Agenda Item 15

TEESSIDE PENSION FUND Q3 2024

CBRE

Quarterly Report
Prepared: 27 November, 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 November 2024, the portfolio comprised 34 properties located throughout the UK, with a combined value of £485.1m. This reflects an overall Net Initial Yield of 5.5%, and an Equivalent Yield of 5.88%.

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 £28,613,928 per annum against a gross market rental value of £27,578,437 per annum.

The weighted average unexpired lease term is 8.9 years to the earlier of the first break or expiry and 9.6 years to expiry, ignoring break dates.

teesside pension fund

Fund Summary

Total Pension Fund Value (March 2024)	**£5,477m**
Real Estate Weighting (long term target allocation)	8.9% (10%)
Direct Portfolio Value (November 2024)	£485.1m

Direct Portfolio

Direct Portfolio Value (November 2024)	£485.1m
Number of Holdings	34
Average Lot Size	£14.3m
Number of Demises	91
Void rate (% of ERV) (Estimated UK Benchmark)	1.5% (7.0% – 9.0%)
WAULT to Expiry (break)	9.6 years (8.9 years)
Current Gross Passing Rent (Per Annum)	£28,613,928
Current Gross Market Rent (Per Annum)	£27,578,437
Net Initial Yield	5.5%
Reversionary Yield	5.3%
Equivalent Yield	5.88%

Portfolio Highlight (Q3 2024) – Verdant Regeneration, New Stanton Park

The Fund is currently negotiating a £25m Bridge Loan Facility to Verdant Regeneration Limited. The loan will aid the borrower with infrastructure and enabling works at the 176-acre site in Ilkeston, Derbyshire. On completion, the Fund's loan book will reach the current target allocation of £100m.

UK Economic Commentary

- Rachel Reeves delivered Labour's first budget under Sir Kier Starmer's premiership on 30th October 2024. As a priority, the Chancellor is looking to plug a c.£22m black hole in the current budget. The Government committed to not raising income tax, VAT or National Insurance in its election manifesto and therefore various forms of wealth taxation will be impacted.

- Recent figures released by the ONS show that UK GDP contracted from 0.7% to 0.5% from Q1 2024 to Q2 2024. However, annual GDP is up 0.5% from Q2 2023. Predictions for 2025 are slightly better, with GDP growth forecast to reach 1.2%.

- After a series of interest rate rises, the Bank of England's Monetary Policy Committee (MPC) voted to reduce the Bank Rate by 0.25 percentage points to 5% on July 31, 2024. Subsequently, on September 19, 2024, the MPC maintained rates at 5%. In November, a second cut took rates to 4.75%, with the Bank Rate expected to fall to 3.75% by the end of 2025.

- The Consumer Prices Index (CPI) rose by 1.7% in the 12 months to September 2024, down from 2.2% in August 2024. The largest downward contribution to the monthly change in the CPI annual rate came from transport, primarily falls in airfares and fuel prices.

- Additionally, the UK's unemployment rate decreased from 4.3% in January-March 2024 to 4.1% in May-July 2024. Job vacancies continue to fall, with approximately 857,000 vacancies in August 2024, a 15,000 decline from July 2024.

UK Real Estate Market Commentary

- The CBRE Index recorded an 'All Property' Total Return of 3.5% over the 12 months to September 2024, improving from the 2.0% Total Return recorded in the 12 months to June 2024 at the previous quarter date. The Index saw a capital fall of 2.2% over the same period to September 2024 – this was an improvement on the fall of 3.6% in the 12 months to June 2024.

- The largest decrease in capital values across the core traditional sectors over the 12 months to September 2024 continued to be observed in the Offices sector, with a fall of -7.6%. A quarter-on-quarter decrease indicates that the office sector is further moving towards stabilisation.

- All Retail assets saw a positive total return of 5.6% in the 12 months to September 2024. This was underpinned by an income return of 7.3%. The best sub-sector performer across the retail landscape over the last year was Shopping Centres, recording a total return of 6.7%. This was closely followed by All Retail Warehouses which recorded a total return of 6.4%.

- Positive capital value movements were seen in the industrial sector for the third consecutive quarter, with an increase of 1.4% seen across 'All Industrials' in the 12 months to September 2024. 'All Industrials South East' continues to perform strongly with an annual capital return of 2.1% and rental value growth of 6.2%.

- Pricing in the real estate market has largely stabilised with upward pressure starting to be seen in several sectors. Retail warehouses, food stores, industrial and budget hotels have all experienced inward yield shifts in Q3 2024. This is positive as the majority of the Fund's holdings are in these sectors.

- We expect continued polarisation with purchasers focusing on acquiring prime assets with strong underlying fundamentals.

- Our view remains that there will be more pain to come for secondary assets which are in over-supplied markets and require further refurbishment/capital expenditure.

- The interest rate fall in July was welcomed by investors, however, it has not improved market liquidity. Investment volumes in Q3 were well below historic market averages. Q4 is unlikely to result in a large uptick due to the aforementioned macro-factors.

Investments

Sales

The Fund made no disposals this quarter.

Acquisitions

The Fund made no acquisitions this quarter.

Direct Portfolio Analysis

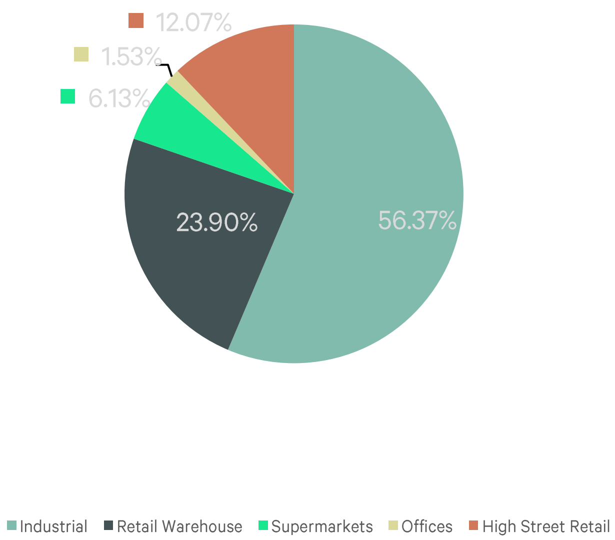
Top Ten Holdings (by Capital Value)

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	PARK ROYAL - Minerva Road	Industrial	£19,700,000	4.1%
10	TONBRIDGE – Tonbridge Retail Park	Retail Warehouse	£19,650,000	4.1%
		Total	**£280,600,000**	**57.8%**

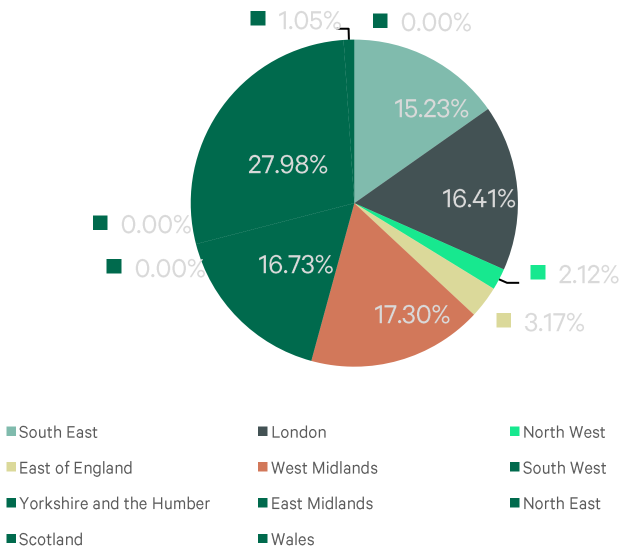
We will seek to extend the weighted average unexpired lease term (WAULT) of the portfolio, as well as diversifying the lease expiry profile.

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)

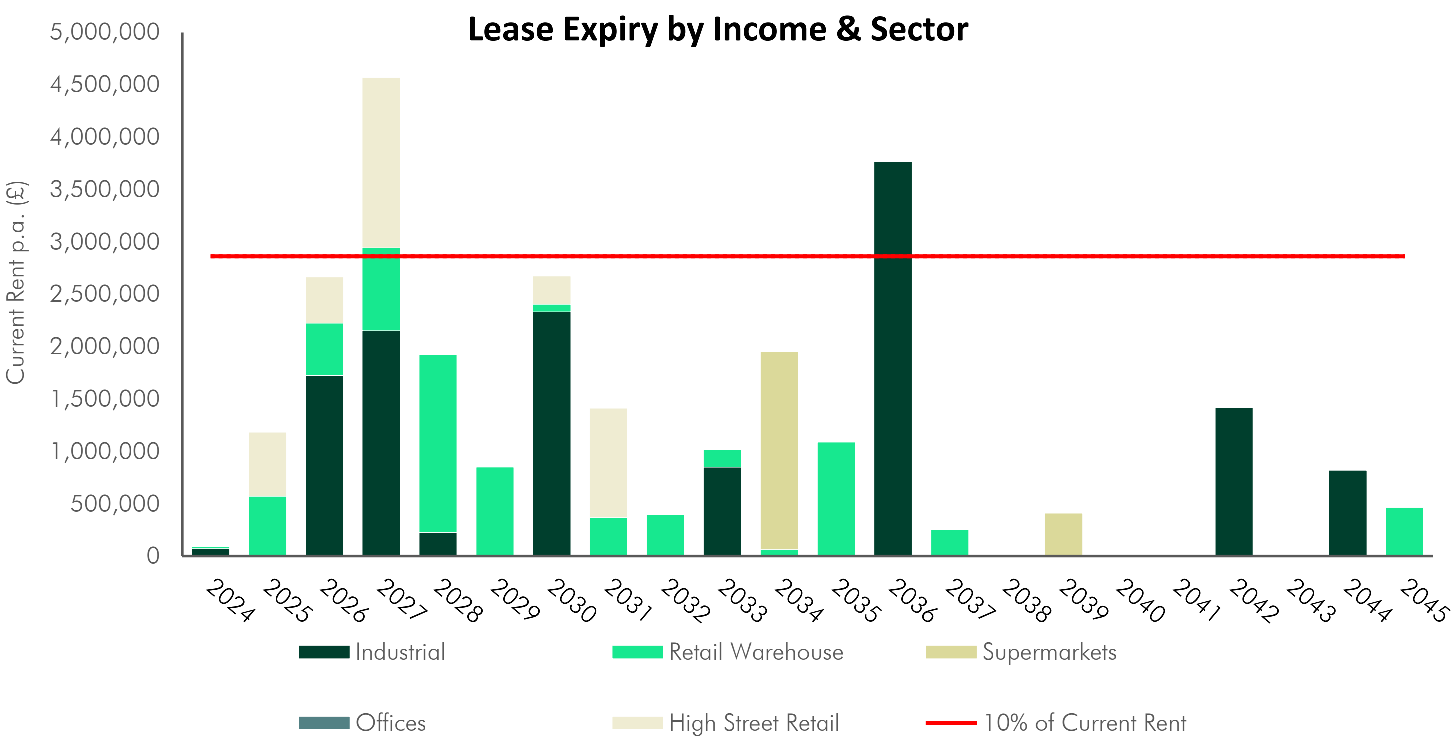
Top Ten Tenants (by Contracted Income)

The Portfolio has 91 demises let to 64 tenants. Of the top ten tenants, 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 Global Combat Systems Munitions Ltd	Industrial	1	£3,767,977	13.2%	86/100	Medium-Low Risk
2	B&Q Ltd	Retail	3	£2,084,211	7.3%	92/100	Medium-Low Risk
3	Iceland Food Limited	Industrial / Retail	2	£1,892,500	6.6%	60/100	Medium-High Risk
4	Leonardo UK Ltd	Industrial	1	£1,653,120	5.8%	95/100	Low Risk
5	Zara UK Limited	Retail	1	£1,580,000	5.5%	88/100	Medium-Low Risk
6	Omega Plc	Retail	1	£1,413,689	4.9%	92/100	Medium-Low Risk
7	Unipart Logistics Limited	Industrial	1	£1,077,000	3.8%	78/100	Medium-Low Risk
8	Royal Mail Group Limited	Industrial	1	£1,074,000	3.8%	19/100	High Risk
9	Libra Textiles Ltd	Industrial	1	£1,050,000	3.7%	93/100	Medium-Low Risk
10	Halycon Fine Art Ltd	Industrial	1	£848,628	3.0%	85/100	Medium-Low Risk
			Total	£16,441,125	57.5%		

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 23 – Dec 24			3 Year (p.a.) Dec 21 – Dec 24			5 Year (p.a.) Dec 19 – Dec 24		
	TPF	Index	Variance	TPF	Index	Variance	TPF	Index	Variance
Income Return	5.77%	5.81%	-0.04%	5.41%	5.38%	+0.03%	5.49%	5.49%	+0.00%
Capital Return	-0.08%	-2.21%	-2.13%	-0.38%	-3.66%	+3.29%	1.67%	-2.77%	+4.43%
Total Return	5.69%	3.48%	+2.20%	5.22%	1.54%	+3.68%	7.37%	2.58%	+4.79%

* 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

Wolseley, Units 1-3 Acre Road Reading – November 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 with completed expected by the end of November 2024.

Carpetright, Tonbridge – November 2024

The tenant recently entered Administration. The Fund has entered into letting discussions with a prospective tenant with lease terms currently being negotiated.

BAE, Washington – November 2024

The Fund has agreed terms for a reversionary lease with BAE Systems plc. The term will 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 expected to complete by the end of 2024.

M&S, Congleton – November 2024

M&S currently occupies unit A1 at Congleton. The tenant has a lease expiry in June 2025. The Fund is currently negotiating an early lease renewal with the tenant.

Barclays, Exeter – November 2024

Barclays are currently in occupation of 1-3 Bedford Street with a lease expiry in June 2025. The Fund is currently in lease renewal negotiations to further extend their longstanding tenancy within the unit.

Charity Bank, Congleton – November 2024

The Fund is agreeing a short-term licence with a charity to allow the installation of a clothing bank in the car park. The bank will enable residents within the catchment to dispose of textiles and clothing, and will contribute to reducing local wastage.

Portfolio Arrears Update – As at 27 November 2024

The table below details the collection statistics for Q3 2024. Rent due for the quarter totalled £6,074,994.35, of which £5,645,616.03 has been collected, reflecting a difference of £429,378.32.

Collection Milestones	Rent Due 29/09/2024	Quarter Date 29/09/2024	Week 1 06/10/2024	Week2 13/10/2024	Week 3 20/10/2024	Week 4 27/10/2024	After 22/07/2024	Difference
Total (£)	6,074,994	4,040,782	1,157,226	325,450	0	19,969	102,189	429,378
Collection Target (%)			92.0%	96.0%	98.0%	99.0%		
Total Collections (%)		66.5%	85.6%	90.9%	90.9%	91.2%	92.9%	

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

September 2024 – 92.9%
June 2024 – 98.9%
March 2024 – 98.4%

The total Collectable Arrears on the entire portfolio is £396,464 as at 30th November 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
- Tenants that are insolvent

Below is a summary of the top ten tenants with the greatest arrears.

B&Q plc (St Albans) – Total arrears of £108,123 (27.3% of the collectable arrears). This mainly relates to the third monthly instalment of the September 2024 quarter's rent, which we are continuing to chase.

Halcyon Fine Art Group Holdings Limited (Sovereign Park) – Total arrears of £89,371 (22.5% of the collectable arrears). This relates solely to the back dated rent following settlement of the outstanding rent review.

Stark Building Materials UK Limited (Bromford Central) – Total arrears of £60,318 (15.2% of the collectable. arrears). Most of these arrears relate to the interim rent charge. This sum is being collected by Freeth's, following agreement of the dilapidation settlement.

B&Q plc (Arbroath) – Total arrears of £24,564 (6.2% of the collectable arrears). This relates solely to service charge arrears and a dispute over charges. These arrears are being discussed as part of the lease renewal negotiations.

Shoe Zone Retail Limited (Congleton) – Total arrears of £22,945 (3.1% of the collectable arrears). This mainly relates to the two quarter's rent, which we continue to chase.

Halfords Limited (Dorchester) – Total arrears of £18,241 (4.6% of the collectable arrears). This mainly relates to the monthly instalments of the September 2024 quarter's rent, which we are continuing to chase.

River Island Fashion Limited (Lincoln) – Total arrears of £10,777 (2.7% of the collectable arrears). This relates mainly to the minor misallocation of rent. We are working with the tenant to resolve this.

Iceland Foods Limited (Swindon) – Total arrears of £8,631 (2.2% 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.

Hobbycraft Trading Limited (Cirencester) – Total arrears of £8,305 (2.1% of the collectable arrears). This relates mainly to the third monthly instalment of the September 2024 quarter's rent, which we are continuing to chase.

Tesco Stores Limited (Stow on the Wold) - Total arrears of £7,218 (1.8% of the collectable arrears). This relates to an underpayment of the September quarter's rent following the implementation of the annual RPI uplift.

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	£25.37m	£15.37m	5.40%	£1.37m	Nov-26	55.0%	1.34x
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		**£72.1m**	**£61.8m**	**4.92%**	**£3.55m**		**55.9%**	**1.99x**

As at 30 September 2024, the Fund had four committed loans, of which £61.8m of the combined £72.1m limits had been drawn. These loans produce a blended return of 4.92%. In the period, the St Arthur Homes loan was increased by £11.5m to fund the refinance of an additional 153 stabilised shared ownership properties over the course of the loan term. The pricing, at 2.25% over the 3 year SONIA swap rate, increased the blended pricing on the St Arthur loan to 5.4%.

The Bank of England base rate was cut by 25bps to 5.0% in August following evidence that inflation and other key indicators were stabilising. SONIA 3 year swap rates adjusted downwards by c.50bps in the quarter.

Pipeline has remained strong throughout 2024. The Preston East loan increase to refinance Unit 3 at the same location and the new Verdant Regeneration opportunity were progressing well at end Q3. Upon successful completion of these loans, the target TPF £100m allocation to lending will have been deployed.

The enduring higher interest rate environment continues to produce strong risk-adjusted return opportunities, improving the blended return across the loan portfolio. Swap rates have fluctuated within a c.80bps range in 2024, but at end Q3 2024 the 3 and 5 year swap rates are within 16bps of the same rates on 31 Jan. CBRE remains confident in deploying further funds into similarly strong lending transactions with returns in the 5.0-7.0% range should Teesside wish to consider increasing the allocation, which we would recommend doing to take advantage of the compelling risk-return metrics available.

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 £19.3m since completion. On 22nd July 2024, Carpetright, a tenant at the scheme, went into administration. 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 £25.4m loan secured against a portfolio of 329 shared ownership units (an increase of 153 on the existing 176 units following the £11.5m refinance in July).
- Preston East: A £16.2m loan secured against 3x long-let, Grade A logistics units near Preston. An additional small ~£3m increase to refinance the fourth and final unit at the was due to close imminently at the end of 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

Titan Investors – Preston East Unit 3, Preston

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.

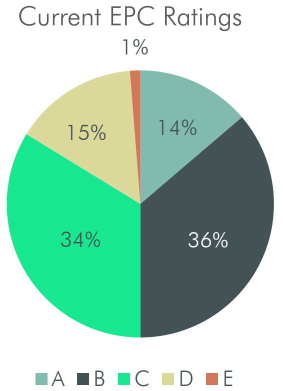
Environmental – sustainable factors will continue to play a part in the definition of 'prime' real estate, and buildings that don't meet the increasingly competitive standards are likely to become obsolete faster. Occupiers will demand that their buildings adhere to the highest environmental standards.

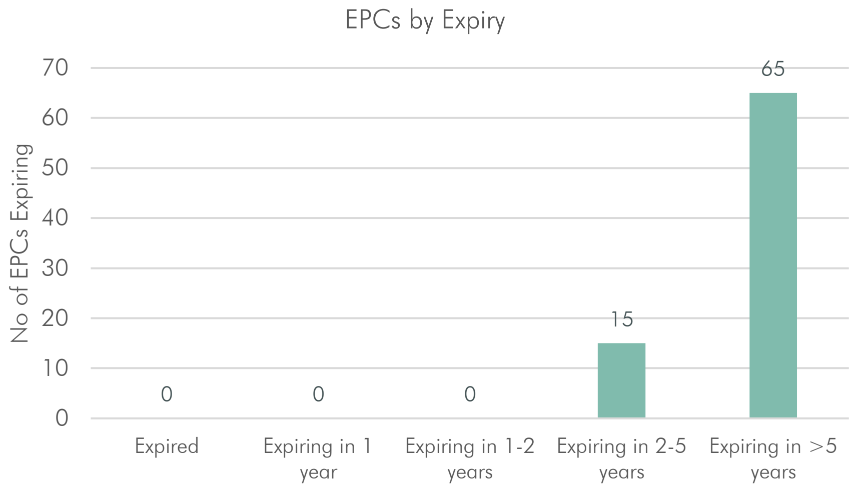
Social - real estate's impact on the local community and on a company's workforce are becoming equally important. Buildings that contribute positively to the world are, therefore, likely to be more resilient than those that do not, and as such, are likely to benefit from increased occupier demand, leading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