DORSET COUNTY COUNCIL PENSION FUND

QUARTERLY REPORT Q3 2018

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1. EXECUTIVE SUMMARY: Q3 2018

MARKET OUTLOOK

- We are projecting UK property to deliver an average annual total return of 3.8% over the period 2019-23.
- Within this outlook, we expect modest All Property capital value falls in 2019/20 as a consequence of declining rents and weaker investor sentiment.
- In this environment good quality buildings in strong locations will prove most resilient.
- Attractive investment opportunities are likely to emerge from the coming uncertainty, so we should remain patient when deploying capital and focus on long-term sustainable income in the interim.

STRATEGY

You have confirmed that you would like to increase your allocation to property from 10% to 11% of total assets which represents approximately £330m. The new allocation of approximately £55m is to target Secure Long Income ("SLI"), beyond which the intention is to transition the portfolio gradually to a 50/50 split between Conventional properties and SLI.

With effect from 1st April 2018, the overall portfolio has been split into Conventional and SLI portfolios, each with distinct benchmarks. In this report, we provide you with an update on the two portfolios' in parallel.

VALUE

The Conventional portfolio was valued at the end of Q3 at £280.6m, comprising £240.4m of direct property and £40.2m of indirect assets. The SLI portfolio was valued at £29.9m.

The portfolio's overall value as at the end of Q3 was therefore £310.5m (90% Conventional/ 10% SLI), leaving approximately £19.5m remaining to invest to reach the target size of £330m.

PERFORMANCE

The Conventional portfolio underperformed over the quarter and 1 year to the end of September on account of the development in Cambridge. It continues to outperform the IPD Benchmark however over 3 and 5 years. The future prospects for the portfolio remain strong, with good quality properties and a favourable sector mix of low retail and high industrial weightings.

The SLI portfolio has recorded its second quarter's performance since being measured separately from the Conventional portfolio. It produced a total return of -1.6% real over the quarter (-0.7% nominal, RPI 0.9% over the quarter). Returns are being dampened by transaction fees (of approximately 6.8%) while the portfolio is in build up.

Overview

The allocation to property has increased from 10% to 11% of Dorset Pension Fund's total assets which represents approximately £330m. The new allocation of approximately £55m is to target SLI property beyond which the intention is to transition the portfolio gradually to a 50/50 split between SLI and Conventional properties.

Total Portfolio Value

	Value	Assets
UK Direct	£270.3m	32
Indirect	£40.2m	3
Total value of portfolio	£310.5m	
Largest asset	Woolborough Lane Ind Estate Crawley	
Largest tenant	ACI Worldwide EMEA Ltd	

'Conventional' Portfolio

Value	£280.6m
NIY	4.9%
Vacancy rate	2.4%
AWULT to expiry (to break)	8.4yrs (7.8 yrs)

'Secure Long Income' Portfolio

Value	£29.9m
NIY	3.5%
Vacancy rate	0%
AWULT to expiry (to break)	21.8 yrs (18.1 yrs)

Performance Target

'Conventional': To achieve a return on Assets at least equal to the average IPD Quarterly Universe return.

CONVENTIONAL	Portfolio	Target	Relative
Q3 2018 %	0.9	1.5	-0.5
1 Yr %	8.0	8.4	-0.3
3 Yr % p.a. (2016-2018)	7.5	7.4	0.2
5 Yr % p.a. (2014-2018)	11.3	10.9	0.4

'Secure Long Income': To achieve a return at least equal to LPI + 2.0% p.a.

SLI	Nominal	RPI	Real
Q3 2018 %	-0.7	0.9	-1.6

INCOME

The Conventional portfolio has an net income yield of 4.4% p.a. with 4.8% from direct property and 2.8% p.a. for the indirect assets. The vacancy rate for the direct portfolio was 2.6% of rental value at the end of Q3.

The Secure Long Income portfolio has a net income yield of 3.2% p.a. There are no vacancies in the SLI portfolio.

Transcations

	Q3 2018
Money available	£19.5m
Purchases	£9.0m
Sales	£0.4m

2. MARKET COMMENTARY

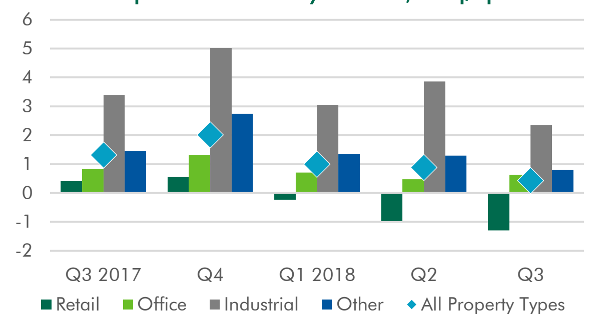
UK ECONOMIC OUTLOOK

The UK economy is continuing along its recent path of stable, below-trend growth. Recent high frequency data has been firm, meeting or modestly exceeding expectations, but not suggesting an imminent change in trajectory. In August the three-monthly rate of GDP growth increased to 0.7%, its strongest outturn since early-2017, although this was flattered by the comparison with the period of weather-related disruption earlier in the year. This is likely to be as good as it gets over the coming 12 months as growth continues at a modest rate.

As we write this (19 October), time is running out for an agreement to be reached on the withdrawal of the UK from the EU. The situation remains fluid, with frequent contradictory announcements from both parties. Our 'base case' forecasts (set out on the next page) assume that a deal will be reached, allowing trade to continue on current terms during a transition period to end-2020, or beyond. However, it is likely that this will be achieved only by deferring substantive talks on future, permanent trading arrangements until after the UK's departure. Without further clarity, uncertainty will persist and this will act as a drag on UK economic growth through 2019 and into 2020. Despite the above, we acknowledge the possibility of a 'no deal' Brexit, either by the failure of the UK and EU to agree terms or by the UK parliament voting against it, has increased. This would likely see UK economic growth grind to a halt through much of 2019/20.

UK PROPERTY PERFORMANCE

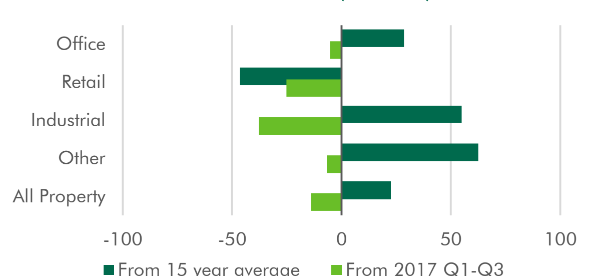
Capital values, at the All Property level, continued to rise in Q3, but the pace has slowed. At 0.4% quarter-on-quarter, growth was less than half that recorded in Q2. Excluding the period of disruption around the EU referendum, this is the weakest quarterly outturn since 2013. The slowdown was broad-based with only the office sector bucking the trend. If the recent trends persist, especially declines in the retail sector, the 2-year run of All Property capital growth could come to an end in Q4. Accentuated sectoral differences remain however.



Source: MSCI/IPD Monthly Index.

Although still strong, industrial rental growth appears to have passed its peak. From this point we expect more differentiation by location than we have seen over the past few years. The development pipeline is responding for larger warehouses in certain parts of the country, with supply-constrained urban locations continuing to outperform. We should also ask ourselves if affordability will become an issue in locations that have experienced rapid rental growth. Investment volumes have slowed sharply, although coming from record-breaking levels in 2017 they remain healthy by average standards. With more properties coming to the market in Q4, we are intrigued to see whether historically high pricing can be maintained. We have highlighted previously that investors are not sufficiently differentiating between assets of different quality, providing an opportunity to dispose of secondary properties at strong prices. This window is closing.

The spate of retailer CVAs and administrations has triggered fear in the investment market, with recent retail transaction volumes even lower than during the financial crisis. There is a considerable stock of retail property which owners would seek to exit, but their pricing aspirations – driven by historic book values – are disconnected from market conditions. Values in the sector have further to fall. As this unfolds we should be ready for mispriced opportunities. Careful consideration will be required to establish where occupier demand is sustainable and rents have found a firm floor. For now, identifying replacement tenants is often a difficult task.

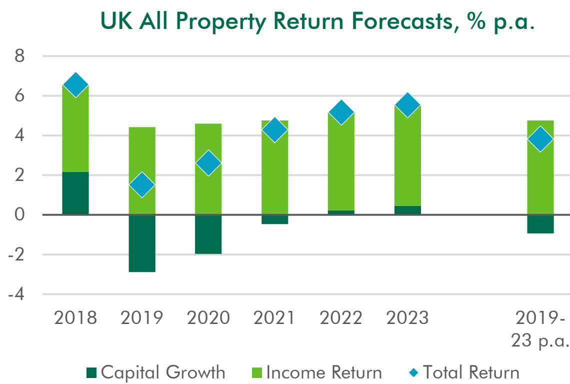


Source: Property Data.

The office sector, typically the most cyclical part of the market, is relatively stable at present. Take up for Q1-Q3 across the 'Big 6' regional cities was fractionally higher than the same period of 2017 and more than 50% above the 10-year average. This, along with attractive relative pricing, has kept investor demand strong for good quality assets, driving yield compression. In Central London take-up has been robust in 2018, although net absorption is still modestly negative on an annual basis, and the rapid expansion of serviced office operators complicates the picture. A common feature across the country is that demand is focussed on modern, efficient space. While new buildings experience strong pre-letting activity, vacancy rates are rising for second-hand space. In keeping with the retail and industrial sectors, property selection remains critical.

Rental growth across the alternative sectors has remained in positive territory, but returns continue to be driven by the investment market. During Q3 the 'other' sector saw initial yields compress by 19 bps, with only regional offices experiencing a larger shift. Fierce competition for property providing secure long income continues and will increasingly push investors into other non-traditional parts of the market, especially where these property types are supported by positive structural or demographics trends. One area that looks particularly attractive is affordable housing, offering the benefits of long, often index-linked, income from strong covenants and underpinned by a persistent demand-supply mismatch in the residential market.

PROPERTY MARKET OUTLOOK



Sources: MSCI/IPD, CBRE Global Investors.

Since our last commentary we have revised our forecasts and extended the horizon to end-2023. The impact has been a small downgrade to the 5-year All Property total return outlook, primarily driven by a more cautious outlook for the retail sector and 2018, a relatively strong year, moving into the rear view mirror. We are projecting UK property to deliver an average annual total return of 3.8% over the period 2019-23. Within this outlook, we expect modest All Property capital value falls in 2019/20 as a consequence of declining rents and weaker investor sentiment. In this environment good quality buildings in strong locations will prove most resilient. Attractive investment opportunities are likely to emerge from the coming uncertainty, so we should remain patient when deploying capital and focus on long-term sustainable income in the interim.

3. STRATEGY

Size	▪ Target size £330m – current size £310.5m. You have confirmed that you would like to increase your allocation to property from 10% to 11% of total assets which represents approximately £330m. ▪ The new allocation of approximately £55m is to target Secure Long Income. ▪ The longer term intention is to transition the portfolio gradually to a 50/50 split between Conventional property and SLI. ▪ Conventional and SLI portfolios' have had distinct benchmarks since 1st April 2018.
Performance objectives	▪ Coventional portfolio: "To achieve a return on Assets at least equal to the average IPD Quarterly Universe Portfolio Return including Transactions and Developments for a rolling five year period commencing 1 January 2006." ▪ Secure Long Income Portfolio: "To achieve a total return greater than, or equal to, Limited Price Inflation ("LPI") plus 2.0% p.a. measured over the long run (7-10 years) commencing 1 April 2018."
Income yield	▪ Strive for the Conventional portfolio income yield to exceed the IPD index income yield. ▪ Continue to focus on maintaining a low void rate and a resilient income yield. ▪ Ensure held properties / new SLI acquisitions have strong rental growth prospects, long leases and an element of indexation.

ALLOCATION

Property type	▪ Conventional portfolio: Remain well diversified as the portfolio transitions to a 50/50 split to SLI, with holdings in good locations with a proportion of exposure to properties that will allow active management to generate outperformance. ▪ We anticipate maintaining a total of between 15-20 assets with an average lot size of between £8m and £11m. ▪ Invest indirectly to gain exposure to sectors or lot sizes that the fund would be unable to achieve through direct investment e.g Shopping Centres. ▪ Secure Long Income portfolio: target lot sizes between £3m and £20m with an average lease length in excess of 15 years at purchase with approximately 70% of the portfolio having index linked rent reviews once fully invested.
Geographic allocation	▪ Diversified by location but with a bias towards London and the South East.
Sector allocation	▪ Diversified by sector with a maximum of 50% in any single sector. ▪ Target a lower than average weighting to Offices and Retail and a higher than average weighting to Industrial and Alternatives. ▪ Source suitable SLI investments that could be available in any sector.

OTHER RESTRICTIONS AND GUIDELINES

We have agreed with you to prepare a new IMA to reflect a revised target of 50% Conventional 50% SLI income to be transitioned over a medium term time horizon. The restrictions below are taken from the existing IMA.

Investment size	▪ Target a maximum of 10% in any single asset.
Tenants	▪ Maximum rent from any single tenant 10% of rental exposure. ▪ Target financial strength better than the benchmark.
Lease length portfolio	▪ Target new assets where the lease expiry profile fits with the existing profile of the Fund. ▪ Seek to maintain expiries in any one year below 10% of the Fund's lease income. ▪ Target an average unexpired lease term in excess of the Benchmark.
Development	▪ Development may be undertaken where the major risks can be mitigated and the risk/ reward profile is sufficient to justify it.
Debt	▪ Avoid debt exposure.
Environmental and Social Governance ("ESG")	▪ Energy performance: to improve EPC ratings where it is financially viable and, where applicable, apply for certification.

4. PORTFOLIO OVERVIEW

VALUATION

Portfolio structure (Q3 2018)		
Direct portfolio (September 2018 Values)	**£270.3m**	87.1%
Conventional portfolio	£240.4m	
Secure Long Income portfolio	£29.9m	
Indirect assets (September 2018 Values)	**£40.2m**	12.9%
Total value of portfolio	**£310.5m**	**100%**

The direct property portfolio was valued independently by BNP Paribas on 30 September.

During the quarter, we completed the purchase Astra House in Harlow (£9.0m) for the SLI portfolio and eight properties staircased in the Derwent portfolio (£0.4m), which sits in the Conventional portfolio.

The indirect assets are valued at £40.2m (including the Fund's investment in Park Plaza, Waterloo), an increase of 2.5% over the quarter.

The overall value of the portfolio now stands at £310.5m, with approximately £19.5m remaining to invest to reach the target size of £330m.

RISK CONTROL MEASURES

In this section we present the structure of the Conventional and Secure Long Income portfolios separately.

THE CONVENTIONAL PORTFOLIO

Portfolio structure – (Direct property only)		Aim
Number of properties	25	15-20
Number of tenancies	77 with a further 3 units void	45-80
Net initial yield	4.5% p.a.	Above benchmark
Vacancy rate (% of rent)	2.4%	Below benchmark
Rent with +10 years remaining	17.2% of total rent	Minimum 20% of total rent
Rent with +15 years remaining	5.9% of total rent	Minimum 10% of total rent
Largest property (% of direct value)	Woolborough Lane IE (8.9%)	Below 10%
Largest tenant (% of direct rent)	ACI Worldwide (8.7%)	Below 10%
Tenure (Freehold/Leasehold)	86% / 14%	Minimum 70% freeholds

PROPERTY / TENANT DIVERSIFICATION

AIM: To ensure portfolio has an appropriate number of properties and tenants to dilute asset specific risk.

The Conventional portfolio is well diversified with 25 properties and 80 lettable units. The largest direct property investment in the portfolio is Woolborough Lane Industrial Estate, Crawley and the largest tenant is ACI Worldwide EMEA Ltd.

ACTION: To maintain a diversified property and tenant mix.

NET INITIAL YIELD ("NIY")

AIM: To maintain a net initial yield above the benchmark.

	Conventional Portfolio	IPD Quarterly Universe
Initial yield p.a.	4.9%	4.5%
Income return over quarter	1.1%	1.1%

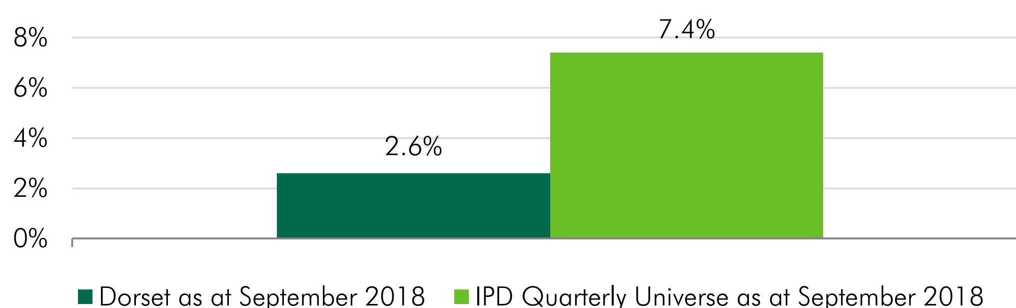
ACTION: The portfolio's NIY is currently 40bps ahead of the IPD Quarterly Universe Benchmark. We plan to maintain a yield advantage by:

1. letting vacant space;
2. pursuing lease renewals with existing tenants at the earliest opportunity;
3. settling rent reviews where there are outstanding reversions;
4. closely monitoring non recoverable expenditure.

VACANCY RATE

AIM: To maintain a low void rate through letting vacant space and mitigating future expiry risks.

Figure 5 Vacancy Rate



The portfolio's vacancy rate remained at 2.6% of rental value over the quarter and continues to be well below the market average of 7.4%. It comprises an industrial unit at the Apsley Centre in Staples Corner (0.4%) and another one at Sumner Road Road in Croydon (0.3%) and two floors at the office building in Aberdeen (1.9%). The Croydon unit has been let since the end of the quarter.

The vacancy rate is set to rise however following the adminstrations of Toys R Us and Maplin earlier this year accounting for a total prospective 4.2% increase in the void rate.

ACTION: To let vacant space through using best in class letting agents and proactively manage upcoming lease expiries.

LEASE LENGTH AND EXPIRY PROFILE

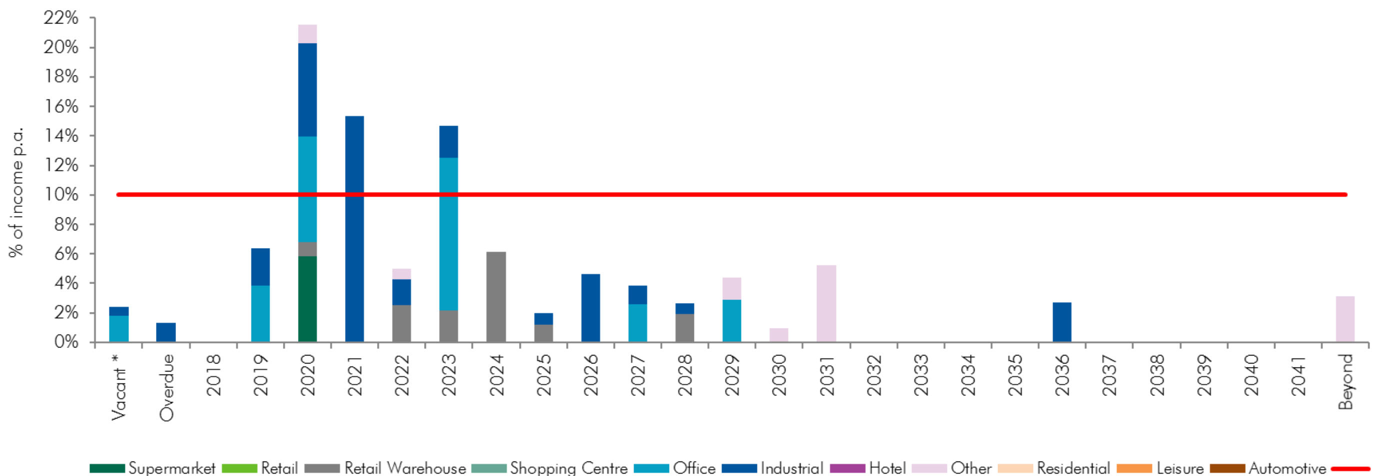
AIM: To maintain a well diversified lease expiry profile and keep the portfolio's average lease length in excess of the benchmark lease length.

UNEXPIRED LEASE TERM, YEARS

	PAS assumption*	Incl All Breaks	Excl. all breaks
Fund	8.5	7.8	8.6
Benchmark	12.6	11.8	13.1

*Breaks are assumed to be executed if the lease is overrented and the break is at the option of the tenant or mutual. The figures exclude indirect assets. The Park Plaza hotel in Waterloo indirect asset, if included, would increase the average unexpired lease term of the portfolio to over 15 years.

Figure 6 Lease Expiry Profile



* Vacancy rate expressed as percentage of ERV

The average lease length of the Fund using the PAS assumption is in a reasonable position relative to the Benchmark. The main risk is the 2020 expiry spike. The risk is however well diversified across 10 different units and we are already talking to the majority of tenants with leases that expire that year. Terms have been agreed for a new lease relating to 5.9% out of the 20.7% of income currently expiring in 2020.

ACTION: Seek to extend the average lease length through the active management of lease events in the portfolio. Aim to establish a "dumbbell" shaped expiry profile to allow short term asset management to be balanced by long term secure income.

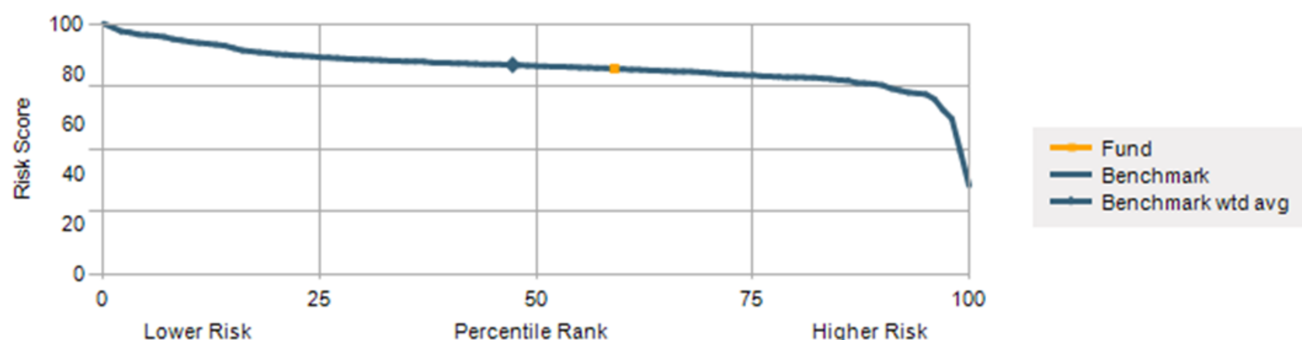
With the inclusion of Waterloo in the graph the proportion of income expiring beyond 2041 increases to 6.9%.

TENANT FINANCIAL STRENGTH

AIM: To maintain covenant strength better than the benchmark.

The graph below compares the covenant risk score of the Conventional portfolio compared to the Benchmark as at 30 September 2018. The portofio is now in the mid quartile with a Weighted Risk Score on the 59th percentile and is currently behind the benchmark (47th) demonstrating that the covenant risk of the portfolio is marginally above the average benchmark risk. However as can be seen from the graph below the risk weighting line is relatively flat with small movements in risk profile dramtically impacting the risk score.

Figure 7 Ranking Of Weighted Risk Score



ACTION: Seek to improve the covenant risk profile of the portfolio through letting activity and ensuring tenants are properly classified by IPD.

INCOME AND LEASE TYPE

AIM: To maintain the weighting to Secure Long income within the Conventional portfolio in excess of 15% of that portfolio's income.

Open market income – this is the standard rent review structure for UK direct property leases and makes up the majority of the portfolio income. It generally involves a five yearly open market rent review, which is upwards only.

SLI income – defined as properties let on long leases, usually with inflation-linked rent review structures and those which have defined uplifts (fixed increases) periodically, or property types where open market rental growth is expected to keep up with inflation. This type of income is effective in generating a consistent real return.

The proportion of SLI within the Conventional portfolio is currently 13% of total income, this increases to 16% including Park Plaza, Waterloo.

% of Conventional portfolio income	Q3 2018
Open market income	87%
SLI	13%

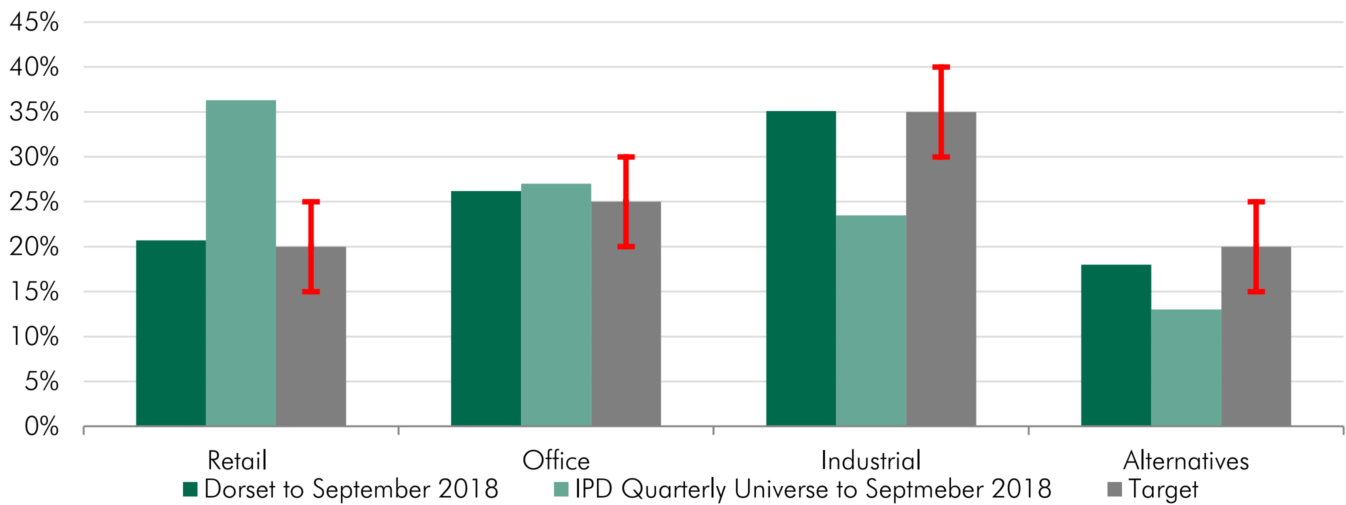
% of Conventional portfolio income – including Park Plaza, Waterloo	Q3 2018
Open market income	84%
SLI	16%

ACTION: Continue to monitor SLI ratio to Open Market income when considering transition towards 50/50 split of all assets between Conventionl property and SLI over the medium term.

SECTOR AND GEOGRAPHICAL STRUCTURE

AIM: To maintain a well diversified portfolio as part of our overall risk management strategy.

Figure 8 Portfolio Sector Weightings



The Conventional portfolio's sector weightings are displayed above in comparison to the Benchmark with a target range shown in red reflecting our house view recommendations. The portfolio's sector split has continued to be beneficial with the low retail weighting and marginally underweight position to offices, given that overall these two sectors have been the poorest performing sectors over recent years. We plan to broadly maintain these weightings as we gradually transition the portfolio to 50% Conventional / 50% Secure Long Income.

Figure 9 Geographical Structure

The geographical split of the Conventional portfolio is also well diversified, with a bias towards London and the South East where there is the greatest demand for land. There is also a large Eastern weighting; Cambridge falls into this region although it has historically performed more like the South East market and is therefore considered a positive risk when compared to the Index.

ACTION: Ensure that transactions maintain the geographical and sector diversity within the Conventional portfolio having due regard to the current point in the economic cycle.

DEVELOPMENT

AIM: To maintain development exposure below 10% of the value of the portfolio.

There is currently no speculative development taking place within the portfolio. The development at Cambridge Science Park progressed during Q3 with no major issues.

ACTION: Development may be undertaken where the major risks can be mitigated and the risk/ reward profile is sufficient to justify it having due regard to local supply/ demand dynamics and the point in the economic cycle.

THE SECURE LONG INCOME PORTFOLIO

	Fund	Aim
Number of properties	7	15-20
Number of tenancies	9	25+
Net initial yield	3.5%	2.5%+
Vacancy rate (% of rent)	0%	Below market average
Rent with +15 years remaining	100%	70%+
Largest property (% of direct value)	30.1% (Astra House, Harlow)	Below 15%
Largest tenant (% of direct rent)	36.8% (Ei Group Plc)	Below 15%
Tenure (Freehold/Leasehold)	100% / 0%	Minimum 70% freeholds

PROPERTY / TENANT DIVERSIFICATION

AIM: To ensure the portfolio has an appropriate number of properties and tenants to dilute asset specific risk.

The SLI portfolio currently has 7 properties and 9 lettable units. We plan to have between 15 and 20 properties once fully invested with over 25 lettable units to ensure the portfolio is sufficiently diversified. The largest property in the portfolio is Astra House, Harlow which accounts for 30.1% of value and the largest tenant is Ei Group Plc, representing 36.8% of the total rent roll. Ei Group is the tenant of all four of the portfolio's public houses. These percentages will fall as further capital is invested.

ACTION: To maintain a diversified property and tenant mix.

INDEXATION

AIM: For the portfolio's income to grow in line with LPI (defined as the percentage change in RPI, capped at 5% and collared at 0% p.a.) and to achieve the total real return objective of LPI + 2% p.a.

37% of the SLI portfolio's income is subject to reviews to open market rental value. These relate to the four London public houses, where historic rental growth has outpaced inflation and we expect this trend to continue; 36% of the income is subject to CPI linked reviews with a cap and collar at 3.5% p.a. and 0.5% p.a. respectively; 20% of the income is subject to uncapped reviews in line with RPI and the remaining 8% is tied to a rent review linked to the higher of open market or RPI but capped at 3.5% p.a. with a collar at 1.5% p.a.

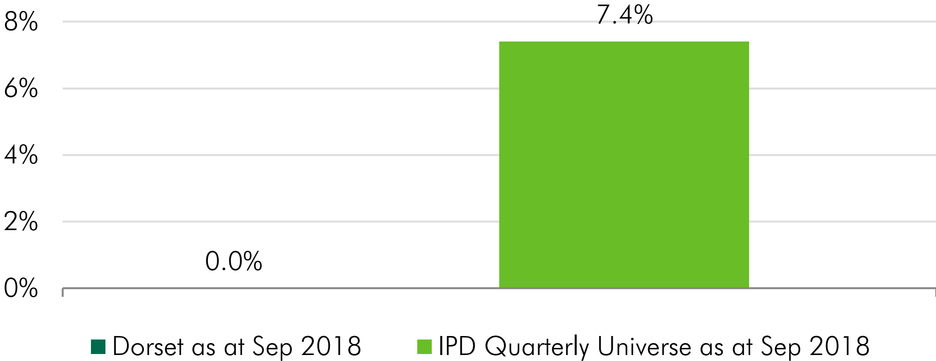
ACTION: To ensure the portfolio's income grows in line with LPI, to achieve the target real return and for at least 70% of the portfolio's income to be index linked once fully invested.

VACANCY RATE

AIM: To maintain a low void rate through letting vacant space and mitigating future expiry risks.

The SLI portfolio currently has no vacancies. We carefully monitor all the tenants and will appoint letting agents where we suspect an upcoming vacancy.

Figure 10 Vacancy Rate



ACTION: Proactively manage upcoming lease expiries.

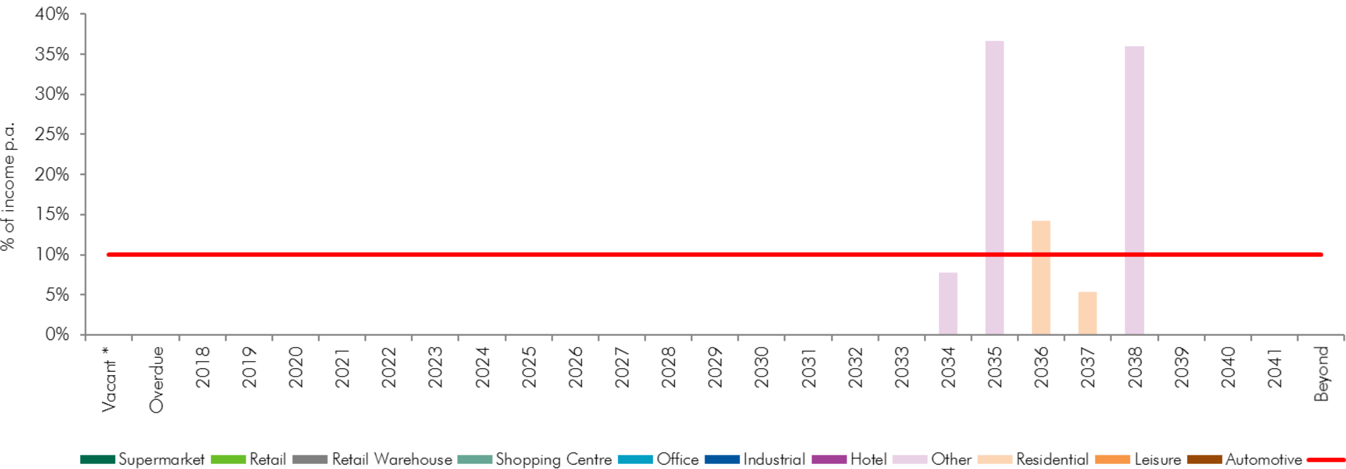
LEASE LENGTH AND EXPIRY PROFILE

AIM: To maintain an average unexpired lease term for the portoflio of at least 15 years.

UNEXPIRED LEASE TERM, YEARS

	Incl All Breaks	Excl. all breaks
Fund	23.1	17.4

Figure 11 Lease Expiry Profile



* Vacancy rate expressed as percentage of ERV

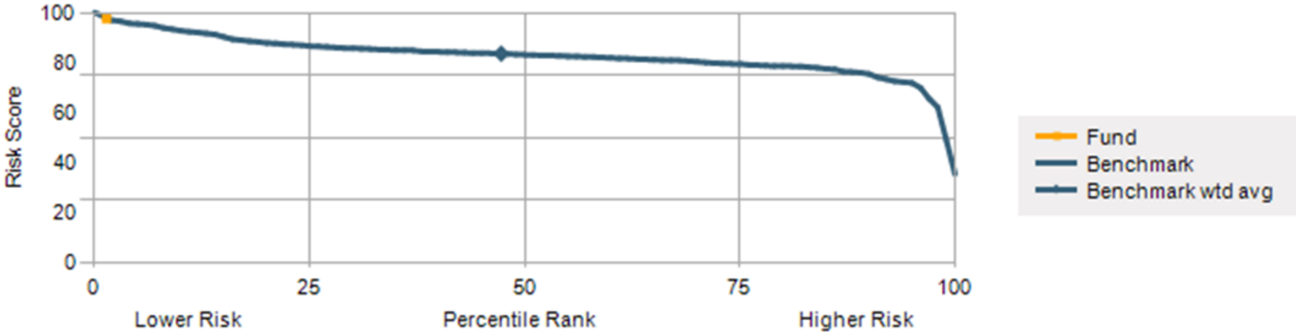
ACTION: Ensure the average unexpired lease term for the portoflio is at least 15 years.

TENANT FINANCIAL STRENGTH

AIM: To maintain covenant strength better than the IPD Quarterly Universe.

The graph below compares the covenant risk score of the SLI portfolio to the IPD Quarterly Universe as at 30 September 2018. The Weighted Risk Score is on the 2nd percentile and is well ahead of IPD (47th) demonstrating that the covenant strength of the portfolio is very strong.

Figure 12 Ranking Of Weighted Risk Score



ACTION: To maintain the low risk score of the portfolio with new purchases.

SECTOR AND GEOGRAPHICAL STRUCTURE

AIM: To ensure appropriate diversification by sector and geography.

100% of the portfolio is currently composed of alternative use properties, with public houses, a restaurant and a keyworker housing investment.

Figure 13 Geographical Structure

49% of the SLI portfolio is in London, providing long term security and good prospects for higher value alternative uses in the future.

ACTION: To ensure appropriate diversificaiton with new purchases.

5. DIRECT PERFORMANCE - CONVENTIONAL PORTFOLIO

PERFORMANCE OBJECTIVE

The target for the Conventional portfolio is to achieve a return on Assets at least equal to the average IPD Quarterly Universe Portfolio Return including Transactions and Developments for a rolling five year period commencing 1 January 2006.

Q3 2018	Portfolio	Benchmark	Relative
Capital growth	-0.2%	0.4%	-0.6%
Income return	1.1%	1.1%	0.0%
Total return	0.9%	1.5%	-0.5%

Source: CBREGI and IPD Quarterly Benchmark Report

The portfolio underperformed the IPD Quarterly Universe by -0.5% over the last three months, with a total return of 0.9% against 1.5% for the Benchmark. The direct portfolio underperformed by -0.9% with a total return of 0.6% while the indirect holdings outperformed with a total return of 3.1%, 1.6% ahead of the IPD Quarterly Universe. The direct standing investments (properties held throughout the year, ignoring transactions and developments) performed in line with the IPD Quarterly Universe, also returning 1.5% over the quarter.

Industrials continued to be the market's best performing assets over the quarter while retail was the poorest given the challenges facing the sector. With a total return of 2.3% over the quarter, the industrials were the portfolio's best performing assets. The portfolio's retail recorded the lowest return delivering -0.4% over the quarter, reflecting the difficult market conditions.

The indirect outperformance was driven by capital growth at the Park Plaza hotel at Waterloo, which grew by 6.9% over the quarter. It provided a positive weighted contribution to overall performance of 0.4%.

The development at Cambridge Science Park dragged the overall performance of the portfolio over the quarter, providing a total return of -12.8% and a negative weighted contribution of -0.8%. This was the first quarter in which the valuers have split the asset into two separate holdings, which led them to focus on the value of the existing building which will become vacant early next year. The valuers have conducted an appraisal reflecting the costs of refurbishment which has resulted in a lower value than previously attributed. Work to the new building is on track and the investment is set to perform well.

12 months to Q3 2018	Portfolio	Benchmark	Relative
Capital growth	3.4%	3.7%	-0.3%
Income return	4.5%	4.5%	0.0%
Total return	8.0%	8.4%	-0.3%

Source: CBREGI and IPD Quarterly Benchmark Report

3 yrs to Q3 2018	Portfolio	Benchmark	Relative
Capital growth	2.6%	2.6%	0.0%
Income return	4.8%	4.6%	0.2%
Total return	7.5%	7.4%	0.2%

Source: CBREGI and IPD Quarterly Benchmark Report

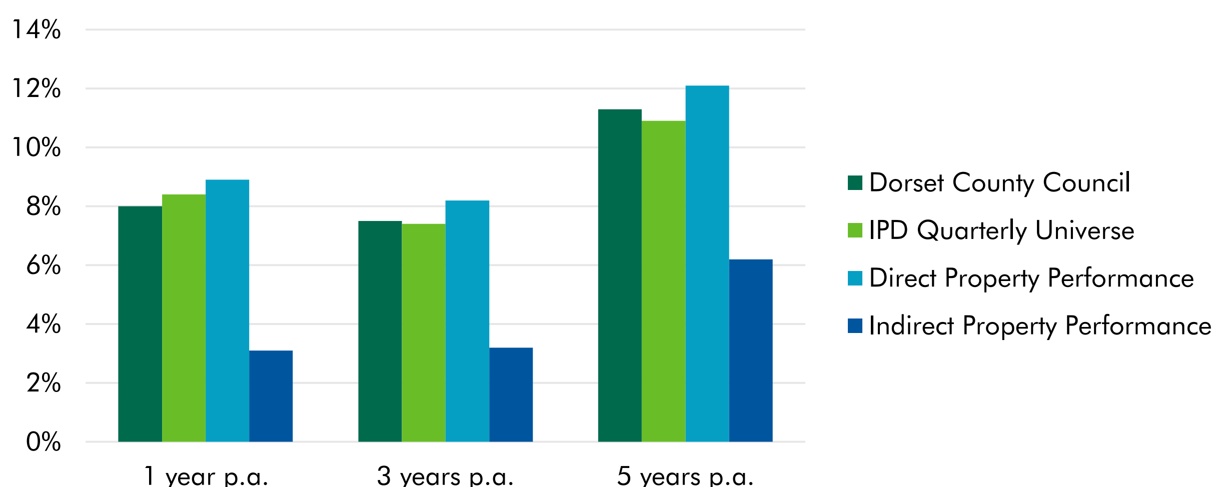
5 yrs to Q3 2018	Portfolio	Benchmark	Relative
Capital growth	5.8%	5.8%	0.0%
Income return	5.2%	4.8%	0.4%
Total return	11.3%	10.9%	0.4%

Source: CBREGI and IPD Quarterly Benchmark Report

The portfolio is slightly behind the Benchmark over 1 year and outperforming over 3 and 5 year periods. Performance has been driven by both the strong income return and capital growth over the longer time periods. The longer term performance is of particular note given the amount of purchase activity over this time frame. The figures also demonstrate the advantage over the longer term of running a higher income strategy, provided the quality of the properties within the portfolio is maintained.

ROLLING PERFORMANCE FIGURES

Figure 9 Annualised Total Return Rolling Performance



The portfolio is slightly behind over 1 year and outperforming over 3 and 5 year rolling periods. This chart includes all benchmarked assets, therefore comprising all direct and indirectly held assets during each time horizon. The direct property performance has continued to outperform the Benchmark over the rolling timeframes shown above. The indirect property performance has been weaker than the direct holdings across the timeframes shown. The indirect property holdings owned over these timeframes comprise Shopping Centre exposure; the assests in these vehicles are generally prime and provide access to a market that we would not purchase directly for a Fund of this size given their scale. However, shopping centres have dragged performance given the well documented problems in the retail sector. We are seeking to divest from one of these holdings to reduce the weighting to the indirect retail sector.

The Fund continues to achieve its key objective on the five year rolling performance measure.

DIRECT SLI PERFORMANCE

PERFORMANCE OBJECTIVE

The target is to achieve a total return greater than, or equal to, Limited Price Inflation ("LPI") plus 2.0% p.a. measured over the long run (7-10 years) commencing 1 April 2018.

Q3 2018	Nominal total return	RPI	Real total return	Nominal IPD Quarterly Universe
SLI Portfolio	-0.7	0.9%	-1.6%	1.5%

Source: CBREGI and IPD Quarterly Benchmark Report

This is the second quarter that the Secure Long Income portfolio has been reported separately from the Conventional portfolio.

The SLI portfolio generated a nominal total return of -0.7% over the quarter, equating to a real return of -1.6% (RPI was 0.9%). There was no capital growth with the performance coming from the income return of 0.8%. Returns are likely to be subdued while we build up the portfolio given the impact of transaction fees. This was a case in point for Quarter 3, where the transaction fees for the purchase of Astra House in Harlow dragged performance. The standing investments (ignoring transactions) produced a nominal return of 0.9% over the quarter, equating to 0% real.

6. ACCOUNTING AND ADMINISTRATION

RENT COLLECTION AND ARREARS

The three measures listed below; the arrears level, speed of rent collection and service charge account closure position, are designed to be "litmus" tests showing the health of the accounting and administration of the portfolio.

The targets are designed to be demanding, however, we would expect to hit GREEN a large proportion of the time.

ARREARS LEVEL (RENT, SERVICE CHARGE, INSURANCE OVER THREE MONTS OLD)

Target			
GREEN	Max. £25,000, no single item over £10,000		
AMBER	Max. £75,000		
RED	Above £75,000		
RESULT	30 September 2018	GREEN	£17,068.97 (excludes £424,560.75 that relates to administrations)
	30 June 2018	GREEN	£4,845.94 (excludes £190,400.10 that relates to administrations)
	31 March 2018	GREEN	£1,868.38 (excludes £124,191.81 that relates to administrations)
	31 December 2017	GREEN	£4,022.88

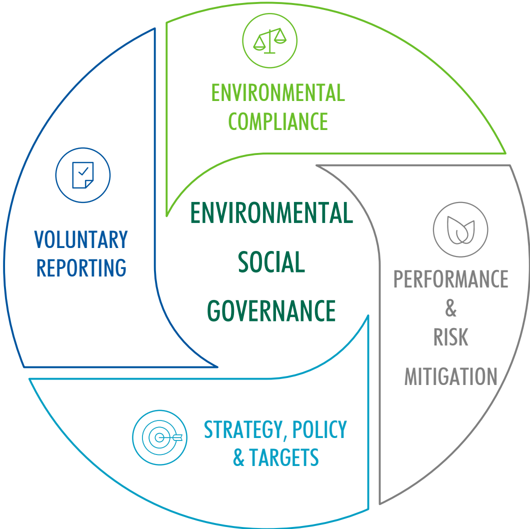
SPEED OF RENT COLLECTION

Target			
GREEN	90% of collectable rent banked by 6th working day after the quarter day, 95% by 15th working day		
AMBER	80% by 6th working day, 90% by 15th		
RED	Worse than Amber		
RESULT	30 September 2018	GREEN	(95.5% collected in 6 days, 96.8% by 15th day)
	30 June 2018	GREEN	(88.8% collected in 6 days, 98.3% by 15th day)
	31 March 2018	GREEN	(93.09% collected in 6 days, 97.0% by 15th day)
	31 December 2017	GREEN	(93.9% collected in 6 days, 99.7% by 15th day)

SERVICE CHARGES – ACCOUNT CLOSURE POSITION

Target			
GREEN	all service charge accounts closed within 3 months of the year end		
RED	any account not closed		
RESULT	30 September 2018	GREEN	None currently outstanding.
	30 June 2018	RED	Payment outstanding due to query regarding completion monies.
	31 March 2018	GREEN	None currently outstanding.
	31 December 2017	GREEN	None currently outstanding.

7. ESG PROGRAMME



Environmental Compliance

With relevant and changing legislation, such as the CRC and ESOS.

Performance & Risk Mitigation

Managing strategic risks and enhancing value through improving low energy performance.

Strategy, Policy & Targets

Establishing portfolio wide policies & specific Fund targets and strategies.

Voluntary Reporting

Reporting on the Fund's progress against ESG objectives.

Figure 1 Change in level of risk across all units (left) and value (right) within the Dorset County Council

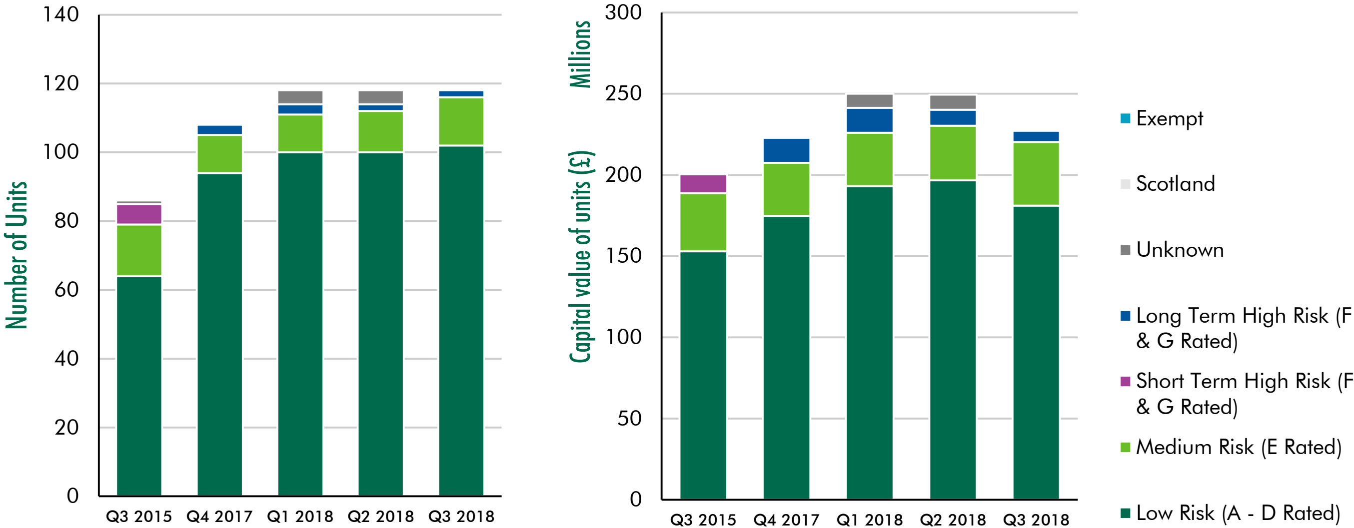
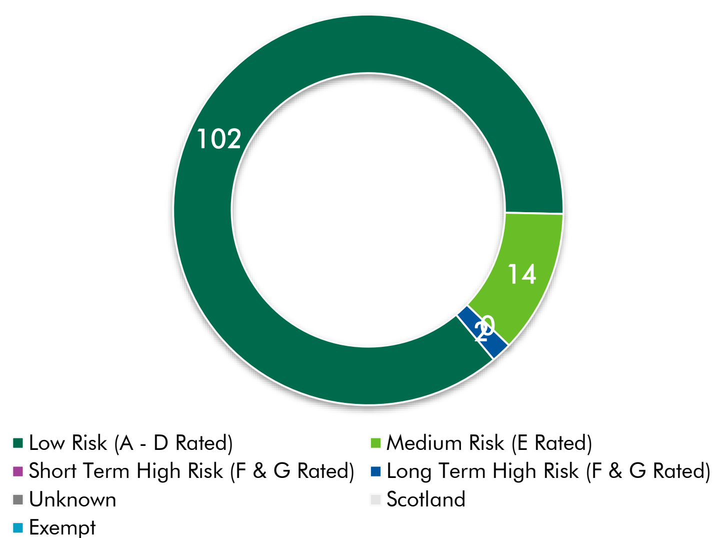


Table 1 Actions completed in Q3 2018

Portfolio/Asset	Unit	Action	Outcome
Apsley Centre, Apsley Way, Staples Corner, London	Unit D	Refurbishment Project	Improvement works to the unit included sustsinability input and significant improveents in the EPC rating. The unit is now a D rating (low risk category).

Figure 2 Fund Risk Management Action Plan



Action plan	Medium Risk	Short Term High Risk	Long Term High Risk
	No. of units		
High quality EPC			
Modelled EPC / tenant engagement	12		1
Refurbishment planned			1
Redevelopment planned			
Considering sale			

Table 2 Actions planned in Q4 2018

Portfolio/Asset	Unit	Action	Outcome
Portfolio	All	Annual ESG Report 2018	Issue fund's annual ESG report, including water and carbon footprints, case studies and key asset strategies.
All Sites	All	ESG +	Confirm / Amend ESG+ strategy following proposal review.
All Sites	All	Green lease clause review	Consultation regarding current green lease clauses with selected fund solicitors – potential amendments to wording of the clauses and their categorisatio (Basic, Intermediate, Leader).

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