Agenda Item 9

CBRE

TEESSIDE PENSION FUND
Q2 2020

Quarterly Report
Prepared: 7th September 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, 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 (Valuation)

At 30th June 2021, the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £280.63m. This reflects an overall Net Initial Yield of 5.19%, and an Equivalent Yield of 5.60%.

The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 87.3% 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 £16,124,049 per annum against a gross market rent of £16,472,145 per annum, making the portfolio slightly reversionary in nature.

The weighted average unexpired term is 7.9 years to the earlier of first break or expiry, and 8.8 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	£280.63m

Direct Portfolio

Direct portfolio value	**£280.63m**
Number of holdings	28
Average lot size	£10.02m
Number of demises	75
Void rate (% of ERV) (Benchmark)	1.5% (8.0%)
WAULT to expiry (break)	8.8 years (7.9 years)
Current Gross Passing Rent (Per Annum)	£16,124,049
Current Gross Market Rent (Per Annum)	£16,472,145
Net Initial Yield	5.19%
Reversionary Yield	5.50%
Equivalent Yield	5.60%

Portfolio Highlight (Q2 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.

UK Economic Commentary

- *Rising Covid-19 (Delta variant) cases, global supply chain disruptions and labour shortages are weighing on activity in the third quarter. That said, we expect these to subside as the vaccination programme progresses and the furlough scheme unwinds at the end of September. We remain optimistic that GDP will return to its pre-pandemic level in Q4 of this year.*

- The recent wave of Covid-19 cases (mostly delta variant) was a reminder that we have not yet achieved the vaccination levels required to stop mass transmission. Rising cases feeding into hospitalisations has lessened but evidence suggests that consumer confidence can be hit by rising cases. This may slow the return to normal patterns of leisure spending which is why it is a key potential downside risk being monitored.

- This is evident in retail sales. Retail sales volumes fell by 2.5% between June and July. While some of this reflects changing consumption patterns following the reopening of services, consumer spending more broadly was flat during July suggesting this is likely concerns around rising Covid-19 case numbers.

- Internet sales as a percentage of total retail sales increased by 0.7pp in July to 27.9%. The proportion of internet sales has continued to fall as shops have reopened but remains well above end-2019 levels.

- Overall, individuals borrowed no additional credit and continued to accumulate cash in July at a faster rate than before Covid-19, taking “excess savings” to 176bn, or 8.3% of 2020 GDP.

- The end of the furlough scheme has been timed about right. Demand for labour is strong and we expect that the end of the furlough scheme will allow most to either return to their job or to find new work.

- The UK is experiencing a spike in inflation. Supply chain issues and increased spending are contributing to this, but are mainly transitory elements. Also this is largely the result of base effects whereby current prices are being compared with the depressed prices a year. As this is likely to be only a temporary spike in inflation, we expect the Bank of England to keep interest rates on hold for the next few years.

- Long-term interest rates are expected to drift upwards from the very low levels seen during the pandemic, but we see the UK remaining in a low interest rate environment for the coming years, which remains favourable to property markets.

UK Real Estate Market Commentary

- Year on year total returns for All UK Property grew by 7.4% (1.1%* capital return, 6.2%* income return) for the period Q2 2020 to Q2 2021**. This returns figure is above the 5 year average and marks a strong bounce back after the negative returns of the previous 12 month period.

- Quarterly total returns for All UK Property for Q2 2021 recorded 3.2% (1.8% capital return, 1.3% income return).

- Industrials total returns were 7.0% over Q2 2021 (5.9% capital return, 1.1% income return).

- Rental values for All UK Property increased by 0.2% over the second quarter of 2021. This figure was largely pulled up by the 1.5% rise in values in the Industrial sector. Office sector rents fell marginally by -0.2% over the quarter while Retail rents fell -0.7%.

- The investment market for UK commercial real estate reached volumes of £13.9bn in Q2 2021. This brings the half year total to nearly £25bn. International investors were responsible for over half the capital invested into UK commercial real estate for the third consecutive quarter.

- The Central London office market saw £2.7bn of transactions complete in Q2, close to average quarterly volumes in 2019 (£2.8bn). This activity was driven by large £100m+ transactions, which accounted for almost 90% of the market volumes. Q2 also saw the largest transaction in this market since 2019 Q1, with the £635m sale of 30 Fenchurch Street.

- Regional Office volumes were £2.4bn in 2021 Q2, boosted by the £730m sale of 36 Arlington assets to Brookfield. Over the last 12 months, regional office sales reached £6.5bn.

- Industrial volumes reached £3.9bn in Q2, bringing the 12-month rolling total to an all-time high of £14.3bn.

- Retail saw £1.3bn in transactions in Q2, bringing the 12-month rolling total to £5.2bn (the highest total since 2019 Q2).

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

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

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. Construction started on-site in the first week of August.

Direct Portfolio Analysis

Top Ten Holdings (by Value)

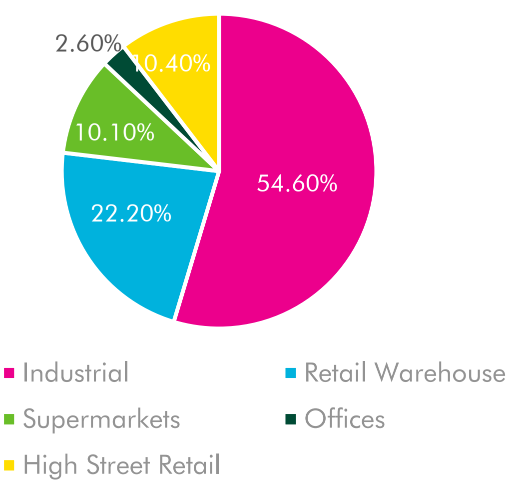
No.	Asset	Sector	Value	% of Direct Portfolio
1	THORNE - Capitol Park	Industrial	£32,150,000	11.5%
2	GATESHEAD - Team Valley	Industrial	£21,000,000	7.5%
3	BIRMINGHAM - Bromford Central	Industrial	£18,150,000	6.5%
4	RUGBY - Valley Park	Industrial	£17,250,000	6.1%
5	LUTTERWORTH - Magna Park	Industrial	£16,650,000	5.9%
6	STOW-ON-THE-WOLD - Fosse Way	Supermarkets	£15,175,000	5.4%
7	PARK ROYAL - Minerva Road	Industrial	£14,500,000	5.2%
8	SWADLINCOTE - WILLIAM NADIN WAY	Industrial	£13,175,000	4.7%
9	EXETER - H&M High Street	High Street Retail	£13,100,000	4.7%
10	PARK ROYAL - Coronation Road	Industrial	£12,300,000	4.4%
		Total	**£168,975,00**	**61.8%**

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

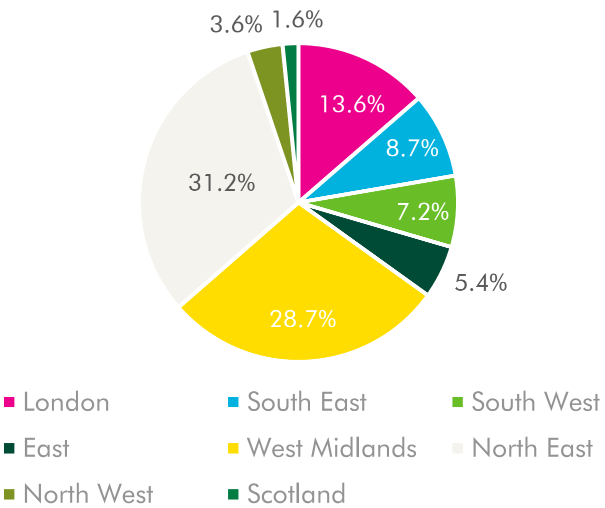
In addition to recommendations on industrial purchases, we may also recommend alternative and long-let investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure, supermarkets and student housing.

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 65 tenants. The largest tenant is Omega Plc which accounts for c.8.4% of the annual contracted income. Experian currently lists Omega as representing a "Very Low Risk" of business failure.

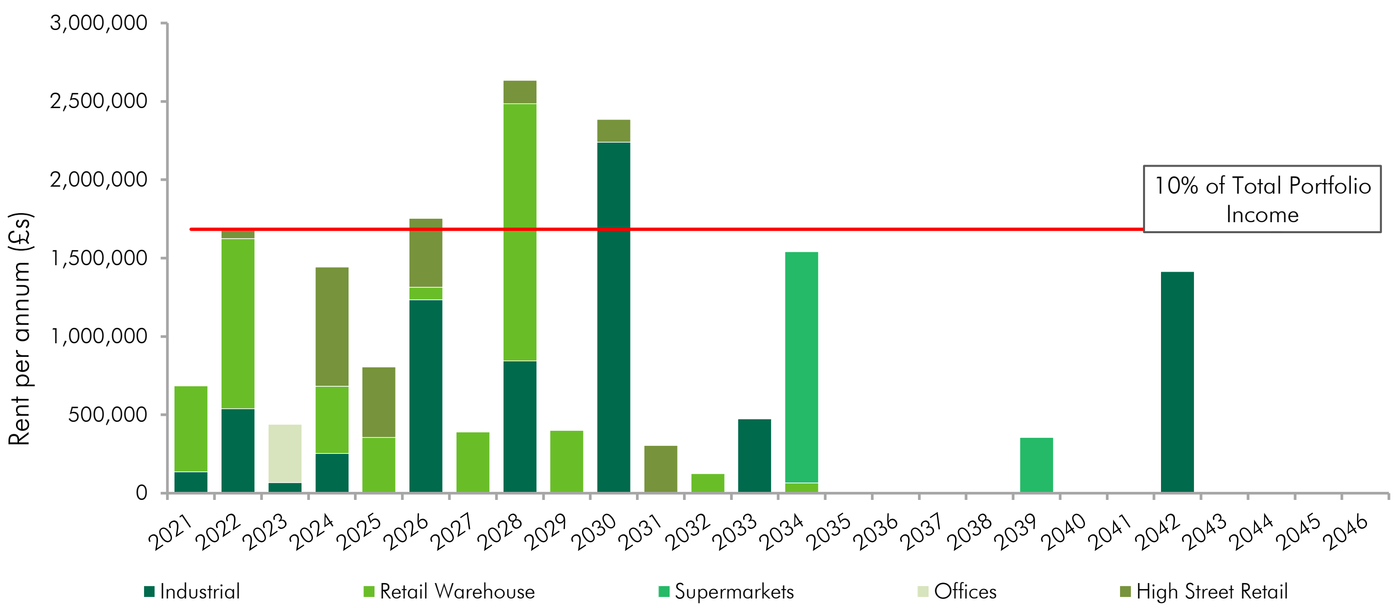
As a significant portion of the portfolio income will be from the top ten tenants, we will monitor their covenant strength and flag any potential issues. This is particularly relevant at the current time as the Covid-19 pandemic is putting increased pressure on all businesses. Our most recent assessment 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	8.39%	Very Low Risk
2	Royal Mail Group Limited	Industrial	1	£1,040,000	6.17%	Very Low Risk
3	B&Q plc	Retail	2	£997,000	5.92%	Very Low Risk
4	DHL Supply Chain Ltd.	Industrial	1	£868,635	5.16%	Very Low Risk
5	Brunel Healthcare	Industrial	1	£843,761	5.01%	Very Low Risk
6	Libra Textiles	Retail	1	£762,500	4.53%	Very Low Risk
7	ASDA Stores Limited	Industrial	1	£755,000	4.48%	Very Low Risk
8	H&M	Industrial	1	£740,000	4.39%	Very Low Risk
9	Tesco Stores Limited	Supermarkets	1	£713,853	4.24%	Very Low Risk
10	Matalan Retail Limited	Retail	1	£500,000	2.97%	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

Unit 1, Cirencester – June 2021

The Fund has completed a new 15-year lease to PureGym at Cirencester Retail Park. The lease reflects a passing rent of £125,000 per annum benefits from 5-yearly RPI linked rent reviews with a tenant break option on the 10th anniversary.

Unit 2, Cirencester – July 2021

The Fund has surrendered the lease for Peacock stores at Cirencester and subsequently agreed a new lease with Hobbycraft for a new 10-year lease with a tenant only break option on the 5th anniversary. The lease is in solicitors hand and due to complete in September.

Acre Road, Reading – June 2021

The Fund has completed a new 10 year lease to Active PCB, an existing occupier of Unit C on the estate; Active PCB will take a lease on Unit B & C. Both leases reflects a total rent of £226,000 per annum, an uplift in passing rent of 9% on Unit C.

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.

Halfords, Dorchester – April 2021

The Fund completed a 5-year reversionary lease with Halfords at a rent of £111,282 per annum.

Royal Mail, Gateshead – March 2021

The Fund has instructed a rent review surveyor to settle the September 2020 outstanding rent review. An uplift in passing rent is anticipated to be agreed.

Portfolio Arrears Update

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 24 June	Collectable Rent	Quarter Date up to and including 24/06/2021	Week 1 up to and including 01/07/2021	Week 2 up to and including 08/07/2021	Week 3 up to and including 15/07/2021	Week 4 up to and including 22/07/2021	Payment after 22/07/2021	Difference
	4,396,245.79	4,396,245.79	2,602,962.77	246,262.02	254,053.36	39,299.83	0.00	331,302.10	922,365.71
Non Collectable Total		0.00							
Collections Including non collectables			59.21%	64.81%	70.59%	71.48%	71.48%	79.02%	
Collections Excluding non collectables			59.21%	64.81%	70.59%	71.48%	71.48%	79.02%	

teesside pension fund

Portfolio Arrears Update – 1st September 2021

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

June 2021 – 79.0%

March 2021 – 94.0%

December 2020 – 91.3%

The total Collectable Arrears on the entire portfolio is £2,066,973 as at 1st September.

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 62.5% (£1,292,521) of the total arrears:

Matalan Retail Limited (Northwich) – Total arrears of £300,445 (14.5% of the collectable arrears). These arrears relate mainly to the March and June 2021 quarter's rent, to which Matalan have made no payments towards.

Nuffield Health (Guildford) – Total arrears of £269,593 (13.0% of collectable arrears). These relate mainly to the June 2020 rent (where they paid zero) plus December 2020 and June 2021 quarters (where they have only paid about one third).

Halcyon Fine Art Group Holding Limited (Park Royal) – Total arrears of £210,986 (10.2% of the collectable arrears). Most of these arrears relate to a back dated rent review increase going back to 2018. Covid concessions have been granted and legal notice has been served on the previous tenant. The tenant is currently adhering to their payment plan and reducing their arrears.

Libra Textiles Limited (Rotherham) - Total arrears of £210,000 (10.2% of the collectable arrears). This relates solely to part of their June 2021 quarterly rent where a side letter has been agreed. This sum will be repaid under three instalments on 29 September 2021, 25 December 2021 and 25 March 2022.

Sportsdirect.com Retail Limited (Cirencester) – Total arrears of £185,336 (9.0% 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 September 2021 (18-months), plus service charge and insurance premium. No payments have been received at all since 2nd March 2020.

Saint Gobain Building distribution Limited (Bromford Central) - Total arrears of £116,161 (5.6% of the collectable arrears). These arrears are spread across their two leases and relate mainly to a back dated rental uplift. We are liaising with the tenant over payment.

The remaining £774,452 (37.5% of the collectable arrears) of arrears is spread across 57 tenants, ranging from £77,380 to £100.

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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