Agenda Item 9

CBRE

TEESSIDE PENSION FUND Q3 2021

Quarterly Report

Prepared: 24th November 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 September 2021, the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £288.35m. This reflects an overall Net Initial Yield of 5.09%, and an Equivalent Yield of 5.51%.

The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 90.2% 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 £16,174,042 per annum against a gross market rent of £16,549,145 per annum, making the portfolio slightly reversionary in nature.

The weighted average unexpired term is 7.8 years to the earlier of first break or expiry, and 8.7 years to expiry, ignoring break dates.

Fund Summary

Total Pension Fund Value (June 2021)	**£4,705m**
Real Estate Weighting (allocation)	6% (9%)
Direct Portfolio Value	£288.35

Direct Portfolio

Direct portfolio value (September 2021)	**£288.35m**
Number of holdings	28
Average lot size	£10.30m
Number of demises	75
Void rate (% of ERV) (Estimated UK Benchmark)	1.65% (7.0% – 9.0%)
WAULT to expiry (break)	8.7 years (7.8 years)
Current Gross Passing Rent (Per Annum)	£16,174,042
Current Gross Market Rent (Per Annum)	£16,549,145
Net Initial Yield	5.09%
Reversionary Yield	4.53%
Equivalent Yield	5.51%

Portfolio Highlight (Q3 2021)

The Fund has completed two new lettings at Cirencester Retail Park to Hobbycraft and PureGym. These leasing transactions have reduced the Park's vacancy rate to 0% and increased the total rent by 36.3% (+£188,190 p.a).

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UK Economic Commentary

- We expect economic recovery to continue despite the headwinds. We are forecasting real GDP growth of 6.9% in 2021 and 5% in 2022.
- We believe that supply bottlenecks and rising energy prices will continue to put upward pressure on inflation, with inflation remaining elevated throughout the first half of 2022 before returning towards 2 per cent in the second half of 2022.
- HMRC data show the UK added a net 160,000 payroll jobs in October - despite the end of furlough scheme - with total number of jobs now 235,000 higher than pre-Covid level (Feb 2020).
- The headline UK unemployment rate (3m average) fell from 4.5% in August to 4.3% in September, with the single-month estimate for September just 3.9%. This appears to be real - i.e., driven by higher employment, not people dropping out of the labour market.
- A strong labour market release and increasing inflation increases the likelihood of an earlier interest rate rise. While the Bank of England has communicated that it is concerned about expectations of future inflation and stands ready to raise interest rates, the CBRE view is that the Bank of England will raise Bank Rate in the middle of next year.
- Long-term interest rates have drifted up from the very low levels seen at the height of the pandemic but remain low by historical standards. We expect that they will continue to rise, reaching 1.4 per cent by end-22. We expect that this will have very little impact on prime property pricing.

UK Real Estate Market Commentary

- Year on year total returns for All UK Property grew by 12.5% (6.5%* capital return, 5.6%* income return) for the period Q3 2020 to Q3 2021**. This returns figure is above the 5 year average and marks a strong bounce back after the negative returns recorded during 2020.
- Quarterly total returns for All UK Property for Q3 2021 recorded 5.1% (3.8% capital return, 1.3% income return).
- Industrials total returns were 8.6% over Q3 2021 (7.5% capital return, 1.0% income return).
- Rental values for All UK Property increased by 0.6% over the third quarter of 2021. This figure was largely pulled up by the 1.7% rise in values in the Industrial sector. Both Office and Retail sector rents rose marginally by 0.1% over the quarter.
- The investment market for UK commercial real estate reached volumes of £13.2bn in Q3 2021. This brings the YTD total to nearly £38bn. This quarter saw the £1.7bn acquisition of ASDA's distribution centres by Blackstone, the largest deal of the year so far.
- The Central London office market saw £2.3bn of transactions complete in Q3. Nearly two thirds of this total was attributed to overseas investors, with three of the five largest deals being bought by Asian investors.
- Regional Office volumes were £1.9bn in 2021 Q3, bringing YTD volumes to £5.3bn, already close to surpassing the £5.4bn seen in 2020 overall.
- Industrial volumes reached £3.9bn in Q3, matching Q2's total and bringing the 12-month rolling total to an all-time high of £16.5bn.
- Retail saw £1.3bn in transactions in Q3, bringing the 12-month rolling total to £5.5bn (the highest total since 2019 Q1).

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

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

Investments

Sales

No sales this period.

Acquisitions

No acquisitions this period.

Direct Portfolio Analysis

Top Ten Holdings (by Value)

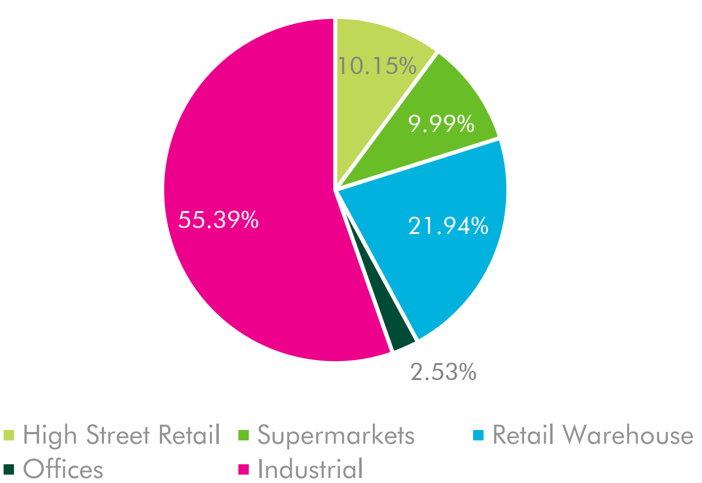
No.	Asset	Sector	Value	% of Direct Portfolio
1	THORNE - Capitol Park	Industrial	£34,200,000	11.9%
2	GATESHEAD - Team Valley	Industrial	£21,750,000	7.5%
3	BIRMINGHAM - Bromford Central	Industrial	£18,450,000	6.4%
4	LUTTERWORTH - Magna Park	Industrial	£17,700,000	6.1%
5	RUGBY - Valley Park	Industrial	£17,250,000	6.0%
6	STOW-ON-THE-WOLD - Fosse Way	Supermarkets	£15,300,000	5.3%
7	PARK ROYAL - Minerva Road	Industrial	£15,150,000	5.3%
8	SWADLINCOTE - William Nadin Way	Industrial	£13,600,000	4.7%
9	EXETER - H&M High Street	High Street Retail	£13,100,000	4.5%
10	PARK ROYAL - Coronation Road	Industrial	£12,800,000	4.4%
		Total	**£179,300,000**	**62.2%**

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

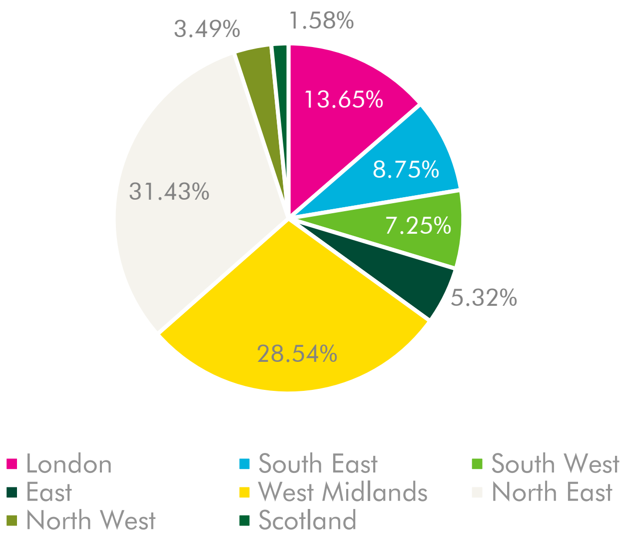
In addition to recommendations on industrial purchases, we may also recommend alternative and long-let investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure, supermarkets and student housing.

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 61 tenants. The largest tenant is Omega Plc which accounts for c.8.3% of the annual contracted income. Experian currently lists Omega as representing a "Very Low Risk" of business failure.

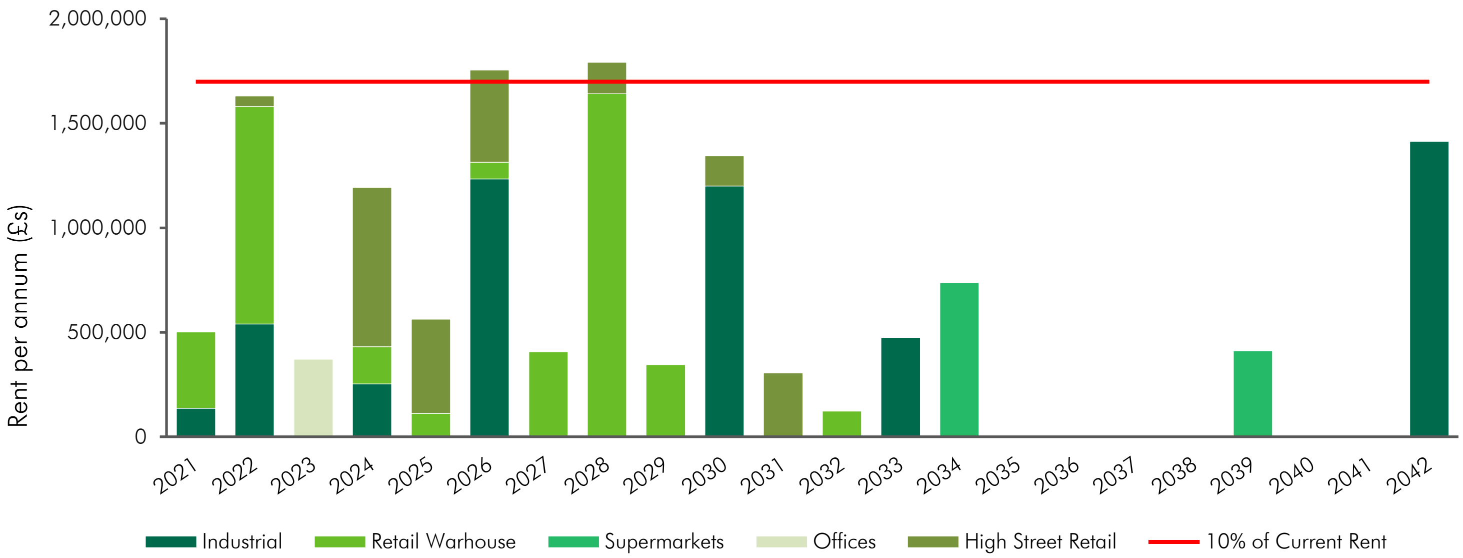
As a significant portion of the portfolio income will be from the top ten tenants, we will monitor their covenant strength and flag any potential issues. This is particularly relevant at the current time as the Covid-19 pandemic is putting increased pressure on all businesses. Our most recent assessment 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	8.3%	Very Low Risk
2	Royal Mail Group Limited	Industrial	1	£1,040,000	6.1%	Very Low Risk
3	B&Q plc	Retail	2	£997,000	5.9%	Very Low Risk
4	Unipart Logistics Limited	Industrial	1	£868,635	5.1%	Very Low Risk
5	Libra Textiles	Retail	1	£850,000	5.0%	Very Low Risk
6	Brunel Healthcare	Industrial	1	£843,761	5.0%	Very Low Risk
7	ASDA Stores Limited	Industrial	1	£755,000	4.4%	Very Low Risk
8	H&M	Retail	1	£740,000	4.4%	Very Low Risk
9	Tesco Stores Limited	Supermarkets	1	£737,823	4.3%	Very Low Risk
10	Matalan Retail Limited	Retail	1	£500,000	2.9%	Very Low Risk
			Total	£8,745,909	51.5%	

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 into the new year. 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

Pets at Home, Arbroath – October 2021

The Fund has agreed terms with Pets at Home for a 5-year reversionary lease reflecting £12.00 psf, a 5% increase in the Retail Park's estimated rental value.

Unit 2, Cirencester – September 2021

The Fund has surrendered the lease for Peacock stores at Cirencester and subsequently let the unit to Hobbycraft on a new 10-year term with a tenant only break option on the 5th anniversary. The store is now open and trading.

Harrow Green, Bromford Central – September 2021

The Tenant has indicated a willingness to renew their lease. We expect terms for this renewal to reflect those agreed on the completed lease at unit 4 of the estate.

Unipart, Rugby – August 2021

The Fund has instructed a rent review surveyor to settle the October 2021 rent review. An uplift in the passing rent is anticipated to be agreed.

Royal Mail, Gateshead – May 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 – 22nd November 2021

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 29 September	Collectable Rent	Quarter Date up to and including 29/09/2021	Week 1 up to and including 06/10/2021	Week 2 up to and including 13/10/2021	Week 3 up to and including 20/10/2021	Week 4 up to and including 27/10/2021	Payment after 27/10/2021	Difference
	4,194,954.74	4,194,954.74	2,509,472.12	438,681.56	37,589.76	115,635.12	69,600.00	289,035.73	734,940.45
Non Collectable Total		0.00							
Collections Including non collectables			59.82%	70.28%	71.17%	73.93%	75.59%	82.48%	
Collections Excluding non collectables			59.82%	70.28%	71.17%	73.93%	75.59%	82.48%	

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Portfolio Arrears Update – 22nd November 2021

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

September 2021 – 82.5%

June 2021 – 90.4%

March 2021 – 97.0%

The total Collectable Arrears on the entire portfolio is £1,892,102 as at 22nd November.

The Collectable Arrears exclude the following:

Tenants that are insolvent (99p Stores Limited at Cirencester, Peacocks Stores Limited at Cirencester, Laura Ashley Ltd at Congleton, Homestyle Group Operations Ltd at Congleton). Tenants that have overall credit balances on their accounts and tenants with recent charges raised within the last month

Below, is a summary of the top eight tenants with the greatest arrears, account for 64.3% (£1,216,653) of the total collectable arrears:

Nuffield Health (Guildford) – Total arrears of £310,717 (16.4% of collectable arrears). Nuffield continue to pay their quarterly rent on a monthly basis but have missed a number of payments. In 2021 they have currently paid one third for September, and two thirds of the June quarters rent. In 2020 they paid nothing towards their June rent and only paid one third of December's rent. They also have service charge and insurance outstanding.

Tesco Store Ltd (Stow on The Wold) – Total arrears of £214,235 (11.3% of collectable arrears). This relates solely to the September quarter rent, which the tenant is querying as the RPI rent increase is being finalised.

Libra Textiles Limited (Rotherham) – Total arrears of £174,900 (9.2% 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.

Matalan Retail Limited (Northwich) – Total arrears of £150,445 (8.0% of the collectable arrears). These arrears relate mainly to the March 2021 quarter's rent, to which Matalan have made no payments towards. We are continuing to chase.

Saint Gobain Building Distribution Limited (Bromford Central) – Total arrears of £132,395 (7.0% 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.

Harrow Green Ltd (Bromford Central) – Total arrears of £81,011 (4.3% of the collectable arrears). Most of these arrears relate to the September 2021 and June 2021 quarters rent, which the tenant has not yet paid anything towards. We have raised this with the tenant and is due to be paid imminently.

Toughglaze (UK) Ltd (Park Royal) – Total arrears of £77,352 (4.1% of the collectable arrears). The majority of this tenant's arrears relates to the June 2021 quarter's rent, which the tenant has not yet paid anything towards.

Shoe Zone Retail Ltd (Congleton) – Total arrears of £75,598 (4.0% of the collectable arrears). The majority of this tenant's arrears relates to the December 2020, June 2021 and September 2021 quarter's rent, which the tenant has not yet paid anything towards.

The remaining £675,450 (35.7% of the collectable arrears) of arrears is spread across 56 tenants, ranging from £69,317 to £25.

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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