Agenda Item 13

CBRE

TEESSIDE PENSION FUND

Quarterly Portfolio Strategy Report

30th September – 31st December 2020

Prepared 17th February 2020

PREPARED FOR

teesside pension fund

CONTENTS

1 EXECUTIVE SUMMARY

EXECUTIVE SUMMARY
Portfolio Strategy

You have advised us that your objective is to increase the property portfolio to £350m in a risk controlled manner.

CBRE Recommended Strategy

- To diversify the portfolio through different property types, unit sizes, occupier businesses, quality, income expiry and geographical regions.
- To make acquisitions and disposals that help balance the portfolio's overall lease expiry profile.
- Maintain a long term heavily weighted position in industrial and retail, alongside an under weight position in offices. Acquire prime, well let properties, together with some RPI linked assets.
- Keep the vacancy rate lower than typical institutional investment portfolio levels, whilst reducing income risk in particular years.

SECTOR	CURRENT WEIGHTING	TARGET WEIGHTING
Industrial	49.7%	40.2%
Retail Warehouse	24.3%	30.0%
Long Income	10.8%	18.5%
Offices	2.7%	2.5%
High Street Retail	12.4%	8.8%
	100%	**100%**

EXECUTIVE SUMMARY
Portfolio Profile

- At 31st December 2020, the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £268.52m. This reflects an overall Net Initial Yield of 5.08%, and an Equivalent Yield of 5.86%.

- The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 86.5% of the portfolio by capital value. There are 75 demises and a total net lettable area of 1,949,442 sq ft.

- The weighted average unexpired term is 7.7 years to the earlier of first break or expiry, and 8.8 years to expiry, ignoring break dates.

- The portfolio also has the following characteristics:

  - The vacancy rate is currently 2.45% of Estimated Rental Value. By comparison we are informed, 'MSCI Quarterly Index Q3 2020 Void Rate", is 11.90%.

  - The top ten tenants constitute 54.2% of the total gross annual income of the portfolio, while the top twenty tenants constitute 76.8%.

  - Current gross passing rent is £14,804,215 per annum, against a gross current market rent of £16,619,463 per annum, making the portfolio slightly reversionary in nature.

EXECUTIVE SUMMARY
Portfolio Activity

Investments

Sales

- No sales this period.

Acquisitions

- The Fund has agreed terms to purchase an income strip as a liability matching asset. This is focussed on the development of a 210,000 sq ft industrial unit for £28.2m reflecting 5.04% NIY. The unit will be let to Leonardo MW on a 35-year lease, with fixed annual 2.70% uplifts. There will be an option to purchase the asset in favour of the tenant at lease expiry.

EXECUTIVE SUMMARY

Portfolio Activity & Strategy

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

June – 96.0%

September – 95.0%

December - 80.7%

The total Collectable Arrears on the entire portfolio is £1,795,031 as at 11th February.

The Collectable Arrears exclude the following:

- Tenants that are insolvent (99p Stores Limited at Cirencester, Laura Ashley Ltd at Congleton, Homestyle Group Operations Ltd at Congleton) and also tenants that have overall credit balances on their accounts.

Below, is a summary of the top eight tenants with the greatest arrears, which account for 82.6% (£1,481,231) of the total arrears:

- **Halcyon Fine Art Group Holding Limited (Park Royal)** – Total arrears of £608,687 (33.9% of the collectable arrears). Most of these arrears relate to a back dated rent review increase going back to 2018, albeit they have not yet paid their December quarter's rent. A 50% rent concession is being agreed for the December 2020 and March 2021 due to assist with Covid-trading issues.

- **River Island Clothing Co. Limited (Lincoln)** – Total arrears of £261,250 (14.6% of the collectable arrears). This tenant has not yet been granted any rent concession. A few small payments have been made but these arrears relate to 9½ months' worth of rent outstanding between 1st April 2020 and 28th February 2021. A new lease backdated lease is being finalised, due to commence on 7 July 2020. This will see most of the arrears cleared.

- **Nuffield Health (Guildford)** – Total arrears of £184,478 (10.3% of the collectable arrears). This tenant was granted a one-quarter rent concession for the March 2020 quarter. Their arrears relates mainly to the June 2020 quarter rent to which they have made no payment towards and the December quarter rent where they have so far paid one third's instalment. There are also some insurance and head landlord service charges outstanding. The tenant originally advised that they would begin to pay rent monthly from their date of reopening from lockdown 1 (25th July 2020).

- **Peacocks Stores Limited (Cirencester)** – Total arrears of £123,430 (6.9% of the collectable arrears). This tenant has not yet been granted any rent concession and the arrears relates to their monthly rent from 28th March 2020 through to 27th February 2021 (11-months), plus service charge and insurance premium. No payments have been received at all since 2nd March 2020.

- **Sportsdirect.com Retail Limited (Cirencester)** – Total arrears of £115,111 (6.4% of the collectable arrears). This tenant has not been granted any rent concession and the arrears relates to their monthly rent from 28th March 2020 through to 27th February 2021 (11-months), plus service charge and insurance premium. No payments have been received at all since 2nd March 2020.

- **Pizza Hut (UK) Limited (Ipswich)** – Total arrears of £75,107 (4.2% of the collectable arrears). This tenant was granted a one-quarter rent concession for the March 2020 quarter. This tenant has not paid their June, September or December quarter rents and have insurance and service charge also outstanding. The tenant entered a CVA in September. Under the term of the CVA rent is now turnover based and this is in the process of being calculated. Negotiations are ongoing with Pizza Hut in relation to their lease.

- **Toughglaze (UK) Limited (Park Royal)** – Total arrears of £70,932 (4.0% of the collectable arrears). These arrears relate mainly to the December quarter's rent and service charge for which no payment has been made. They have also not paid last year's insurance premium.

- **Partridges of Sloane Street Limited (Gloucester Road)** – Total arrears of £42,236 (2.4% of the collectable arrears). These arrears relate mainly to the December quarter's rent for which no payment has yet been made.

The remaining £312.442 (17.4 % of the collectable arrears) of arrears is spread across 61 tenants, ranging from £39,675 to £.04.

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EXECUTIVE SUMMARY

Quarterly Rent Collection Statistics

Quarterly Rent Collection Statistics at 101th February 2021

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 29 September	Collectable Rent	Quarter Date up to and including 29/09/2020	Week 1 up to and including 06/10/2020	Week 2 up to and including 13/10/2020	Week 3 up to and including 20/10/2020	Week 4 up to and including 27/10/2020	Payment after 27/10/2020	Difference
	3,826,828.71	3,826,828.71	2,182,009.49	415,645.48	231,748.36	24,059.69	98,006.50	137,961.35	737,397.84
Non Collectable Total		0.00							
Collections Including non collectables			57.02%	67.88%	73.94%	74.56%	77.13%	80.73%	
Collections Excluding non collectables			57.02%	67.88%	73.94%	74.56%	77.13%	80.73%	

These figures relate to rents that only became due on the September English Quarter Day (25th December 2020).

The difference of £737,398 relates to a number of Tenants and is due to varying situations across the portfolio, on a Tenant specific basis. The 5 largest debtors for the December quarter include H&M Hennes & Mauritz Uk Ltd (£222,000), Halcyon Fine Art (£90,000), Nuffield Health (£70,943), Toughglaze (UK) Ltd (£66,180), and Partridges of Sloane Street (£42,000).

All tenants are either being chased or have paid, with payment receipt pending bank transfer completion. A number of Tenants are subject to varying temporary arrangements with regards to their rental payments as a result of the ongoing Covid-19 pandemic. These are being handled on a tenant specific basis, with each request and agreement being considering in isolation.

CBRE have collected 81% of collectable rent (to 11th February 2021).

2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

PROPERTY MARKET & SECTOR FORECASTS

Economic Performance Q4 2020

November data confirmed that the second national lockdown in England had a far smaller impact on activity than the first, as businesses and consumers adapted to the new environment and key sectors such as construction and education remained open. December likely saw m/m growth as non-essential retailers were allowed to open in the first half of the month. Taken together, we expect GDP grew 0.4% in the final quarter, implying a contraction of 9.9% in 2020 overall.

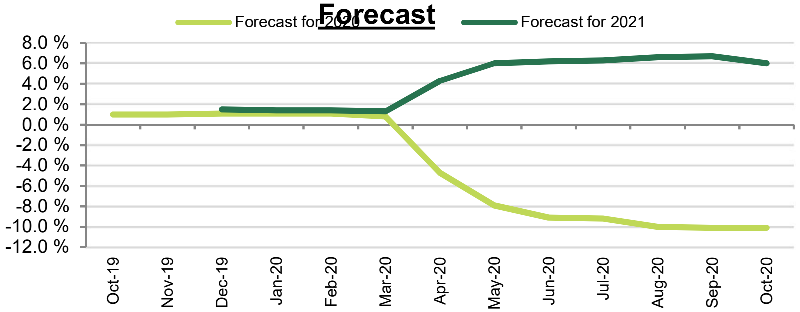
Looking forward, it is likely to be a challenging first quarter. The government's vaccination programme aims to vaccinate all over-70s by the middle of February and the high priority groups (over 50) by Easter. For the economy, this almost certainly means that the majority of services that are closed will remain closed for the most (if not all) of the first quarter.

That said, we remain optimistic that UK activity will pick up considerably from Q2. If the vaccine rollout is successful in reducing cases and hospitalisations (which we think it will be), in Q2 over 50% of the population will have been partly vaccinated, unlocking allowing the government to lift restrictions and unlock considerable services spending in the economy.

As with the first lockdown, we expect a strong mechanical bounce back in Q2 2021 followed by above average growth rates for the rest of the year, with the UK economy returning to pre-pandemic levels of output in mid-2022.

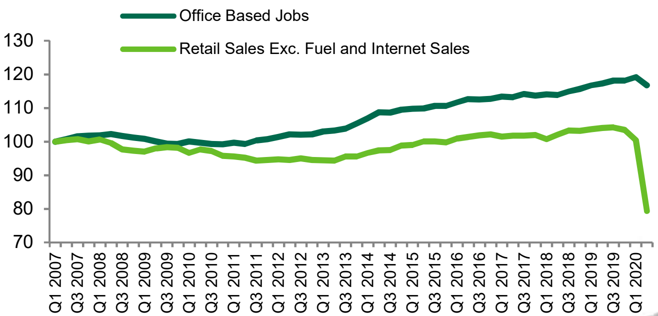
It's important to note that the 2021 outlook remains highly uncertain with the risks tilted to the downside. While the end of Brexit negotiations will bring an end to some of the uncertainty faced by businesses, the rules surrounding financial services and 'equivalence' will continue to be negotiated into 2022. In any case, we continue to believe Covid-19 and its consequences pose a greater risk to commercial real estate, and thus financial services and the risk to financial service occupiers should be considered in perspective.

Evolution of UK GDP Growth Forecast



Source: HM Treasury Consensus

Economic Drivers of Commercial Property Demand

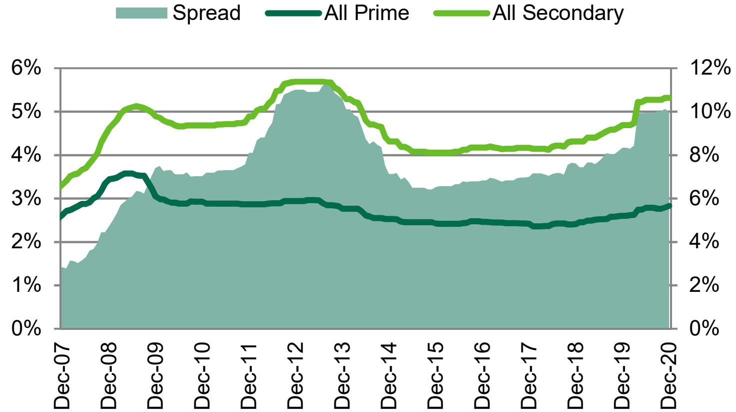


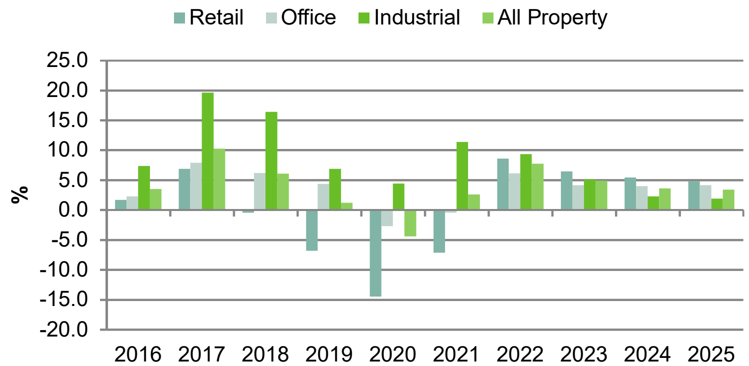
Source: CBRE, Oxford Economics, ONS

PROPERTY MARKET & SECTOR FORECASTS
Property Market Q4 2020

- Year on year total returns for All UK Property fell by -2.2% (-7.6%* capital return, 5.8%* income return) for the period Q4 2019 to Q4 2020**. Year on year returns at this level are significantly lower than the 5-year average as the down draft of the pandemic hits performance but especially the Retail sector.
- Quarterly total returns for All UK Property for Q4 recorded 1.6% (0.2% capital return, 1.4% income return).
- Industrials total returns were very strong over Q4 2020 at 7.3% (4.8% capital return, 4.9% income return).
- Rental values for All UK Property fell by -0.5% over the fourth quarter of 2020. This figure was largely pulled down by a fall of -1.9% in the Retail sector and marginal falls for Offices. The industrial sector reported rental value growth over the quarter.

Prime Vs Secondary All Property Yields (excl. Central London) Property Total Returns





Source: CBRE Monthly Yields, Dec 2020

Source: MSCI, CBRE, November 2020

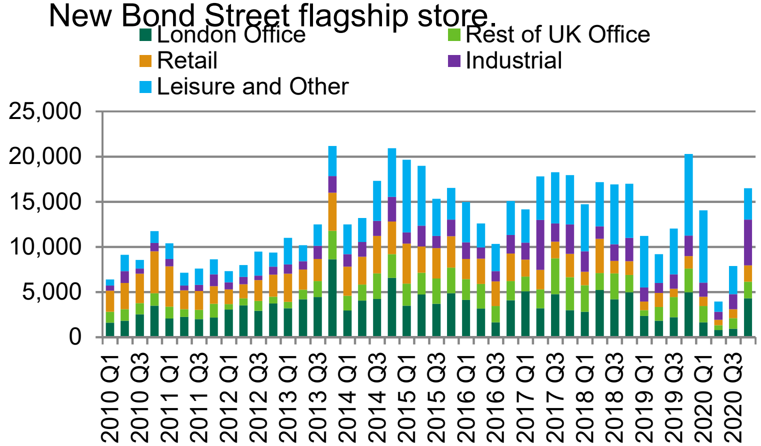
* *Return figures will not always sum due to separate compound calculations*

** *Based on CBRE Monthly Index, all property total returns Dec 2020*

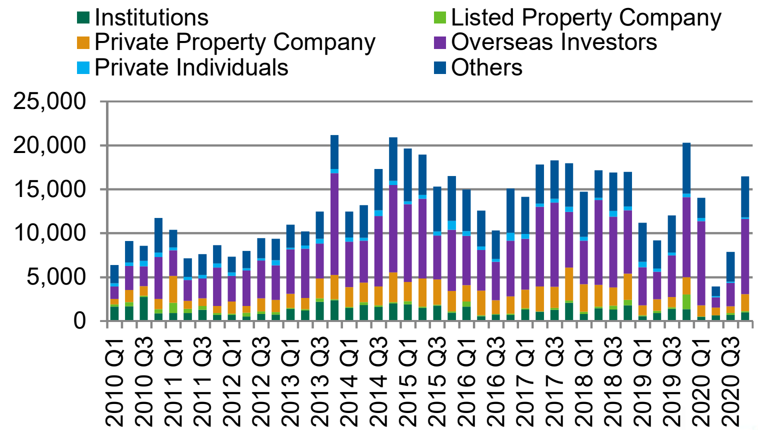
PROPERTY MARKET & SECTOR FORECASTS
Property Market Q4 2020 Transactions

- Investment into UK commercial real estate across all sectors reached £16.5bn in Q4, bringing volumes for 2020 to £42.3bn. This is a 20% drop from 2019 investment levels (£53.2bn), with OPRE and Central London offices the hardest hit (44% and 33% fall respectively).
- International investors were responsible for more than half (52%) the capital invested into UK commercial real estate in Q4 2020, above the 10-year quarterly average of 43%. Global travel restrictions had hindered international investment since March, with only 32% of investment capital coming from overseas in Q2 and Q3.
- Investment transactions for ‘All Offices’ totalled £6.1bn in Q4 2020, almost half the annual total of £13.0bn. The Central London office market saw £4.3bn transact in the final quarter of the year, above the 5-year quarterly average of £3.3bn. The largest deal in Q4 was 1&2 New Ludgate for £552m to Singaporean investor Sun Venture.
- The Industrial sector saw seven portfolios transact for more than £100m in the final quarter of 2020, pushing volumes to £5bn in Q4, making it the 2nd highest quarterly total on record for the sector.
- Retail transactions totalled £1.8bn for the quarter, the largest of which was Chanel’s £300m acquisition of their New Bond Street flagship store.

Commercial Property Investment Transactions (£millions)



Source: : CBRE, Property Data, January 2021



Source: : CBRE, Property Data, January 2021

PROPERTY MARKET & SECTOR FORECASTS

UK Returns Forecast Q4 2020

	2018	2019	2020	2021 (Forecast)	2022 (Forecast)	2023 (Forecast)	2024 (Forecast)	2025 (Forecast)	Annualised 2021-2025
Total return: % per year									
Retail	-0.5	-6.8	-14.5	-7.1	8.6	6.5	5.4	4.8	3.5
Office	6.2	4.4	-2.7	-0.5	6.1	4.1	4.0	4.1	3.6
Industrial	16.4	6.9	4.4	11.4	9.4	5.1	2.3	1.9	5.9
All Property	6.0	1.2	-4.4	2.6	7.7	4.9	3.6	3.4	4.4
Income return: % per year									
Retail	5.1	5.3	5.5	6.0	5.9	5.7	5.6	5.6	5.8
Office	4.0	4.1	3.9	4.0	4.0	3.9	3.9	3.9	3.9
Industrial	4.5	4.4	4.3	4.1	4.1	4.0	4.1	4.3	4.1
All Property	4.6	4.6	4.5	4.3	4.3	4.2	4.2	4.3	4.3
Capital growth: % per year									
Retail	-5.3	-11.6	-19.0	-12.3	2.5	0.7	-0.2	-0.8	-2.2
Office	2.1	0.3	-6.3	-4.3	2.1	0.2	0.1	0.2	-0.4
Industrial	11.4	2.4	0.1	7.0	5.1	1.0	-1.8	-2.3	1.7
All Property	1.4	-3.3	-8.5	-1.7	3.3	0.6	-0.6	-0.9	0.1
Nominal rental value growth: % per year									
Retail	-2.2	-4.9	-10.3	-8.3	-1.3	-0.6	-0.9	-1.0	-2.4
Office	0.8	1.5	-1.7	-4.8	0.6	2.6	3.2	2.9	0.9
Industrial	4.6	2.9	1.9	2.1	3.3	2.3	2.0	1.4	2.2
All Property	0.5	-0.6	-3.5	-2.8	1.1	1.4	1.2	0.8	0.3
Equivalent Yields - % at end year									**Change pp**
Retail	5.7	6.1	6.7	7.0	6.7	6.6	6.4	6.4	-0.4
Office	5.6	5.6	5.7	5.7	5.6	5.6	5.7	5.8	0.1
Industrial	5.3	5.3	5.3	5.0	4.9	4.9	5.1	5.3	-0.1
All Property	5.5	5.6	5.7	5.6	5.5	5.4	5.5	5.6	-0.2

*Forecast figures based on Q3 2020 quarterly valuations

The spread in performance between the sectors is currently at its widest with the sector performance divergence persisting over time. The covid-19 pandemic increased ecommerce and much of the increase in internet shopping will persist. The retail sector seeing values fall significantly before reaching a new level.

The all Property Total Returns for outturn for 2019 was 1.2% and losses are expected at the aggregate level in 2020 (-4.4%). Retail is forecast to post losses of -14.5% in 2020 with significant falls in values that has been more significant in shopping centres than elsewhere. Supermarkets in the retail space have performed better. The industrial sector will continue to outperform other sectors. The demand for logistics space from greater online shopping has supported the industrial sector. Continued investor demand for industrial assets has pushed yields down. We expect All Property Returns to recovery marginally in 2021 with a stronger return expect in 2022. On the whole the outlook is driven by the economic recovery and with interest rates remaining low any push upward on property yields is most unlikely to come from rising interest rates in the near term. The 5-year annualised total return for 2021-2025 is 4.4% per annum.

Rental falls are forecast in the near term for all sectors except industrial property.

3 PORTFOLIO STRATEGY AND FORECASTING

PORTFOLIO STRATEGY AND FORECASTING
Portfolio Strategy

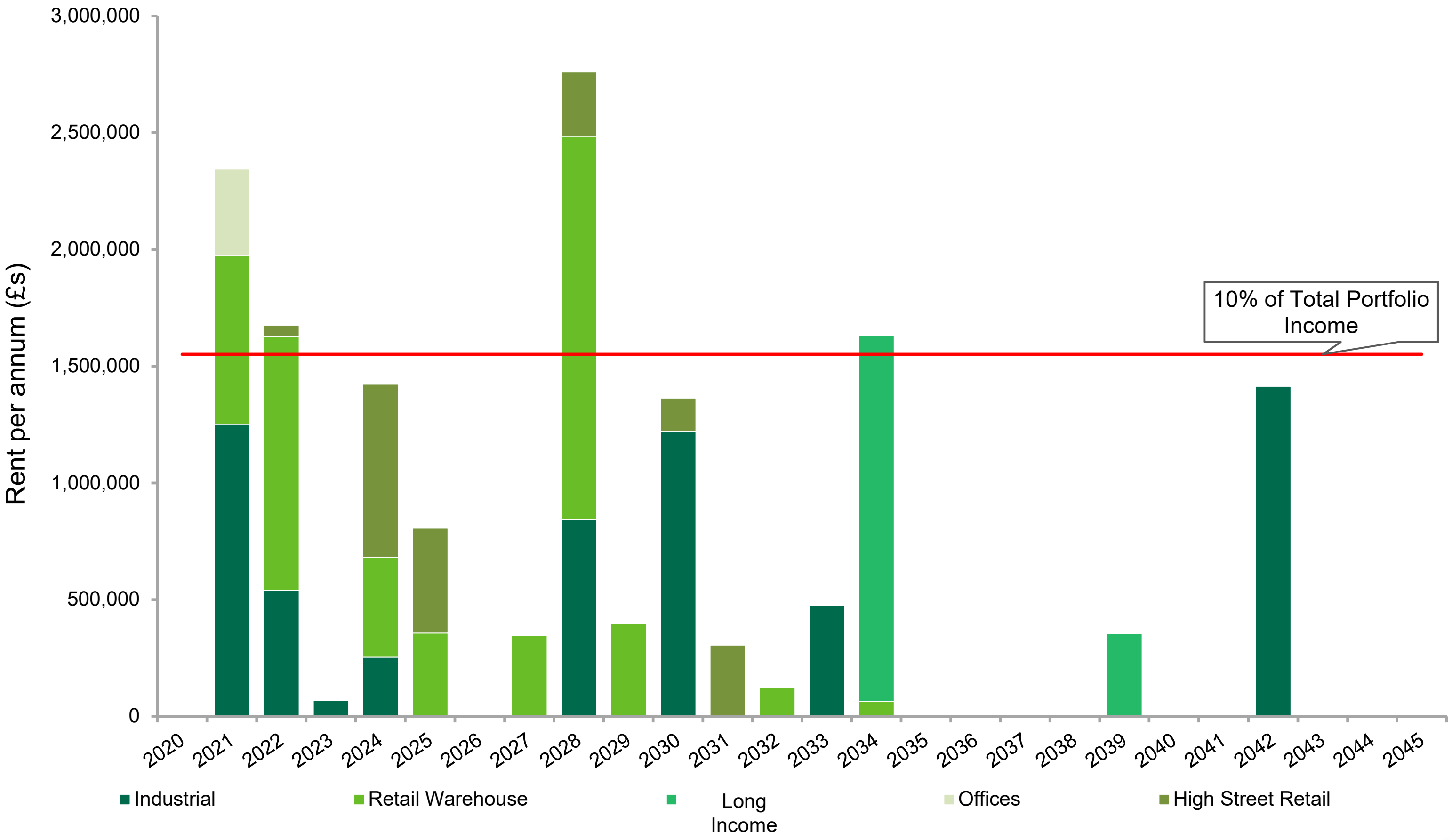
Top Down Strategy

- The Teesside Pension Fund was valued at £4.150bn in June 2020. The Direct Property Portfolio held by the Fund was valued at £268.52m (December 2020), equating to 6.5% of overall Fund value. The Fund's level of real estate exposure is generally considered underweight, when compared with similar pension funds.
- 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 strong. This will ensure that purchases are accretive to the portfolio's performance.
- As we continually assess all of the properties within the portfolio, we will also consider sales based on asset specific considerations.
- A key driver of the portfolio performance will continue to come from effective asset management of the existing stock to maximise rental income and extend lease lengths.
- A graph showing the expiry profile, per sector, is shown overleaf.

PORTFOLIO STRATEGY AND FORECASTING

Portfolio Strategy

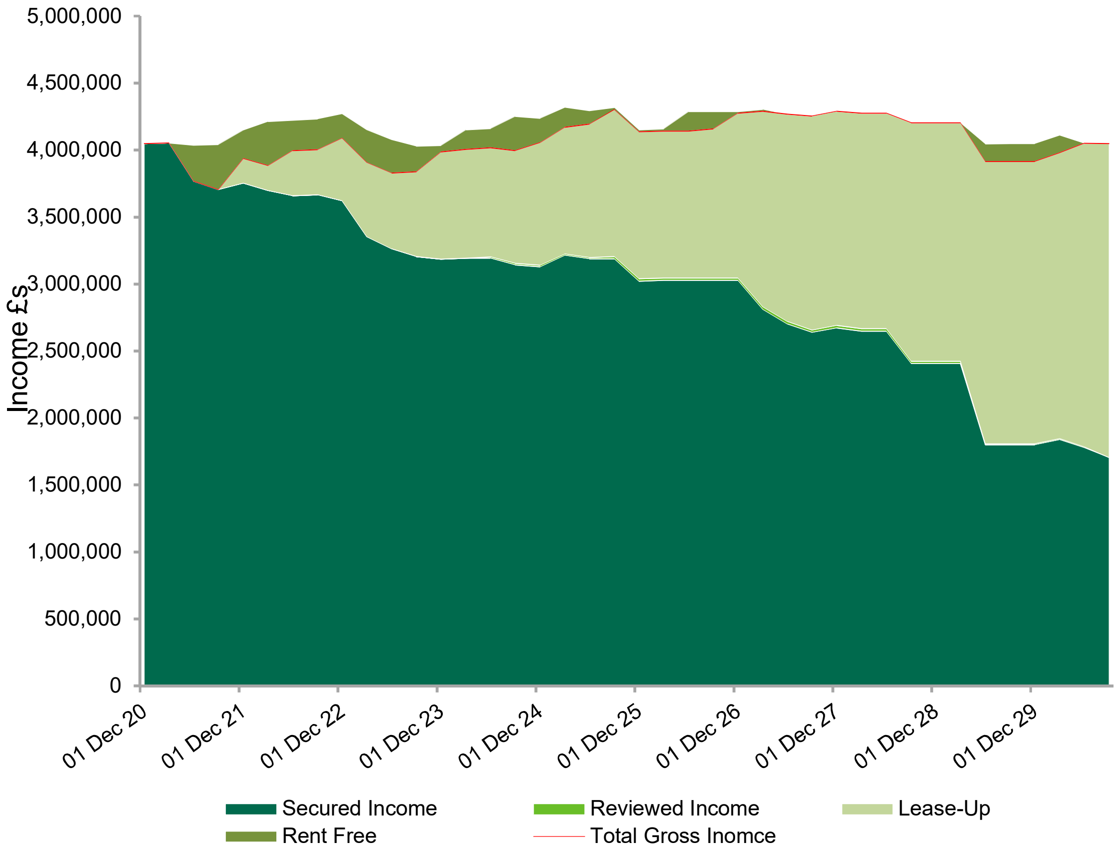
Lease Expiry Profile



PORTFOLIO POSITIONING AND FORECASTING

Portfolio Analysis

Existing Portfolio Income Profile



The income forecast includes our current rental growth projections. These have been adapted to reflect anticipated rental movement, based on the quality and sub-location of individual assets.

REGION	% OF PORTFOLIO CAPITAL VALUE
London	12.7%
South East	9.0%
South West	8.9%
East	6.0%
West Midlands	27.0%
North East	30.8%
North West	3.9%
Scotland	1.7%
Total	**100%**

SECTOR	% OF PORTFOLIO (Rental Value)
Industrial	39.1%
Retail Warehouse	33.3%
Long Income	12.4%
Offices	2.5%
High Street Retail	12.7%
Total	**100%**

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TOP 20 TENANTS (BY CURRENT RENT)

POSITION	TOP 20 TENANTS	TOTAL AREA	CURRENT RENT (£PA)	ERV (£PA)	% OF PORTFOLIO	NO. OF LEASES	FIRST LEASE EVENT
1	Omega Plc	320,815	£1,413,690	£1,400,000	8.69%	1	21 August 2042
2	Royal Mail Group Limited	207,572	£1,000,000	£1,000,000	6.15%	1	23 September 2030
3	B&Q plc	107,068	£997,000	£1,010,000	6.13%	2	31 January 2027
4	DHL Supply Chain Ltd.	146,138	£868,635	£875,000	5.34%	1	28 September 2021
5	Libra Textiles	129,952	£850,000	£780,000	5.23%	1	01 August 2034
6	Brunel Healthcare	136,342	£843,761	£680,000	5.19%	1	10 April 2028
7	ASDA Stores Limited	122,157	£755,000	£755,000	4.64%	1	25 December 2025
8	H&M	32,501	£740,000	£570,000	4.55%	1	23 June 2024
9	Tesco Stores Limited	25,084	£713,853	£570,000	4.39%	1	28 July 2034
10	Matalan Retail Limited	51,753	£500,000	£415,000	3.07%	1	27 November 2028
11	Halycon Fine Art Ltd	38,722	£475,000	£500,000	2.92%	1	22 December 2033
12	Barclays	18,833	£450,000	£410,000	2.77%	1	23 June 2025
13	Wickes Building Supplies Limited	28,338	£396,750	£385,000	2.44%	1	29 September 2028
14	DSG Retail Limited (t/a Currys/PC World)	25,000	£375,000	£315,000	2.31%	1	28 September 2022
15	B&M Retail Limited (t/a B&M Homestore)	25,000	£375,000	£315,000	2.31%	1	28 September 2022
16	Institute of Cancer Research	9,502	£371,420	£371,420	2.28%	1	17 February 2021
17	Nuffield Health	26,458	£354,715	£331,000	2.18%	1	04 April 2039
18	Pets at Home Ltd	15,577	£325,825	£242,500	2.00%	2	05 January 2024
19	Aurum Group Limited	1,440	£305,000	£282,000	1.88%	1	01 March 2031
20	River Island Clothing Co Ltd	1,270	£275,000	£195,000	1.69%	1	30 November 2028
	TOTAL	**1,469522**	**£12,385,649**	**£11,401,9204**	**76.1%**	**22**	

4 PORTFOLIO ACTIVITY

PORTFOLIO ACTIVITY

ASSET MANAGEMENT COMMENTARY

LUTTERWORTH, MAGNA PARK

February 2021

A new 10-year reversionary lease has been completed with ASDA, the sitting tenant, at a rent of £755,000 pax, an increase of 14%. This Lease completed 12th February 2021.

BIRMINGHAM, BROMFORD CENTRAL

January 2021

The Fund has agreed terms with a new tenant at Unit 4, Bromford Central. The Lease reflects a 10-year term with a tenant only break in the 5th anniversary of the Lease. Agreed at a rent of £110,461 pax, in-line with the current unit valuation. Solicitors have been appointed to complete the letting.

CIRENCESTER, UNIT 1

December 2020

Terms have been agreed with a gym operator to take the vacant unit at Cirencester Retail Park. The Lease is for a 15 year term with a tenant break option on the 10th anniversary. Solicitors are currently appointed to complete the letting.

READING, ACRE ROAD

February 2021

Terms are close to being agreed with a national logistics operator to let Unit 2 Acre Road, currently vacant. The lease will reflect a 10-year term with a tenant only break option on the 5th anniversary. It is anticipated terms will be agreed by March 2021. The unit will also benefit from a planned external respray of the paintwork, modernising the estate.

CBRE

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