TEESSIDE PENSION FUND Q4 2023

Quarterly Report
Prepared: 28th February 2024

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 and diversify 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 investment decision making process and ongoing asset management.

Executive Summary

As at 31st December 2023, the portfolio comprised 34 properties located throughout the UK, with a combined value of £485.2m. This reflects an overall Net Initial Yield of 5.43%, and an Equivalent Yield of 5.81%.

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 £28,255,314 per annum against a gross market rental value of £27,374,662 per annum.

The weighted average unexpired lease term is 9.5 years to the earlier of the first break or expiry, and 10.0 years to expiry, ignoring break dates.

Fund Summary

Total Pension Fund Value (September 2023)	**£5,100m**
Real Estate Weighting (long term target allocation)	9.5% (10%)
Direct Portfolio Value (December 2023)	£485.2m

Direct Portfolio

Direct Portfolio Value (December 2023)	£485.2m
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)	10.0 years (9.5 years)
Current Gross Passing Rent (Per Annum)	£28,255,314
Current Gross Market Rent (Per Annum)	£27,374,662
Net Initial Yield	5.43%
Reversionary Yield	5.54%
Equivalent Yield	5.81%

Portfolio Highlight (Q4 2023) – Old Brompton Road, London, SW7

The Fund has completed a Lease renewal with Cancer Research for a term of 10-years at £416,000 p.a., a 12% increase on the passing rent of the unit. The Fund benefits from RPI linked rent reviews collared and capped at 2% and 4%. The tenant benefits from a total of 18 months' rent free. The Fund simultaneously permitted the tenant to undertake a comprehensive refurbishment of the office at its own cost.

teesside pension fund

UK Economic Commentary

- In the three months to December 2023, GDP shrank by 0.3%. On a quarterly basis, this led to two consecutive falls in GDP following an unrevised fall of 0.1% in July to September 2023. Resulting in a technical recession.
- Inflation fell in the last quarter of 2023 before flat-lining in January 2024. This brought UK inflation closer to other advanced economies; the latest data shows UK headline CPI of 4% in January 2024. The quarterly decline in inflation was largely driven by a fall in goods prices but also by core inflation falling to 5.1%, 200bps lower than the peak in May. We anticipate inflation to continue to move towards the Bank of England's target, reaching it by early 2025.
- Unemployment declined slightly to 3.8% in the last quarter of 2023, vacancies also fell for the 19th consecutive period. Nominal pay increased to 6.2%, down 170bps since the summer peak and there is evidence of the labour market softening. Unemployment is forecast to peak at 4.5% in 2024 before declining.
- Restrictive monetary policy and weak consumer demand in the first half of 2024 will prevent a full economic recovery. As inflation continues to remain in line with the Bank's target and interest rates are cut, we expect confidence will return boosting consumer and business activity. We forecast GDP will grow by 0.5% and 1.6% in 2024 and 2025 respectively. Sustained high mortgage costs remain a burden for many households and this will continue with more than 1 million mortgages due for refinance before the end of 2024 and many borrowers facing a 350-400bps increase in rates and providing a significant drag on the economy.
- Geo-political risks remain, particularly around the conflict in the Middle East which could destabilise energy markets affecting the decline of inflation, delaying interest rate cuts and dampening the growth outlook.

UK Real Estate Market Commentary

- The CBRE Index recorded an 'All Property Total Return' of -4.3%* over the 12 months to December 2023, an improvement on the -11.1% Total Return recorded to September 2023. This has been driven by the drop-out of the significant capital value fall seen in Q4 2022.
- All Property yields increased by 23bps in Q4 2023, meaning yields rose 44bps over 2023. Most of the yield expansion was seen in H2, as values fell by 3.6%, and yields only increased by 7bps in H1 2023. However, some of the outward movement in capital values was offset by rental growth as all UK Property saw rental values increase by 1.1% in Q4 2023, and 3.6% throughout 2023. The industrial sector continues to outperform the other sectors, posting rental value growth of 1.9% in Q4 2023. Office rental values increased by 0.7% over the quarter, while retail rents also rose by 0.5%.
- Investment activity improved over Q4 2023 with £10.7bn of real estate investments transacting, an increase from the revised estimate of £9.3bn at the end of Q3. However, the figure for the full year 2023 is £43.3bn which is 30.2% lower than the £62bn recorded for 2022. Transactional volumes were higher than the COVID-19 impacted 2020, but lower than all other years since 2013.
- Domestic investors accounted for 54.5% of transactions by volume in 2023. This was a reversal of the trend seen over the previous 3 years where cross-border capital had taken the lead role in UK investment activity. In Q4, European money was the largest source of cross-border capital, but it was North America that accounted for the most cross-border transactions in 2023.
- Volumes were down for the industrial sector, whilst the residential and office sectors saw a significant increase in trading volumes over Q4. Residential had the highest share of the investment volume at £3.4bn, followed by £2.6bn of office transactions and industrial at £1.2bn.
- 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 investors who require leverage.
- The only occasions that we have seen strong investor appetite are for core opportunities that offer good reversionary potential. For these opportunities there has been a depth of buyers and pricing has been stronger.

* Based on CBRE Monthly Index, all property total returns to December 2023

Investments

Sales

No sales this period.

Acquisitions

No acquisitions this period.

Direct Portfolio Analysis

Top Ten Holdings (by Capital Value)

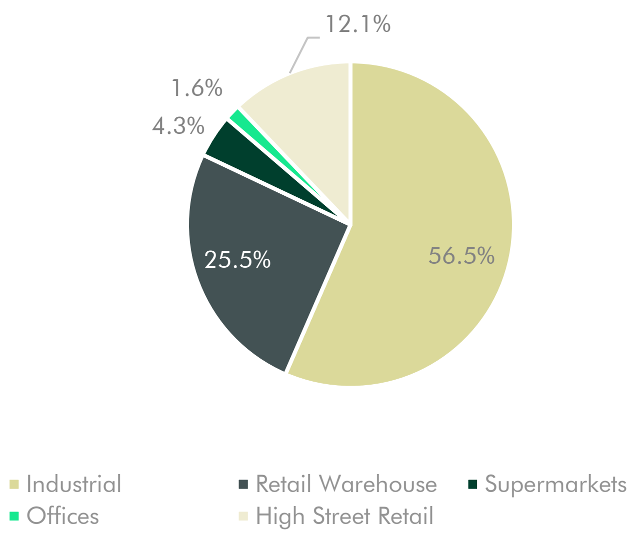
No.	Asset	Sector	Value	% of Direct Portfolio
1	WASHINGTON - Radial 64	Industrial	£50,250,000	10.4%
2	SWINDON - Symmetry Park	Industrial	£31,600,000	6.5%
3	THORNE - Capitol Park	Industrial	£31,300,000	6.5%
4	LONDON - Long Acre	High Street Retail	£31,000,000	6.4%
5	ST ALBANS - Griffiths Retail Park	Retail 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	£20,200,000	4.2%
9	TONBRIDGE - Tonbridge Retail Park	Retail Warehouse	£19,650,000	4.0%
10	PARK ROYAL - Minerva Road	Industrial	£19,600,000	4.0%
		Total	**£282,900,000**	**58.3%**

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

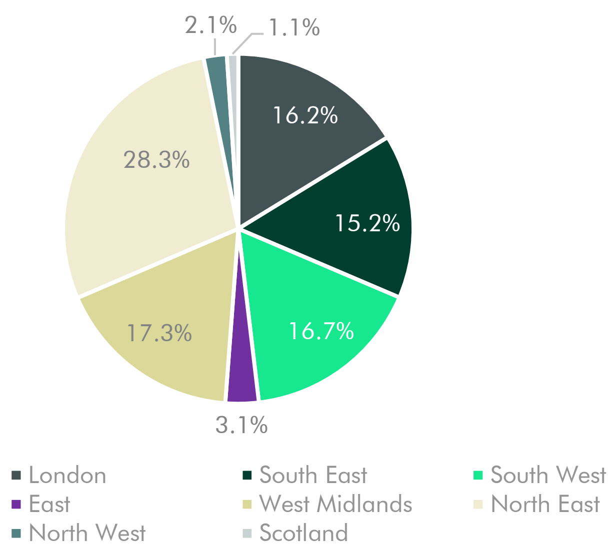
In addition to recommendations on industrial purchases, we may also recommend alternative and long-let investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure, supermarkets and student housing.

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 has 92 demises let to 64 tenants. Of the top ten tenants, 80% have an INCANS classification of Medium-Low Risk or better, a strong rating. A summary of the top ten tenants covenant strength is detailed below.

#	Tenant	Sector	# Leases	Contracted Rent p.a.	% of Portfolio Rent	INCANS Global Score	INCANS Category
1	BAE Systems Ltd	Industrial	1	£3,658,230	13.2%	82/100	Medium-Low Risk
2	B&Q Plc	Retail	3	£1,934,838	7.0%	92/100	Medium-Low Risk
3	Iceland Food Limited	Industrial / Retail	2	£1,798,211	6.5%	53/100	Medium-High Risk
4	Leonardo UK Ltd	Industrial	1	£1,609,659	5.8%	96/100	Low Risk
5	Zara UK Limited	Retail	2	£1,580,000	5.7%	90/100	Medium-Low Risk
6	Omega Plc	Industrial	1	£1,413,689	5.1%	94/100	Medium-Low Risk
7	Brunel Healthcare	Industrial	1	£1,105,901	4.0%	76/100	Medium-Low Risk
8	Unipart Logistics Limited	Industrial	1	£1,077,000	3.9%	81/100	Medium-Low Risk
9	Royal Mail Group Limited	Industrial	1	£1,074,000	3.9%	18/100	High Risk
10	Libra Textiles Ltd	Retail	1	£850,000	3.1%	90/100	Medium-Low Risk
			Total	**£16,101,528**	**57.9%**		

The INCANS Global Score predicts the likelihood that a company will seek credit relief (or worse, go out of business) within the next 12 months. The scale is based on the historical default data from every company in that country over recent history. A higher score indicates a lower probability of failure or default. It can be interpreted as the rough percentile the company sits in against all global companies in terms of their failure risk over all of modern history. e.g. 100/100 means that the company is broadly in the top 1% of all global companies that have existed over modern history.

A key part of the Analysis is the % Probability of Default or "PD Rates". This approach is widely used in the Bond Market for assessing counterparty default risk. PD rates project the probability that a tenant will fail over the next 1 to 10 years based on corporate failure data from 2007 to today. The Table below shows the PD rates for top 3 bands are very low. In the UK, Very Low Risk tends to be Government or Government Type entities. Similarly, the next Grade, Low Risk, requiring a minimum score of 95, is also very exclusive. The corresponding Corporate Bond ratings are shown for context.

Category	INCANS Global Score	Equivalent Bond Default Risk	1 Yr Default Probability	Tenant Example
Very Low Risk	99-100	AA- to AAA	<0.1%	Transport for London
Low Risk	95-98	A- to A+		EE Limited
Medium-Low Risk	76-94	BBB- to BBB+	0.1% to 0.5%	Marks & Spencer PLC
Medium-High Risk	33-75	BB- to BB+	0.5% to 1.5%	WM Morrison Supermarkets Limited, Tesco
High Risk	5-34	B- to B+	1.5% to 15%	WeWork International Limited
Very High Risk	1-4	CCC- to CCC+	>15%	Cineworld Cinemas Limited

The information used to calculate the INCANS Score is wide ranging. Data including business age, location and line of business are all taken into consideration. INCANS also consider the Principal's experience, and performance of associated businesses, plus ratios taken from Company Accounts (including liquidity, solvency, profitability, debt, late filing and detrimental notes). Businesses regularly mirror the payment habits of businesses they are trading with. Payment trends and percentages of prompt or late payments will affect the Score in addition to comparison with industry payment averages. Finally, INCANS also consider publicly available detrimental information such as County Court Judgements (CCJs), mortgages / charges and the legal pre-failure events (administration, receivership, bankruptcy, etc.).

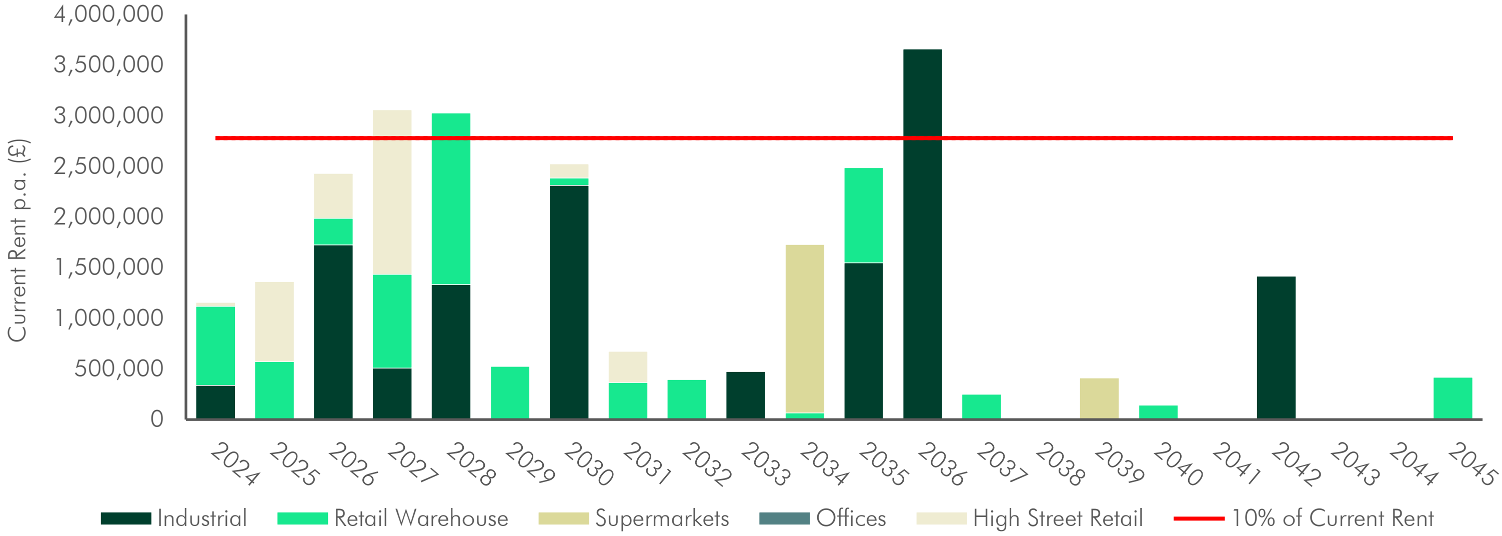
It should also be noted the INCANS Score is dynamic, meaning that it is recalculated every time INCANS receive a new piece of information about an organisation, or when information changes. For example, as the age of an organisation increases its risk typically decreases and the associated Failure Scores will change to reflect this.

To summarise, a classification of Medium to Low Risk, the majority of the Top 10 Teesside Pension Fund tenants, is a strong rating.

Direct Portfolio Analysis (continued)

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.



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 22 – Dec 23			3 Year (p.a.) Dec 20 – Dec 23			5 Year (p.a.) Dec 18 – Dec 23		
	TPF	Index	Variance	TPF	Index	Variance	TPF	Index	Variance
Income Return	5.6%	5.2%	+0.4%	5.3%	5.1%	+0.2%	5.5%	5.3%	+0.2%
Capital Return	-0.9%	-3.9%	+3.0%	3.9%	-1.7%	+5.6%	0.3%	-3.2%	+3.5%
Total Return	4.8%	1.7%	+3.1%	9.6%	3.5%	+6.1%	5.9%	2.1%	+3.8%

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

Asset Management Update

Direct Property Portfolio, INCANS – February 2024

INCANS is a data analytics platform which analyses tenant income risk. CBRE Investment Advisory recently adopted their software and has introduced it to the Fund. We will use it to analyse income risk for existing tenants as well as potential acquisitions.

Swadlincote, Brunel Healthcare – February 2024

The Fund has agreed terms to extend the Lease with Brunel Healthcare for a term of 20 years, increasing the term certain by 16 years, at a re-based rent of £818,000 p.a. The rent is reviewed in-line with RPI collared and capped at 2% and 5%. The tenant benefits from an initial 6 months' rent free on completion of the Lease. The new Lease is close to completion.

Congleton, Car Park Works – December 2023

The Fund has completed a full refurbishment of the car park at Congleton Retail Park. The project was well received by the occupiers and has led to an improved customer experience. Following completion in December, the Fund has received renewed occupier interest in the three vacant units.

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.

Portfolio Arrears Update – 23rd February 2024

The below table details the collection statistics for Q4 2023. Rent due for the quarter totalled £5,553,694 of which £5,498,132 has been collected, reflecting a difference of £55,562.

Collection Milestones	Rent Due 25/12/2023	Quarter Date 25/12/2023	Week 1 01/01/2024	Week 2 08/01/2024	Week 3 15/01/2024	Week 4 22/01/2024	After 22/01/2024	Difference
Total (£)	5,553,694	3,835,968	164,907	745,844	144,324	482,898	124,191	55,562
Collection Target (%)			92.0%	96.0%	98.0%	99.0%		
Total Collections (%)		69.1%	72.0%	85.5%	88.1%	96.8%	99.0%	

The rent collection across the entire portfolio in the previous three quarters has reflected the following.
September 2023 – 99.9%
June 2023 – 100%
March 2023 – 99.7%

The total Collectable Arrears on the entire portfolio is £509,228 as at 23rd February 2024.

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 arrears greater than £10,000. These nine tenants account for £430,985 (84.6%) of the total arrears:

B&Q plc (St Albans) – Total arrears of £200,975 (39.5% of the collectable arrears). These arrears relate to the third monthly instalment of the December Quarters rent (expected on 1st March). In addition, they have one month's instalment of the September quarter rent outstanding and two quarter's unpaid service charge. All sums are being chased.

Iceland Foods Limited (Swindon) – Total arrears of £76,194 (15.0% of the collectable arrears). This relates mainly to the annual insurance premium, where the tenant has disputed the level of the insurer's commission.

Active-PCB Solutions Limited (Reading) – Total arrears of £31,951 (6.3% of the collectable arrears). Relates solely to balancing service charge arrears. These charges were raised on 3 January and the tenant is being chased for payment.

Pizza Hut (UK) Limited (Ipswich) – Total arrears of £31,660 (6.2% of the collectable arrears). Relates to the arrears during the period of insolvency. The account reconciliation has now been agreed with the tenant and final charges have been submitted. We have a further meeting next week to confirm final numbers after which we expect payment in full.

B&Q plc (Arbroath) – Total arrears of £27,625 (5.4% of the collectable arrears). This relates to service charge arrears and a dispute over charges. A measured survey has been completed, which confirms the new apportionments for all tenants. A positive meeting has been held with B&Q's service charge consultant and some of their suggestions are being considered.

Shoe Zone Retail Limited (Congleton) – Total arrears of £21,551 (4.2% of the collectable arrears). This relates to discrepancies on the account following completion of the new lease. The reconciliation will likely halve the arrears and enable us to collect the balance from Shoe Zone. This is underway and has seen the overall arrears reduce.

Leaseholders (Cedarland Court) – Total arrears of £15,000 (2.9% of the collectable arrears). This is the latest loan repayment from the new lift installation. This charge was only raised on 4 January.

American Dry Cleaning Company Limited (17/23 Gloucester Road) – Total arrears of £14,408 (2.8% of the collectable arrears). These arrears relate to underpaid rent for both the September and December quarters. We are continuing to chase.

Tesco Stores Limited (Stow-on-the-Wold) – Total arrears of £11,621 (2.3% of the collectable arrears). This relates solely to a back-dated RPI rent review increase and is being chased.

The remaining £78,243 (15.4% of collectable arrears) is spread across 39 tenants, ranging from £9,753 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	60.0%	2.04x
St Arthur Homes	Affordable Housing	£14.1m	£14.1m	4.50%	£0.63m	Nov-2026	55.0%	1.34x
Preston East	Industrial & Logistics	£16.2m	£16.2m	5.21%	£0.84m	Jun-2027	55.4%	1.76x
TOTAL CURRENT		£50.0m	£50.0m	4.42%	£2.21m			

As at 31 December 2023, the Fund had three committed loans, of which the entirety of the combined £50.0m limits had been drawn. These loans produce a blended return of 4.42%.

The Lending market finished 2023 on a quiet note, however the stabilisation of Bank of England base rate and falling inflation towards the back end of the year led most people to conclude that the base rate has peaked.

The start of 2024 has seen a degree of cautious optimism in the lending market. Sponsors appear to be adjusting to the rates environment, meaning more opportunities have come forward.

We continue to target loans at the lowest risk end of the market, which can still command strong rates in the 5-6% range fixed for a 3-5 year term. We are also selectively reviewing opportunities to make higher returns on short-term ‘transitional’ (i.e. business plan led) assets, but only where there is an experienced Sponsor and conservative gearing.

We are continuing to focus on lending opportunities in the £10-45m range with Loan to Value ratios below 60%.

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. The fifth and final drawdown took place in December 2023, capping the maximum loan amount at £14.1m. The balance of the headroom was cancelled after this drawdown, as reflected in the figures above.
- Preston East: A £16.2m loan secured against 3x long-let, Grade A logistics units near Preston. The first tranche of £6.4m drew down in August and the second and final tranche of £9.8m drew down in December 2023.

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.

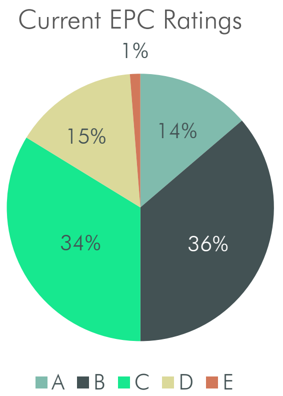
Environmental – sustainable factors will continue to play a part in the definition of 'prime' real estate, and buildings that don't meet the increasingly competitive standards are likely to become obsolete faster. Occupiers will demand that their buildings adhere to the highest environmental standards.

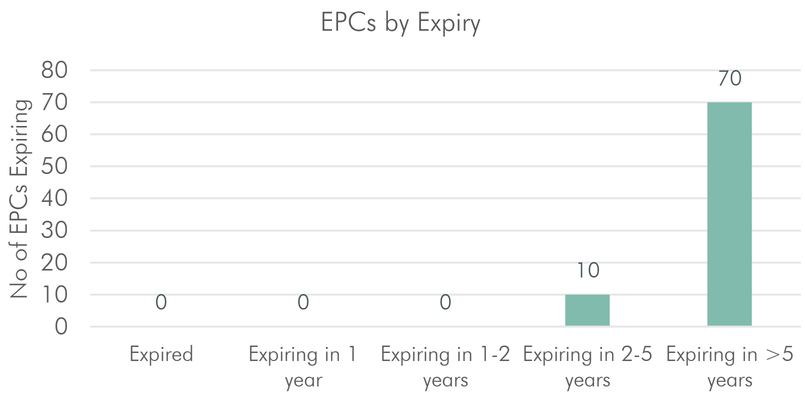
Social - real estate's impact on the local community and on a company's workforce are becoming equally important. Buildings that contribute positively to the world are therefore likely to be more resilient than those that do not, and as such are likely to benefit from increased occupier demand, leading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