a.) Jun 20 – Jun 23			5 Year (p.a.) Jun 18 – Jun 23		
	TPF	Index	Variance	TPF	Index	Variance	TPF	Index	Variance
Income Return	5.1%	5.3%	-0.2%	5.3%	5.3%	0.0%	5.5%	5.4%	+0.1%
Capital Return	-11.7%	-19.2%	+7.5%	4.6%	-0.8%	+5.4%	0.6%	-2.6%	+3.2%
Total Return	-6.9%	-14.9%	+8.0%	10.3%	4.5%	+5.8%	6.1%	2.6%	+3.5%

* 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

Bromford, UK Plumbing Supplies – June 2023

The Fund has completed a Lease renewal with UK Plumbing Supplies for a term of 10-years reflecting an average of £8.00 psf, a 24% increase on the passing rent of the unit. The tenant will benefit from a break on the 5th anniversary of the Lease commencement date.

Exeter, H&M – June 2023

The Fund has removed the tenant's June 2024 break option, increasing the term certain to 8 years, in return for a reduction in the tenant's rent to £22.75 psf, a 19% decrease on the passing rent of the unit.

Ipswich, Costa – June 2023

The Fund has completed a Lease renewal with Costa for a term of 5-years reflecting an average of £30.96 psf, a 4% increase on the passing rent of the unit. The tenant will benefit from a break on the 3rd anniversary of the Lease commencement date, albeit subject to payment of a 3 months' rent penalty to the Fund.

Congleton, B&M – May 2023

The Fund has completed a Lease renewal with B&M for a term certain of 10-years reflecting an average of £11.00 psf, a 30% decrease on the passing rent of the unit. The tenant benefits from 12 months rent free on the Lease commencement date.

Swadlincote, Brunel Healthcare – May 2023

The Fund has completed the April 2023 inflation-linked rent review with Brunel Healthcare, increasing the passing rent by 31%, in line with the RPI provision within the Lease.

Portfolio Arrears Update – 8th September 2023

The below table details the collection statistics for Q2 2023. Rent due for the quarter totalled £5,685,948 of which £5,655,948 has been collected, reflecting a difference of £30,000.

Collection Milestones	Rent Due 24/06/2023	Quarter Date 24/06/2023	Week 1 01/07/2023	Week 2 08/07/2023	Week 3 15/07/2023	Week 4 22/07/2023	After 22/07/2023	Difference
Total (£)	5,685,948	3,589,064	453,306	528,192	0	83,700	1,004,685	30,000
Collection Target (%)			92.0%	96.0%	98.0%	99.0%		
Total Collections (%)		63.1%	71.0%	80.3%	80.3%	81.8%	99.5%	

The rent collection across the entire portfolio in the previous three quarters has reflected the following.
March 2023 – 99.7%
December 2022 – 100.0%
September 2022 – 100.0%

The total Collectable Arrears on the entire portfolio is £229,492 as at 8th September 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 £5,000. These eight tenants account for 85.3% (£195,854) of the total collectable arrears:

Iceland Foods Limited (Swindon) – Total arrears of £72,274 (31.5% of the collectable arrears). The tenant has queried an increase to the annual Insurance Premium (compared to the premium charged by the previous ownership), which is mainly due to an increase in the Reinstatement Cost Assessment. We are working with the tenant to resolve their queries.

Shoe Zone Retail Limited (Congleton) – Total arrears of £37,910 (16.5% of the collectable arrears). This relates to discrepancies with the Completion Statement following the completion of the lease renewal.

B&Q plc (Arbroath) – Total arrears of £26,553 (11.6% of the collectable arrears). This relates solely to service charge arrears. A Measured Survey is being instructed to resolve issues relating to different floor areas, used to calculate the SC.

Pizza Hut (UK) Limited (Ipswich) – Total arrears of £21,117 (9.2% of the collectable arrears). This is an historic issue relating to the period of insolvency. We are requesting Pizza Hut justify these arrears in line with their CVA and Deed of Variation to the Lease, agreed with the Fund.

American Dry Cleaning Company Limited (17/23 Gloucester Road) – Total arrears of £11,073 (4.8% of the collectable arrears). These arrears relate to charges including part of the December 2022 and March & June 2023 quarter's insurance and superior landlord's service charges. We are working with the tenant to get these cleared and considering further action.

Boots UK Limited (Congleton) – Total arrears of £9,933 (4.3% of collectable arrears). This relates to the previous Lease. We are working with Boots to resolve this.

River Island Fashion Limited (Lincoln) – Total arrears of £8,969 (3.9% of collectable arrears). This relates mainly to historic arrears that has been misallocated. The tenant has paid this sum and the allocation is being corrected.

Royal Mail Group Limited (Gateshead) – Total arrears of £8,025 (3.5% of collectable arrears). This relates mainly to two charges that are being chased; firstly, an insurance point and second, relating to the recent rent review arbitration award.

The remaining £33,638 (14.7% of the collectable arrears) of arrears is spread across thirty tenants, sums are £3,464 to 12p.

Lending Update

Debt Investment Portfolio	Sector	Loan Limit	Drawn Balance	Interest Rate	Fully Drawn Income p.a.	Maturity	LTV	ICR
Chester Greyhound	Retail	£19.7m	£19.7m	3.70%	£0.73m	Nov-2025	60.6%	3.33x
St Arthur Homes	Affordable Housing	£16.0m	£11.3m	4.50%	£0.72m	Nov-2026	55.0%	1.38x
TOTAL CURRENT		**£35.7m**	**£31.0m**	**4.06%**	**£1.45m**		**58.0%**[1]	**2.36x**[1]

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

As at 30 June 2023, the Fund had two committed loans, of which £31.0m of £35.7m combined limits was 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 the opportunity to target loans at the lowest risk end of the market. This has been evidenced by the completion of the £16.1m Preston East loan in July, secured at a 5.21% rate and 56% LTV against a new build best in class industrial asset with long leases to high quality tenants.

Further rates growth since the Preston East terms were agreed has led us to now target returns at or above 6.0%, although we continue to react to market movements and our primary focus is on asset quality over opportunistic returns.

In light of the favourable conditions and the tendency of the highest quality opportunities to be at larger ticket sizes, we are seeking loans of between £10m - £45m, but maintaining Loan to Value ratios of 45-60% and adjusting return targets as set out above.

Existing Loan Portfolio

- All existing loans are performing in line with their 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 fund Aprirose's acquisition of Greyhound Retail Park, Chester. Ongoing scheduled amortisation has de-levered the loan to £19.7m since completion. In the period, Unit 2B has been regeared with ScS taking a new 10 year term (previously holding over) at £203,965 p.a.
- St Arthur Homes: A £16.0m loan to support the refinance of a 178-unit shared ownership portfolio. As at 30 June, three drawdowns totalling £11.3m had taken place. The fourth took place in August and the final drawdown is anticipated in November / December. An updated valuation to size the final drawdown will be instructed shortly.

Greyhound Retail Park, Chester

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

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.

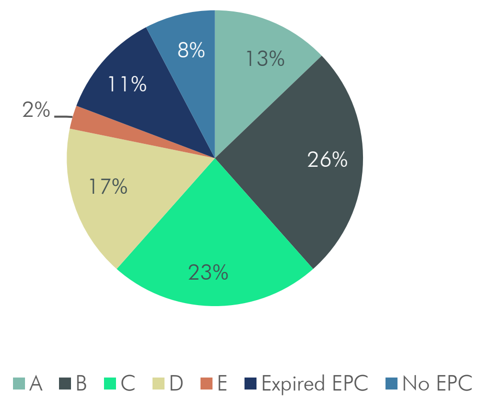
Social - real estate's impact on the local community and on a company's workforce are becoming equally important. Buildings that contribute positively to the world are therefore likely to be more resilient than those that do not, and as such are likely to benefit from increased occupier demand, leading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

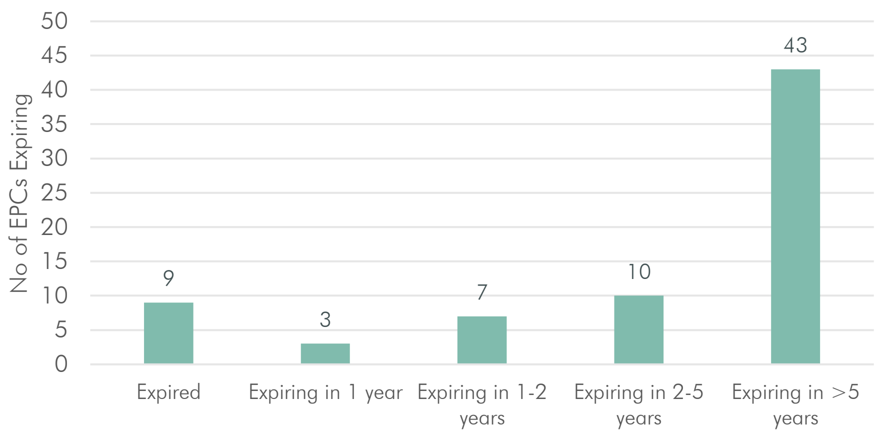
Minimum Energy Efficiency Standards (MEES)

Teesside Pension Fund's property Portfolio currently complies with MEES regulation. The Fund has undertaken a strategic review of the Portfolio to ensure continued compliance with incoming regulation in 2025. Energy Performance Certificates (EPCs) are used to measure compliance. A breakdown of the current ratings and expiry profile across the Portfolio is detailed below:

Current EPC Ratings



EPCs by Expiry



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