

TEESSIDE PENSION FUND

Q2 2024

CBRE

Quarterly Report
Prepared: 11 September, 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 of 30th June 2024, the portfolio comprised 34 properties located throughout the UK, with a combined value of £484.2m. This reflects an overall Net Initial Yield of 4.47%, and an Equivalent Yield of 5.61%.

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 91 demises and a total net lettable area of 2,751,651 sq ft.

The portfolio has a current gross passing rent of £27,284,260 per annum against a gross market rental value of £27,570,187 per annum.

The weighted average unexpired lease term is 9.7 years to the earlier of the first break or expiry and 10.2 years to expiry, ignoring break dates.



Fund Summary

Total Pension Fund Value (March 2024)	£5,468m
Real Estate Weighting (long term target allocation)	8.9% (10%)
Direct Portfolio Value (June 2024)	£484.2m

Direct Portfolio

Direct Portfolio Value (June 2024)	£484.2m
Number of Holdings	34
Average Lot Size	£14.2m
Number of Demises	91
Void rate (% of ERV) (Estimated UK Benchmark)	1.5% (7.0% – 9.0%)
WAULT to Expiry (break)	10.2 years (9.7 years)
Current Gross Passing Rent (Per Annum)	£27,284,260
Current Gross Market Rent (Per Annum)	£27,570,187
Net Initial Yield	4.47%
Reversionary Yield	5.41%
Equivalent Yield	5.61%

Portfolio Highlight (Q2 2024) – Unit B, Interchange Retail Park, Ipswich



The Fund has completed a lease renewal to B&M at Interchange Retail Park. Terms are £312,500 per annum (approx. £12.50 per sq ft) on a 10-year term with a tenant break option in year 5. The tenant will receive 10.5 months rent-free from the term commencement date.

UK Economic Commentary

- In the three months to June, GDP grew by 0.6%, following a 0.7% rise in the previous quarter. A strong-performing services sector has largely driven growth; however, this is having knock-on effects on inflation.
- Headline CPI rose marginally in the year to July to 2.2%, up from 2.0% in June. This slight rise results from gas and electricity prices falling by less than last year. We expect their stickiness and an increase in Ofgem's energy price cap in October to create volatility in the figures for the remainder of the year.
- Unemployment remains at 4.2%, the same level as the previous quarter. Unfilled job vacancies continue to fall but at a slower rate. The tight labour market and strength of the services sector have resulted in 5.7% growth in nominal pay, or 2.5% in real terms. This is positive for consumers but could delay a further interest rate cut if growth doesn't soften.
- Despite strong labour market and core inflation signals, the Bank cut interest rates in August by 25bps and could still make one further cut in Q4 2024. We expect the realisation of real pay growth and increasing confidence that interest rate cuts should bring will be catalysts for consumption and business activity. We forecast UK GDP to grow 1.0% and 1.9% 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. Homeowners face a potential 300-400bps increase in rates (dependent upon when households are fixed), which could drag on spending power and, thus, the economy.
- Labour won the UK General Election by a landslide and are stating that they want to increase spending on housing and infrastructure significantly, which is expected to be positive for the real estate market. This, by default, should mean we can expect higher taxes to fund the spending commitments, as Keir Starmer's most recent speech insinuates.
- Domestically, sticky services and wage growth risks further inflation. Globally the Middle East conflicts' proximity to key energy markets, may also have an effect on energy prices. Both have the potential to increase inflation and delay interest rate cuts, dampening the growth outlook.

UK Real Estate Market Commentary

- The CBRE Index recorded an All-Property Total Return of 2.0% over the 12 months to June 2024. This is an increase from the 1.5% Total Return recorded in the year to March 2024. Despite this, All-Property capital values decreased by 3.6% over the last 12 months.
- All Property yields increased by 5bps throughout Q2 2024, meaning yields have expanded by 10bps over H1 2024. Capital values increased by 0.5% over Q2 2024, after the mild fall of 0.4% in Q1 2024, while UK Property rental values continue to grow steadily, increasing by 0.2% throughout the quarter.
- Retail was the strongest performing sector over Q2 2024, with total returns of 3.1% for the quarter. This was largely due to by Retail Warehouses driving capital value growth of 1.3% at the sector level. The Industrial sector posted total returns of 2.3% over the quarter and continues to exhibit the strongest rental growth as rental values increased by 1.7% in Q2 2024. Office capital values declined by a further 1.2% throughout the quarter, whilst sector rental growth was steady at 0.3%.
- Investment volumes picked up in Q2 2024 compared with Q1 2024, with £12.2bn of transactions completed. This represents a 6% increase on the revised figure for Q1 2024 of £11.1bn. Approximately £46.4bn has been invested in UK real estate markets for 12 months to Q2 2024. Compared with other major Western European markets, the UK was the only market to record a rise in 12-month investment volumes.
- Foreign investment increased during the quarter, accounting for 64% of Q2 acquisitions by value. In contrast, domestic buyers drove activity in Q1, meaning that so far throughout 2024, domestic and foreign buyers have contributed a relatively even contribution to UK investment.
- There are signs that market conditions are now improving, and volumes are expected to increase as investors look to deploy capital gradually and some asset owners need to meet redemption or debt obligations. Prospects for investment volumes are also aided by an improved outlook for interest rates.

* Based on CBRE Monthly Index, all property total returns to June 2024

Investments

Sales

The Fund made no disposals this quarter.

Acquisitions

The Fund made no acquisitions this quarter.

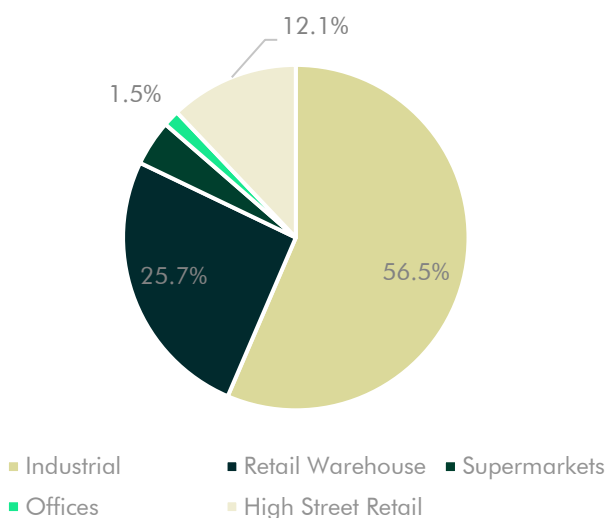
Direct Portfolio Analysis

Top Ten Holdings (by Capital Value)

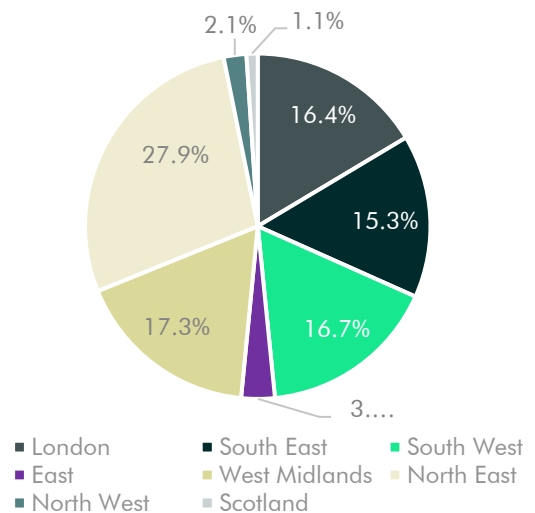
No.	Asset	Sector	Value	% of Direct Portfolio
1	WASHINGTON - Radial 64	Industrial	£50,300,000	10.4%
2	SWINDON - Symmetry Park	Industrial	£31,600,000	6.5%
3	LONDON - Long Acre	High Street Retail	£31,000,000	6.4%
4	ST ALBANS - Griffiths Retail Park	Retail Warehouse	£30,500,000	6.3%
5	THORNE – Capitol Park	Industrial	£29,100,000	6.0%
6	YEOVIL - Lysander Road	Industrial	£27,750,000	5.7%
7	BIRMINGHAM - Bromford Central	Industrial	£20,800,000	4.3%
8	GATESHEAD - Team Valley	Industrial	£20,200,000	4.2%
9	TONBRIDGE - Tonbridge Retail Park	Retail Warehouse	£19,650,000	4.1%
10	PARK ROYAL - Minerva Road	Industrial	£19,600,000	4.0%
Total			£280,500,000	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.

Sector Allocation (by Capital Value)



Geographical Allocation (by Capital Value)



Direct Portfolio Analysis (continued)

Top Ten Tenants (by Contracted Income)

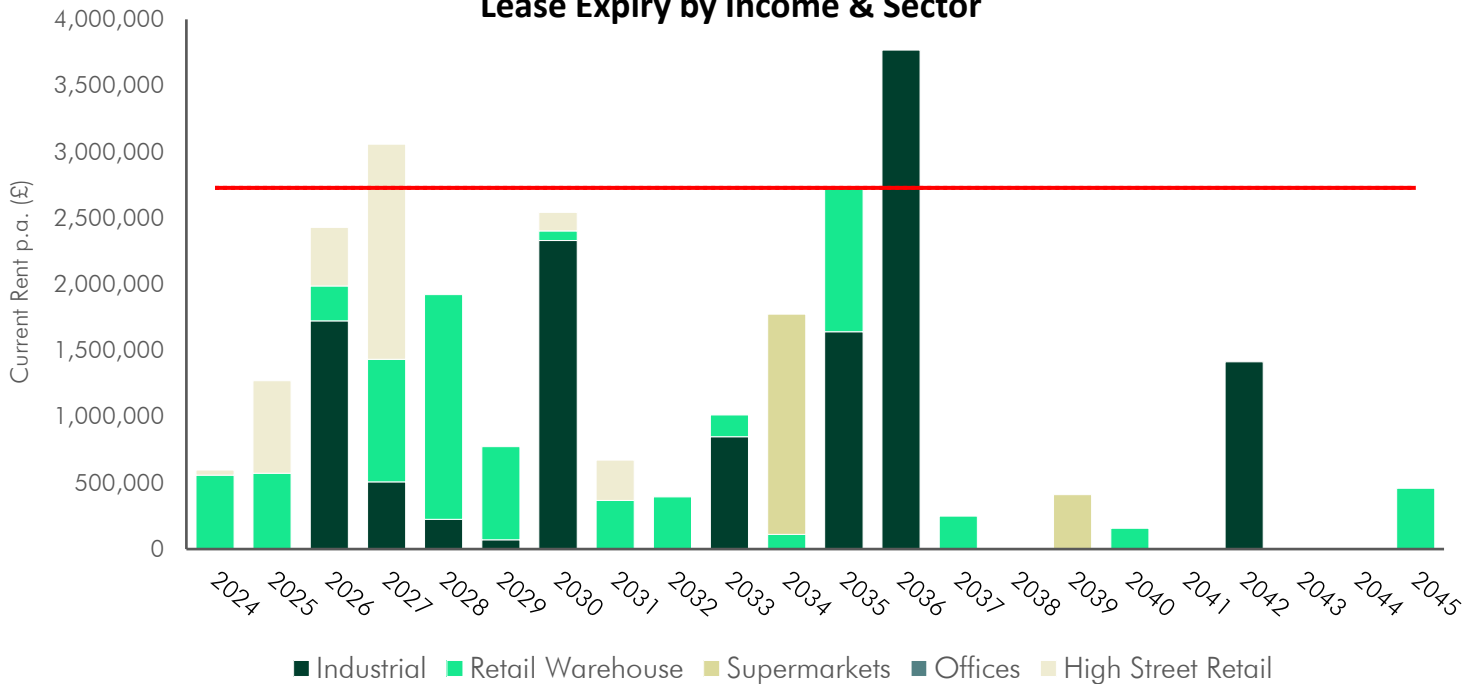
The Portfolio has 91 demises let to 64 tenants. Of the top ten tenants, 70% have an INCANS classification of Medium-Low Risk or better, a strong rating. A summary of the top ten tenants' covenant strength is detailed below.

#	Tenant	Sector	Leases	Contracted Rent p.a.	% of Portfolio Rent	INCANS Global Score	INCANS Category
1	BAE Systems Global Combat Systems Munitions Ltd	Industrial	1	£3,767,977	13.8%	86/100	Medium-Low Risk
2	B&Q Ltd	Retail	3	£2,084,211	7.6%	92/100	Medium-Low Risk
3	Iceland Food Limited	Industrial / Retail	2	£1,892,500	6.9%	60/100	Medium-High Risk
4	Leonardo UK Ltd	Industrial	1	£1,609,659	5.9%	96/100	Low Risk
5	Zara UK Limited	Retail	1	£1,580,000	5.8%	90/100	Medium-Low Risk
6	Omega Plc	Retail	1	£1,413,689	5.2%	92/100	Medium-Low Risk
7	Unipart Logistics Limited	Industrial	1	£1,077,000	3.9%	81/100	Medium-Low Risk
8	Royal Mail Group Limited	Industrial	1	£1,074,000	3.9%	19/100	High Risk
9	Libra Textiles Ltd	Industrial	1	£850,000	3.1%	94/100	Medium-Low Risk
10	Tesco Stores Ltd	Foodstore	1	£813,450	3.1%	74/100	Medium-High Risk
Total				£16,197,664	59.4%		

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.

Lease Expiry by Income & Sector



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 23 – Jun 24			3 Year (p.a.) Jun 21 – Jun 24			5 Year (p.a.) Jun 19 – Jun 24		
	TPF	Index	Variance	TPF	Index	Variance	TPF	Index	Variance
Income Return	5.3%	5.8%	-0.5%	5.1%	5.4%	-0.3%	5.4%	5.5%	-0.1%
Capital Return	1.6%	-3.6%	+1.9%	1.9%	-2.6%	+4.4%	0.3%	-3.0%	+3.3%
Total Return	3.7%	2.0%	+1.7%	7.3%	2.7%	+4.6%	5.8%	2.3%	+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 is regularly articulated to the investment market, and we receive a substantial number of investment opportunities each week.

Asset Management Update

Farmfoods, Congleton – March 2024

On 1st August 2024 the Fund completed the letting of the combined Units G & H with a new tenant, Farmfoods. Terms are £114,075 pa (£13.50 per sq ft) on a 15-year term and a rent-free period of 12 months.

Wolseley, Units 1-3 Acre Road Reading – August 2024

The Fund has agreed terms to renew the Lease with Wolseley UK Limited on Unit A, 1-3 Acre Road, Reading. The term is for an additional 5 years at an increased rent of £70,450 per annum (£12.50 per sq ft). The lease is in the process of being documented.

Halcyon Fine Art, Sovereign Park London – June 2024

On 28th June 2024, Fund completed a rent review. The review comes in the form of a stepped rent structure commencing at £848,628 pa / £24.00 psf in year 1, reaching £972,386 pa / £27.50 psf in year 5, taking the average rent to £912,275 pa / £25.80 psf. This is a c. 43% increase from the previous passing rent of £636,000 pa / £17.99 psf.

B&M, Ipswich – August 2024

On the 20th August, the Fund completed a Lease renewal with B&M Retail Limited on a further 10-year term. The rent will be £312,500 per annum with a break option in year 5 and 10.5 month's rent free. This conclusion was preceded by 23 months of negotiation.

Carpentright, Tonbridge – August 2024

The tenant recently entered Administration. The Fund is exploring several options with offers from a variety of potential tenants.

BAE, Washington – August 2024

The Fund has agreed terms for a reversionary lease with BAE Systems plc. The term is to be extended until December 2042, and the break clause moved out to December 2037. The rent will be reviewed annually at a fixed uplift of 3% pa. In return for the extension, the Fund will provide 3 months rent-free to the tenant. The lease is close to completion.

Portfolio Arrears Update – As at 11 September 2024

The table below details the collection statistics for Q2 2024. Rent due for the quarter totalled £5,487,406, of which £5,428,844 has been collected, reflecting a difference of £58,562.

Collection Milestones	Rent Due 24/06/2024	Quarter Date 24/06/2024	Week 1 01/07/2024	Week2 08/07/2024	Week 3 15/07/2024	Week 4 22/07/2024	After 22/07/2024	Difference
Total (£)	5,487,406	3,817,991	1,476,044	2,818	0.00	0.00	131,991	58,562
Collection Target (%)			92.0%	96.0%	98.0%	99.0%		
Total Collections (%)		69.58%	96.48%	96.53%	96.53%	96.53%	98.93%	

The rent collection across the entire portfolio in the previous three quarters has reflected the following.

June 2024 – 98.9%

March 2024 – 98.4%

December 2023 – 99.0%

The total Collectable Arrears on the entire portfolio is **£645,429** as at 11 September 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 the top ten tenants with the greatest arrears. These tenants account for 90.6% (£585,069) of the total collectable arrears:

- **Halcyon Fine Art Group Holdings Limited** (Sovereign Park) – Total arrears of £341,879 (53.0% of the collectable arrears). This mainly relates to the backdated rent from the recently settled rent review.
- **Stark Building Materials UK Limited** (Bromford Central) – Total arrears of £60,318 (9.3% of the collectable arrears). Most of these arrears relate to an interim rent charge which we are continuing to chase.
- **Carpentryright plc** (Tonbridge) – Total arrears of £45,430 (7.0% of the collectable arrears). This relates to rent and service charge. This tenant has entered administration therefore it is unlikely these arrears will be paid.
- **Encore Group** (Old Brompton Road) – Total arrears of £28,854 (4.5% of the collectable arrears). This is the annual insurance and latest instalment of the lift replacement loan, due from the residential managing agent. These sums are being chased.
- **Unipart Logistics Limited** (Rugby) – Total arrears of £27,226 (4.2% of the collectable arrears). This relates mainly due to the annual insurance that was raised on 9 August. This was raised late due to an error on the premium calculation from the broker.
- **B&Q plc** (Arbroath) – Total arrears of £24,564 (3.3% of the collectable arrears). This relates solely to service charge arrears and a dispute over charges. A measured survey has been completed, which confirms the new apportionments for all tenants. This has been provided to B&Q service charge consultant, to which there has been no further response. We are chasing for payment.
- **Shoe Zone Retail Limited** (Congleton) – Total arrears of £17,748 (2.7% of the collectable arrears). This relates to discrepancies with the completion statement and the reconciliation of the account for the old and new lease, following the completion of the lease renewal.
- **B&Q plc** (St Albans) – Total arrears of £16,501 (2.6% of the collectable arrears). This relates to the service charge and insurance, which is under query and we are working with the tenant to resolve.
- **Iceland Foods Limited** (Swindon) – Total arrears of £11,773 (1.8% of the collectable arrears). This relates to the recharge of the head landlord's service charge. The tenant has queried these charges, which we are seeking to resolve.
- **River island Fashion Limited** (Lincoln) – Total arrears of £10,777 (1.7% of the collectable arrears). This relates mainly to the misallocation of the May 2022 rent. We are working with the tenant to resolve this.

The remaining £60,359 (9.4% of the collectable arrears) is spread across 27 tenants, ranging from £12.93 to £9,693.

Lending Update

Debt Investment Portfolio	Sector	Loan Limit	Drawn Balance	Interest Rate	Fully Drawn Income p.a.	Maturity	LTV	ICR
Chester Greyhound	Retail	£19.28m	£19.28m	3.70%	£0.71m	Nov-25	59.1%	2.94x
St Arthur Homes	Affordable Housing	£13.90m	£13.90m	4.50%	£0.63m	Nov-26	54.5%	1.61x
Preston East	Industrial & Logistics	£16.17m	£16.17m	5.21%	£0.84m	Jun-27	55.4%	1.76x
Bordon	Industrial & Logistics	£11.30m	£11.02m	5.54%	£0.63m	Jun-29	52.5%	1.57x
TOTAL CURRENT		£60.6m	£60.4m	4.63%	£2.81m		55.8%	2.07x

As at 30 June 2024, the Fund had four committed loans, of which £60.4m of the combined £60.6m limits had been drawn. These loans produce a blended return of 4.63%. In the period, the £11.33m 'Bordon' loan to Titan completed on 26 June.

The Bank of England base rate remained at 5.25% as of the quarter's end. However, inflation and other key indicators were shown to be stabilising. As a result, SONIA 3 year swap rates had adjusted downwards by ~25bps by the quarter end from their 2024 April peak.

The pipeline has remained strong throughout 2024, particularly with the new St Arthur portfolio and Preston East Unit 3 increases. We expect the £100m Allocation to be fully deployed by the year end.

The enduring higher interest rate environment has continued to produce strong risk-adjusted return opportunities, improving the blended return across the loan portfolio. This has increased from 4.42% at the end of 2023 to 4.63% at the end of H2 2024. Anticipated downward pressure on swap rates implies that the market peak for returns has passed. However, rates have remained considerably higher than at any other time since the GFC. CBRE would be confident in deploying further funds into similarly strong lending transactions with returns in the 5.0% - 7.0% range should Teesside wish to consider a new Allocation.

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 re-finance of Greyhound Retail Park, Chester. Ongoing scheduled amortisation has de-levered the loan to £19.3m since completion. Carpetright, a tenant at the Park, went into administration 22nd July 2024. The Borrower is now working through a new asset management plan to replace the tenant, which we will continue to monitor and provide updates on as it progresses.
- St Arthur Homes:** A £13.9m loan secured against a portfolio of 176 shared ownership units. An £11.5m increase to refinance a further 153 units was in legals as of 30th June.
- Preston East:** A £16.2m loan secured against 3x long-let, Grade A logistics units near Preston. Terms have been agreed, subject to IC approval, for a small ~£3m increase to refinance the fourth and final unit at the estate once it reaches practical completion in Q3.
- Bordon:** An £11.33m loan secured against a fully let logistics unit in Bordon, Hampshire with a WAULT >14 years. The loan closed in June 2024.



Titan Investors – Bordon, Hampshire



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 investments going forward. CBRE will ensure that responsible investment is 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. As the importance of ESG grows, we will expand upon these with portfolio-level principles and asset-specific initiatives.

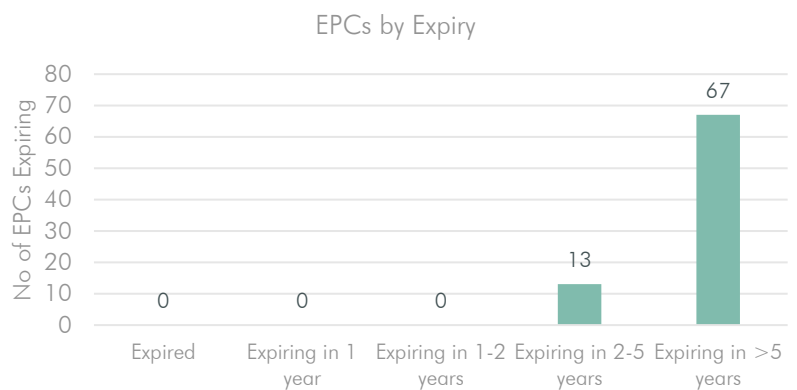
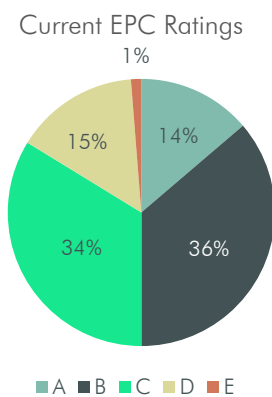
Environmental – sustainable factors will continue to play a part in the definition of ‘prime’ real estate, and buildings that don’t meet the increasingly competitive standards are likely to become obsolete faster. Occupiers will demand that their buildings adhere to the highest environmental standards.

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 regulations 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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