Agenda Item 10

CBRE

TEESSIDE PENSION FUND Q1 2020

Quarterly Report
Prepared: 28th May 2021

Fund Objectives

Teesside's Pension Fund's primary objective is to create a sustainable income stream to match its long term pension liabilities. It does this through investing into 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/core plus properties, over the long term, diversifying the portfolio through different property types, unit sizes, occupier businesses, quality, 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 under weight position in offices.

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

Individual assets will be well suited to the current occupational market, whilst offering future flexibility. Properties will be leased to good quality businesses on institutional lease terms together with some index linked assets.

Responsible Investment

In line with Teesside's Pension Fund's Responsible Investment Policy, CBRE considers Environmental, Social and Governance issues (otherwise known as ESG criteria) as part of its decision making process.

Executive Summary

At 31st March 2021, the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £277.20m. This reflects an overall Net Initial Yield of 5.28%, and an Equivalent Yield of 5.69%.

The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 87.0% of the portfolio by capital value. There are 75 demises and a total net lettable area of 1,949,442 sq ft.

The portfolio has a current gross passing rent of £16,126,215 per annum against a gross market rent of £16,512,145 per annum, making the portfolio slightly reversionary in nature.

The weighted average unexpired term is 8.0 years to the earlier of first break or expiry, and 8.9 years to expiry, ignoring break dates.

Fund Summary

Total Pension Fund Value (December 2020)	**£4,385m**
Real Estate Weighting (allocation)	6% (9%)
Direct Portfolio Value	£277.2m

Direct Portfolio

	TEESSIDE PF
Direct portfolio value	**£277.2m**
Number of holdings	28
Average lot size	£9.9m
Number of demises	75
Void rate (% of ERV) (Benchmark)	1.78% (11.90%)
WAULT to expiry (break)	8.0 years (8.9 years)
Current Gross Passing Rent (Per Annum)	£16,126,215
Current Gross Market Rent (Per Annum)	£16,512,145
Net Initial Yield	5.28%
Reversionary Yield	5.58%
Equivalent Yield	5.69%

Portfolio Highlight (Q1 2021)

The Fund has completed the purchase of an income strip as a liability matching asset. This is focussed on the forward funding of the development of a 210,000 sq ft industrial unit. Purchased for £30.0m reflecting 5.24% NIY.

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UK Economic Commentary

- Growth of 0.4% in GDP during February reversed some of January's 2.2% fall in activity: a result of the implementation of tougher restrictions in England and Wales. While the outlook is improving and positive the UK economy is sitting around 8% below its pre-Covid level. High frequency leading indicators pointed to continued increases in activity in March, with credit and debit card spending and job advertisements trending notably higher. Coupled with the reopening of schools on 8 March (which will have also boosted activity) we expect Q1's GDP fall to be have been just 2% quarter-on-quarter; a fraction of the 19% quarter-on-quarter fall seen in the first lockdown in Q2 2020.

- First, if all goes well with the vaccine roll-out and the emergence of vaccine-resistant variants does not become an issue, the government's roadmap for relaxing restrictions should remain set: a large part of the economy will have re-opened by mid-May, with the remaining restrictions gone by late June. The UK's economic performance is heavily dependent on consumer-facing service spending and rules relaxation will unlock considerable service spending.

- Second, continued restrictions on spending and travel mean households have accumulated unanticipated savings of around £150bn, or 7% of 2020 UK GDP. This means household spending will be a support to the recovery once restrictions are lifted. However, higher-income households will have saved more and typically have a lower propensity to spend but we do expect some of these savings to be spent.

- Third, the government extended the Job Retention Scheme (furlough) until the autumn, beyond the lifting of restrictions. Because of this we now expect unemployment to peak below 6 per cent, severely reducing joblessness and protecting household incomes that will support the recovery.

- We therefore remain optimistic about the UK outlook for the rest of the year. Taken together, we expect GDP growth of 6% in Q2 and 6.7% for 2021 as a whole. This is considerably higher than our 4.2% forecast for the Euro Area which is wrestling with another wave of Covid-19 infections.

UK Real Estate Market Commentary

- Year on year total returns for All UK Property fell by -0.8% (-6.7%* capital return, 6.3%* income return) for the period Q1 2020 to Q1 2021**. 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 Q1 2021 recorded 2.1% (0.7% capital return, 1.4% income return).

- Industrials total returns were 5.8% over Q1 2021 (4.6% capital return, 1.1% income return).

- Rental values for All UK Property increased by 0.1% over the first quarter of 2021. This figure was largely pulled up by the 1.4% rise in values in the Industrial sector. Office sector rents rose marginally at 0.2% over the quarter while Retail rents fell -1.0%.

- The investment market for UK commercial real estate reached volumes of £10.9bn in Q1 2021. Investment totals were similar to the same period last year (c. £10bn) if large £500m+ transactions are excluded from the quarterly volumes. This brings the 12-month rolling total to £39.2bn, the lowest level since 2013 Q1.

- International investors were responsible for over half the capital invested into UK commercial real estate in Q1, above the 10-year quarterly average of 43%. The easing of global travel restrictions boosted international investment from 32% in Q2 and Q3 2020, to 52% in 2020 Q4 and 2021 Q1.

- Office investment volumes were £2.3bn in 2021 Q1. This brought the 12-month rolling total to £11.8bn, nearly half the five-year average of £21.6bn. Central London office transactions totalled £1.3bn in Q1, bringing volumes for the last 12 months to £7.2bn, the lowest levels since 2009 Q4.

- The industrial sector had another strong quarter, with £3.5bn of deals transacting in Q1. This pushed volumes to £11.2bn over the last 12 months, making it the only sector with volumes above the five-year average (£8.3bn).

- Retail saw just over £1.0bn in transactions in Q1, which was similar to volumes seen in 2020 Q1.

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

** Based on CBRE Monthly Index, all property total returns March 2021

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Investments

Sales

No sales this period.

Acquisitions

The Fund has completed the purchase of an income strip as a liability matching asset. This is focussed on the forward funding of the development of a 210,000 sq ft industrial unit. Purchased for £30.0m reflecting 5.24% NIY. The unit will be let to Leonardo UK Limited on a 35-year lease, with fixed annual uplifts. There is an option to purchase the asset in favour of the tenant at lease expiry.

Direct Portfolio Analysis

Top Ten Holdings (by Value)

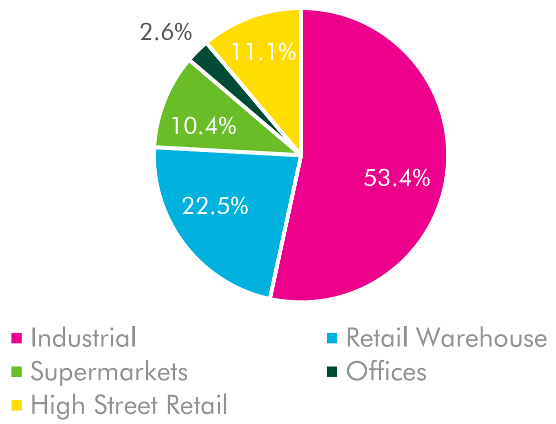
No.	Asset	Sector	Value	% of Direct Portfolio
1	THORNE - Capitol Park	Industrial	£30,350,000	10.9%
2	GATESHEAD - Team Valley	Industrial	£20,500,000	7.4%
3	BIRMINGHAM - Bromford Central	Industrial	£18,150,000	6.5%
4	RUGBY - Valley Park	Industrial	£17,250,000	6.2%
5	LUTTERWORTH - Magna Park	Industrial	£15,700,000	5.7%
6	STOW-ON-THE-WOLD - Fosse Way	Supermarkets	£15,175,000	5.5%
7	EXETER - H&M High Street	High Street Retail	£13,900,000	5.0%
8	PARK ROYAL - Minerva Road	Industrial	£13,600,000	4.9%
9	SWADLINCOTE - WILLIAM NADIN WAY	Industrial	£12,650,000	4.6%
10	PARK ROYAL - Coronation Road	Industrial	£11,700,000	4.2%
		Total	**£168,975,00**	**61%**

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

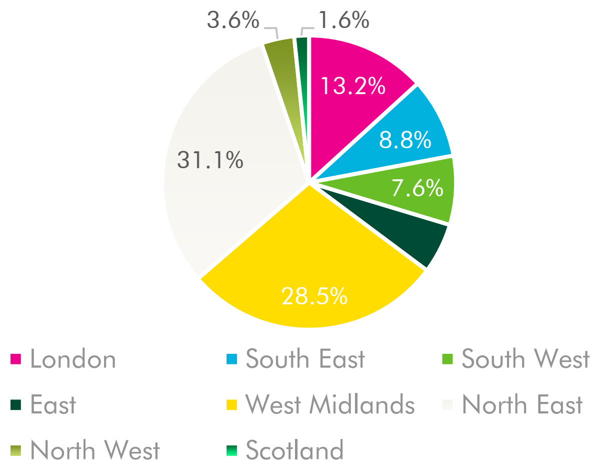
In addition to recommendations on industrial purchases, we may also recommend alternative and long-let investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure, supermarkets and student housing.

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.

Sector Allocation (by Value)



Geographical Allocation (by Value)



Direct Portfolio Analysis (continued)

Top Ten Tenants (by Contracted Income)

The portfolio currently has 75 different demises let to 69 tenants. The largest tenant is Omega Plc which accounts for c.8% of the annual contracted income. Experian currently lists Omega as representing a "Very Low Risk" of business failure.

As a significant portion of the portfolio income will be from the top ten tenants, we will monitor their covenant strength and flag any potential issues. This is particularly relevant at the current time as the Covid-19 pandemic is putting increased pressure on all businesses. Our most recent assessment shows that all of these tenants are classed as having a "low risk" of business failure.

Top Ten Tenants (by Contracted Rent)

#	Tenant	Sector	Number of Leases	Gross Contracted Rent	% of Portfolio Rent	Risk Rating (Experian)
1	Omega Plc	Industrial	1	£1,413,690	8.42%	Very Low Risk
2	Royal Mail Group Limited	Industrial	1	£1,040,000	6.19%	Very Low Risk
3	B&Q plc	Retail	2	£997,000	5.94%	Very Low Risk
4	DHL Supply Chain Ltd.	Industrial	1	£868,635	5.17%	Very Low Risk
5	Brunel Healthcare	Industrial	1	£843,761	5.03%	Very Low Risk
6	Libra Textiles	Retail	1	£762,500	4.54%	Very Low Risk
7	ASDA Stores Limited	Industrial	1	£755,000	4.50%	Very Low Risk
8	H&M	Industrial	1	£740,000	4.41%	Very Low Risk
9	Tesco Stores Limited	Supermarkets	1	£713,853	4.25%	Very Low Risk
10	Matalan Retail Limited	Retail	1	£500,000	2.98%	Very Low Risk
			Total	£8,634,439	51%	

Key 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 below graph identifies the years where more than 10% of the portfolio income is due to expire.

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 Funds strategy. Whilst many of these have not progressed quickly we are optimistic that we may gain traction over the next few weeks as investors begin to consider their strategies and start making decisions. TPF's requirement has been articulated to the market and we are still receiving a substantial number of investment ideas each week.

Asset Management Update

Halfords, Congleton – May 2021

The Fund completed a 5-year reversionary lease with Halfords at a rent of £79,650 per annum, including a tenant only break option on the 3rd anniversary of the reversionary lease.

Speedy Assets, Park Royal – May 2021

A new 10-year lease with Speedy Assets has been completed reflecting a rent of £310,700 per annum, an uplift in rent passing of 27%. The lease does not benefit from any rent free and will include a tenant only break option on the 5th anniversary.

Acre Road, Reading – March 2021

Terms have been agreed with Active PCB, an existing occupier of Unit C on the estate, to take a new 10-year lease on both Unit B and Unit C.

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.

Bromford Central, Birmingham – February 2021

The Fund completed a new 10-year lease on Unit 4 of the estate, 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.

Unit 1, Cirencester – December 2020

Terms have been agreed with a gym operator to occupy 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.

Portfolio Arrears Update

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 29 September	Collectable Rent	Quarter Date up to and including 25/03/21	Week 1 up to and including 01/04/2021	Week 2 up to and including 08/04/2021	Week 3 up to and including 15/04/2021	Week 4 up to and including 22/04/2021	Payment after 22/04/2021	Difference
	4,093,094.53	4,093,094.53	2,520,598.41	142,714.62	78,195.00	24,060.10	241,314.00	681,461.63	404,750.77
Non Collectable Total		0.00							
Collections Including non collectables			61.58%	65.07%	66.98%	67.57%	73.46%	90.11%	
Collections Excluding non collectables			61.58%	65.07%	66.98%	67.57%	73.46%	90.11%	

Portfolio Arrears Update – 28th May 2021

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

March 2021 – 90.1%

December 2020 – 88.4%

September 2020- 95.1%

The total Collectable Arrears on the entire portfolio is £1,531,781 as at 28th May.

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 six tenants with the greatest arrears, which account for 76.5% (£1,171,161) of the total arrears:

River Island Clothing Co. Limited (Lincoln) – Total arrears of £332,453 (21.7% of the collectable arrears). A new lease backdated lease is being finalised to River Island Fashion Limited, due to commence on 7 July 2020. This will see most of the arrears cleared.

Halcyon Fine Art Group Holding Limited (Park Royal) – Total arrears of £305,902 (20.0% 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. The tenant has paid £258,000 and agreed they will pay the arrears off at £50,000 per week.

Nuffield Health (Guildford) – Total arrears of £219,949 (14.4% 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 only paid one third's instalment. There are also some insurance and head landlord service charges outstanding. Discussions with the tenant have been initiated.

Matalan Retail Limited (Northwich) – Total arrears of £157,844 (10.3% of the collectable arrears). These arrears relate mainly to the March 2021 quarter's rent and annual insurance premium, to which Matalan have made no payments towards. We are continuing to chase. Communications with the tenant are on-going.

Sportsdirect.com Retail Limited (Cirencester) – Total arrears of £155,013 (10.1% 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 June 2021 (15-months), plus service charge and insurance premium. No payments have been received at all since 2nd March 2020. There has been no response from the tenant.

The remaining £560,621 (23.5% of the collectable arrears) of arrears is spread across 56 tenants, ranging from £50,902 to £.01.

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 relevant of each of the ESG factors below. These will be expanded upon with portfolio level principles and asset specific initiatives as the importance of ESG grows.

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

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

Governance - market participants will increasingly question the governance and management practices of their partners and supply chain. Rigorous standards will mean businesses will need to become more transparent and engage with their stakeholders to ensure access to the best opportunities.

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