CBRE

TEESSIDE PENSION FUND Q3 2023

Quarterly Report

Prepared: 29th November 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 in 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 and 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 underweight 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 September 2023, the portfolio comprised 34 mixed-use properties located throughout the UK, with a combined value of £487.5m. This reflects an overall Net Initial Yield of 5.46%, and an Equivalent Yield of 5.59%.

The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 94% of the Portfolio by capital value. There are 92 demises and a total net lettable area of 2,752,119 sq ft.

The portfolio has a current gross passing rent of £28,460,734 per annum against a gross market rent of £27,339,662 per annum.

The weighted average unexpired term is 9.7 years to the earlier of the first break or expiry, and 10.3 years to expiry, ignoring break dates.

Fund Summary

Total Pension Fund Value (June 2023)	**£5,051m**
Real Estate Weighting (long term target allocation)	9.7% (10%)
Direct Portfolio Value (September 2023)	£487.5m

Direct Portfolio

Direct Portfolio Value (September 2023)	£487.5m
Number of Holdings	34
Average Lot Size	£14.3m
Number of Demises	92
Void rate (% of ERV) (Estimated UK Benchmark)	0.6% (7.0% – 9.0%)
WAULT to Expiry (break)	10.3 years (9.7 years)
Current Gross Passing Rent (Per Annum)	£28,460,734
Current Gross Market Rent (Per Annum)	£27,339,662
Net Initial Yield	5.46%
Reversionary Yield	5.50%
Equivalent Yield	5.59%

Portfolio Highlight (Q3 2023) – Washington

The Fund has completed the purchase of an Industrial unit located in Washington, Tyne & Wear, let to BAE Systems Ltd. The property totals 346,465 sq ft and is let for an average unexpired term of 12.25 years. Acquired for £50.25m reflecting 6.82% NIY.

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UK Economic Commentary

- Monthly real GDP grew by 0.2% in September, bolstered by strong growth in the services sector. However, GDP showed no growth in the three months to September.

- Headline CPI grew 4.6% over the year to October, down from 6.7% in September and has decreased 550bps since the start of the year. This fall in inflation is largely as a result of lower energy prices in comparison to September 2022.

- Core CPI grew 5.7% in the 12 months to October and is proving sticky due to high wage growth and subsequent high services inflation.

- Unemployment remained at 4.2% for July to September as vacancies fell for the 16th consecutive month to the lowest levels since July 2021. Nominal wages continued to rise at a rate of 7.9%, but thanks to falling inflation, real wages recorded their second month of growth at 1.1%. We expect unemployment will peak at 4.7% at the end of 2024.

- Despite falling inflation, households' incomes remain squeezed due to high mortgage costs. Retail sales fell by 1.1% in the three months leading up to October and remain well below the pre-pandemic trend growth rate.

- The Bank of England paused in November for the second time in 15 meetings, leaving the Base Rate at 5.25%.

- Our Outlook expects inflation will reach the Bank's 2% target by early 2025. Households will subsequently have their purchasing power restored and as real wages recover, consumer spending will increase.

- We expect the Base Rate may have peaked, although given the Bank's reactivity in recent months, any adverse shocks could cause another 25bps hike. Nevertheless, we forecast the Bank to begin cutting rates in H2 2024, reducing debt costs for both businesses and households, and bolstering economic activity.

- Rising mortgage costs remain a burden for many households and this will continue with more than 1 million mortgages due to refinance before 2024 facing 350-400bps increase in rates, providing a significant drag on the economy.

- We forecast GDP growth will be flat in 2023 and grow 0.4% and 1.7% in 2024 and 2025 respectively. The main risk to this outlook is the path of inflation. Sticky inflation could cause a higher base rate peak or necessitate rates stay higher for longer, dampening the growth outlook and economic recovery.

UK Real Estate Market Commentary

- Investment activity remains subdued in the wake of rising interest rates and the downturn in capital values. Our initial estimate of total transaction volume for Q3 2023 is £6.7bn. This is well below our revised total for Q2 of £11.1bn.

- After recovering somewhat last quarter, cross-border investment declined again in Q3 to account for only £2.4bn of the £6.7bn total traded. As in Q2, North American investors provided the largest share of cross-border capital (£1bn), followed by European investors (£0.5bn). Volumes were down across all sectors, but with marked quarter-on-quarter declines for the office and retail sectors and moderate declines in the industrial and residential sectors. Residential had the highest share of volumes at £1.7bn (25%), followed by office and industrial each at £1.5bn (22-23%).

- We have yet to see any material improvement in investment activity, not helped by continued uncertainty in the economic and geopolitical environment, while high costs of debt and refinancing challenges continue to impact on leveraged investors.

- The quarterly total return for All UK Property in Q3 2023 was 0.3%** This was largely driven by income return, as capital values remained flat. Industrial total returns were 2.2% (0.9%* capital return, 1.2%* income return), retail total returns were -0.2% (-1.9% capital return, 1.8% income return) and office total returns were -2.2% (-3.4% capital return, 1.4% income return).

- Rental values for All UK Property increased by 0.9% in Q3. The industrial sector posted the highest rental growth for the quarter with 1.6%, while office rental values increased by 0.6%. Retail rental value growth was 0.3% for the quarter.

- All Property yields increased by 11bps throughout Q3 2023, meaning yields have increased by 21bps so far in 2023. The larger increase in yields in Q3 can be seen by the 1.1% decline in capital values. However, capital values have only decreased by 1.4% throughout 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 September 2023

Investments

Sales

No sales this period.

Acquisitions

The Fund has completed the purchase of an Industrial unit located in Washington, Tyne and Wear, let to BAE Systems Ltd. The property totals 346,465 sq ft and is let for an average unexpired term of 12.25 years. Acquired for £50.25m reflecting 6.82% NIY

In Q2 2021 the Fund forward funded the development of a 210,000 sq ft industrial unit in Yeovil. The development of the property is now complete and has been added to the Direct Portfolio. The unit is occupied by Leonardo UK Ltd, for a term of 35 years at a rent of £1.6m p.a., subject to annual reviews at 2.7%.

Direct Portfolio Analysis

Top Ten Holdings (by Capital Value)

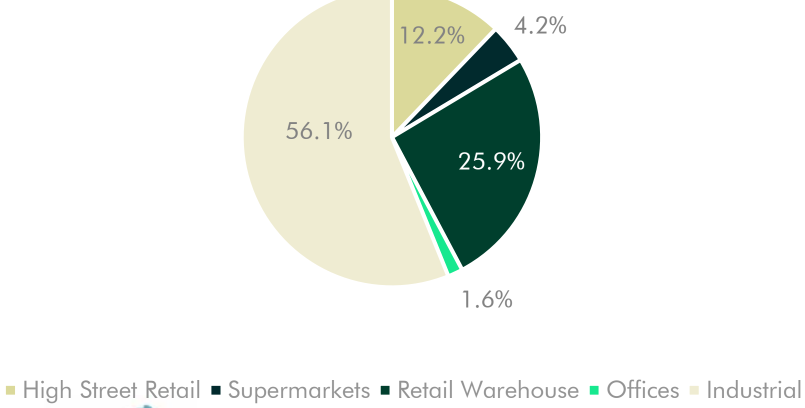
No.	Asset	Sector	Value	% of Direct Portfolio
1	WASHINGTON - Radial 64	Industrial	£50,250,000	10.3%
2	THORNE - Capitol Park	Industrial	£31,300,000	6.4%
3	SWINDON - Symmetry Park	Industrial	£31,150,000	6.4%
4	LONDON - Long Acre	High Street Retail	£31,000,000	6.4%
5	ST ALBANS - Griffiths Retail Park	Retail Warehouse	£30,500,000	6.3%
6	YEOVIL - Lysander Road	Industrial	£27,750,000	5.7%
7	BIRMINGHAM - Bromford Central	Industrial	£21,050,000	4.3%
8	GATESHEAD - Team Valley	Industrial	£20,100,000	4.1%
9	TONBRIDGE - Tonbridge Retail Park	Retail Warehouse	£19,650,000	4.0%
10	PARK ROYAL - Minerva Road	Industrial	£19,500,000	4.0%
		Total	**£282,250,000**	**57.9%**

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

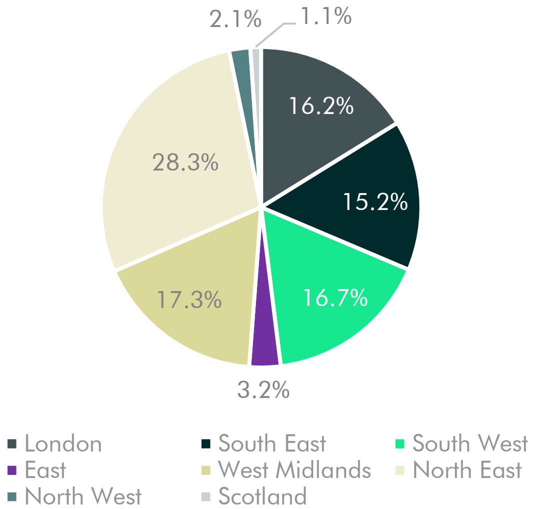
In addition to recommendations on industrial purchases, we may also recommend alternative and long-let investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure, supermarkets and student housing.

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 92 different demises let to 69 tenants. The largest tenant is BAE Systems Limited which accounts for 13.1% of the annual contracted income. Experian currently lists BAE Systems as representing a "Very Low Risk" of business failure.

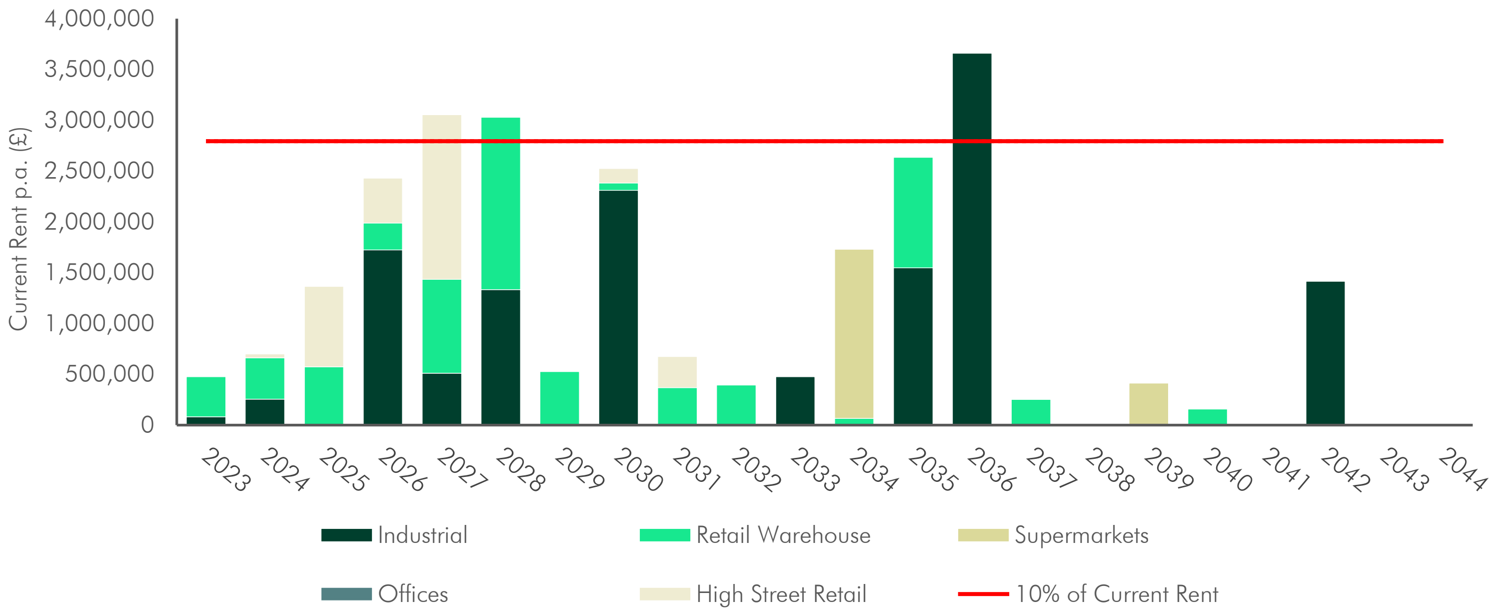
As a significant portion of the portfolio income will be from the top ten tenants, we will monitor their covenant strength and flag any potential issues. Our most recent assessment shows all of these tenants are classed as having a "Very Low Risk" of business failure.

Top Ten Tenants (by Contracted Rent)

#	Tenant	Sector	Number of Leases	Contracted Rent p.a.	% of Portfolio Rent	Risk Rating (Experian)
1	BAE Systems Ltd	Industrial	1	£3,658,230	13.1%	Very Low Risk
2	B&Q Plc	Retail	3	£2,084,211	7.5%	Very Low Risk
3	Iceland Food Limited	Industrial / Retail	2	£1,798,211	6.4%	Very Low Risk
4	Leonardo UK Ltd	Industrial	1	£1,609,659	5.8%	Very Low Risk
5	Zara UK Limited	Retail	2	£1,580,000	5.7%	Very Low Risk
6	Omega Plc	Industrial	1	£1,413,689	5.1%	Very Low Risk
7	Brunel Healthcare	Industrial	1	£1,105,901	4.0%	Very Low Risk
8	Unipart Logistics Limited	Industrial	1	£1,077,000	3.9%	Very Low Risk
9	Royal Mail Group Limited	Industrial	1	£1,074,000	3.8%	Very Low Risk
10	Libra Textiles Ltd	Retail	1	£850,000	3.0%	Very Low Risk
			Total	£16,250,901	58.3%	

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.



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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 Sep 22 - Sep 23			3 Year (p.a.) Sep 20 – Sep 23			5 Year (p.a.) Sep 18 – Sep 23		
	TPF	Index	Variance	TPF	Index	Variance	TPF	Index	Variance
Income Return	5.3%	5.5%	-0.2%	5.3%	5.3%	0.0%	5.5%	5.4%	+0.1%
Capital Return	-9.9%	-15.8%	+5.9%	4.5%	-0.9%	+5.4%	0.3%	-2.9%	+3.2%
Total Return	-4.8%	-11.1%	+6.3%	10.1%	4.4%	+5.7%	5.9%	2.3%	+3.6%

* 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 is regularly articulated to the investment market and we receive a substantial number of investment opportunities each week.

Asset Management Update

Ipswich, Currys Group – November 2023

The Fund has completed a Lease renewal with Currys Group for a term of 10-years at a rent of £312,500 p.a., reflecting £12.50 psf. The tenant will benefit from 21 months' rent free from the Lease commencement date.

Old Brompton Road, Cancer Research – November 2023

The Fund has completed a Lease renewal with Cancer Research for a term of 10-years at £416,000 p.a., reflecting £43.75 psf, a 12% increase on the passing rent of the unit. The rent is reviewed on the 5th anniversary of the Lease in-line with RPI collared and capped at 2% and 4%. The tenant benefits from an initial 12 months' rent free on the Lease commencement date, plus 6 months' in lieu of Landlord works. There is a break option on the 5th anniversary of the Lease. The Fund simultaneously agreed a Licence for Alteration, permitting the tenant to undertake a comprehensive refurbishment of the office at its own cost.

Stow-on-the-Wold, Tesco – November 2023

The Fund has completed the September 2023 inflation-linked rent review with Tesco, increasing the passing rent by 5% to £813,450 p.a., in line with the RPI provision in the Lease.

Direct Property Portfolio - EPCs – November 2023

The Fund has completed a strategic review of asset Energy Performance Certificates (EPCs) across its Portfolio. All assets within the Portfolio now have an EPC rating that complies with current, and incoming regulations in 2025.

Washington, BAE – September 2023

The Fund acquired this asset in Q3 2023. The Fund has begun its post-acquisition Asset Management Strategy, agreeing terms to re-gear and extend the Lease with BAE, creating a 19-year term, in exchange for 3 months' rent free.

Portfolio Arrears Update – 24th November 2023

The below table details the collection statistics for Q3 2023. Rent due for the quarter totalled £5,755,658 of which £5,720,157 has been collected, reflecting a difference of £35,501.

Collection Milestones	Rent Due 29/09/2023	Quarter Date 29/09/2023	Week 1 06/10/2023	Week 2 13/10/2023	Week 3 20/10/2023	Week 4 27/10/2023	After 27/10/2023	Difference
Total (£)	5,755,658	4,171,184	1,108,476	154,138	142,200	22,969	121,191	35,501
Collection Target (%)			92.0%	96.0%	98.0%	99.0%		
Total Collections (%)		72.5%	91.7%	94.4%	96.9%	97.3%	99.4%	

The rent collection across the entire portfolio in the previous three quarters has reflected the following.
June 2023 – 100%
March 2023 – 99.7%
December 2022 – 100.0%

The total Collectable Arrears on the entire portfolio is £362,542 as at 24th November 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 nine tenants account for 92.1% (£333,945) of the total collectable arrears:

B&Q plc (St Albans) – Total arrears of £131,181 (36.2% of the collectable arrears). These arrears relate to the third monthly instalment of the September quarter rent (expected on 1st December) and two quarters' unpaid service charge.

Iceland Foods Limited (Swindon) – Total arrears of £74,534 (20.6% of the collectable arrears). This relates mainly to the annual insurance premium, where the tenant has disputed the level of the insurer's commission.

Shoe Zone Retail Limited (Congleton) – Total arrears of £36,506 (10.1% of the collectable arrears). This Lease was recently renewed. This relates to the reconciliation between the old and new lease. The ongoing reconciliation will halve the arrears and enable the Fund to collect the balance.

Pizza Hut (UK) Limited (Ipswich) – Total arrears of £30,332 (8.4% of the collectable arrears). Current rents are being paid and this relates to the period of insolvency. We had a call with Pizza Hut this week and they are very close to agreeing on the final account reconciliation. Once agreed, the account will be paid in full.

B&Q plc (Arbroath) – Total arrears of £26,553 (7.3% of the collectable arrears). This relates solely to service charge arrears. A Measured Survey has now been completed, which has been provided to B&Q and progress is being made to resolve issues.

Boots UK Limited (Congleton) – Total arrears of £9,892 (2.7% of collectable arrears). This mainly relates to a historic rent on their old lease. We are working with Boots to resolve this.

River Island Fashion Limited (Lincoln) – Total arrears of £8,969 (2.5% of collectable arrears). This relates mainly to historic arrears that were misallocated. The tenant has paid this sum, and the allocation is being corrected.

American Dry Cleaning Company Limited (17/23 Gloucester Road) – Total arrears of £8,408 (2.3% of the collectable arrears). The tenant has cleared old charges, this relates to the balance of the September 2023 rent.

Hobbycraft Trading Limited (Cirencester) – Total arrears of £7,569 (2.1% of the collectable arrears). These arrears relate solely to the third monthly instalment of the September Quarter's rent.

The remaining 7.9% of collectable arrears (£28,598) is spread across 23 tenants, ranging from £4,453 to £12.93.

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
Preston East	Industrial & Logistics	£16.2m	£6.4m	5.21%	£1.50m	Jun-2027	56.0%	1.78x
TOTAL CURRENT		**£51.9m**	**£37.4m**	**4.06%**	**£2.95m**		**57.0%**[1]	**2.25x**[1]

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

As at 30 November 2023, the Fund had three committed loans, of which £37.4m of £51.9m combined limits was drawn. These loans will produce a blended return of 4.06% once St Arthur and Preston East are fully drawn.

We are continuing to target good quality investment lending opportunities for the Fund across all sectors and UK geographies. As previously discussed, 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 Preston East loan in July, secured at a 5.21% rate and 56% LTV against new build, best in class industrial assets with long leases to high quality tenants.

Further rates growth since the Preston 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 / sponsor quality, over opportunistic returns.

In light of the favourable conditions and the tendency of the higher quality opportunities to be at larger ticket sizes, we are also exploring loans up to £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 from JLL to size the final drawdown will be instructed shortly.
- Preston East: A £16.2m loan secured against 3x long-let, Grade A logistics units near Preston. It drew down in August.


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 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.

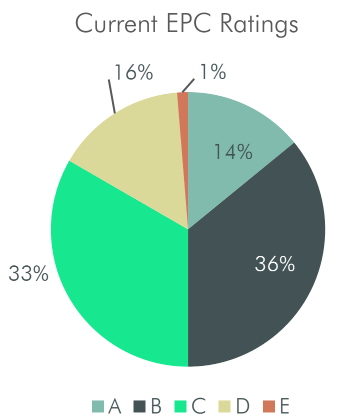
Environmental – sustainable factors will continue to play a part in the definition of 'prime' real estate, and buildings that don't meet the increasingly competitive standards are likely to become obsolete faster. Occupiers will demand their buildings adhere to the highest environmental standards.

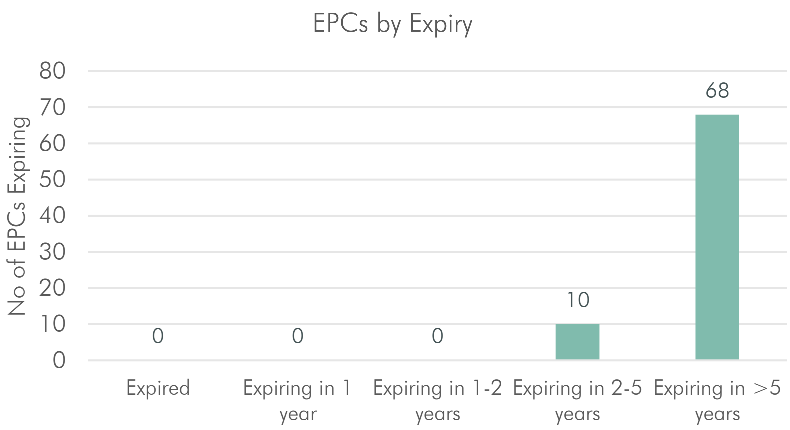
Social - real estate's impact on the local community and on a company's workforce are becoming equally important. Buildings that contribute positively to the world are therefore likely to be more resilient than those that do not, and as such are likely to benefit from increased occupier demand, leading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

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:





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