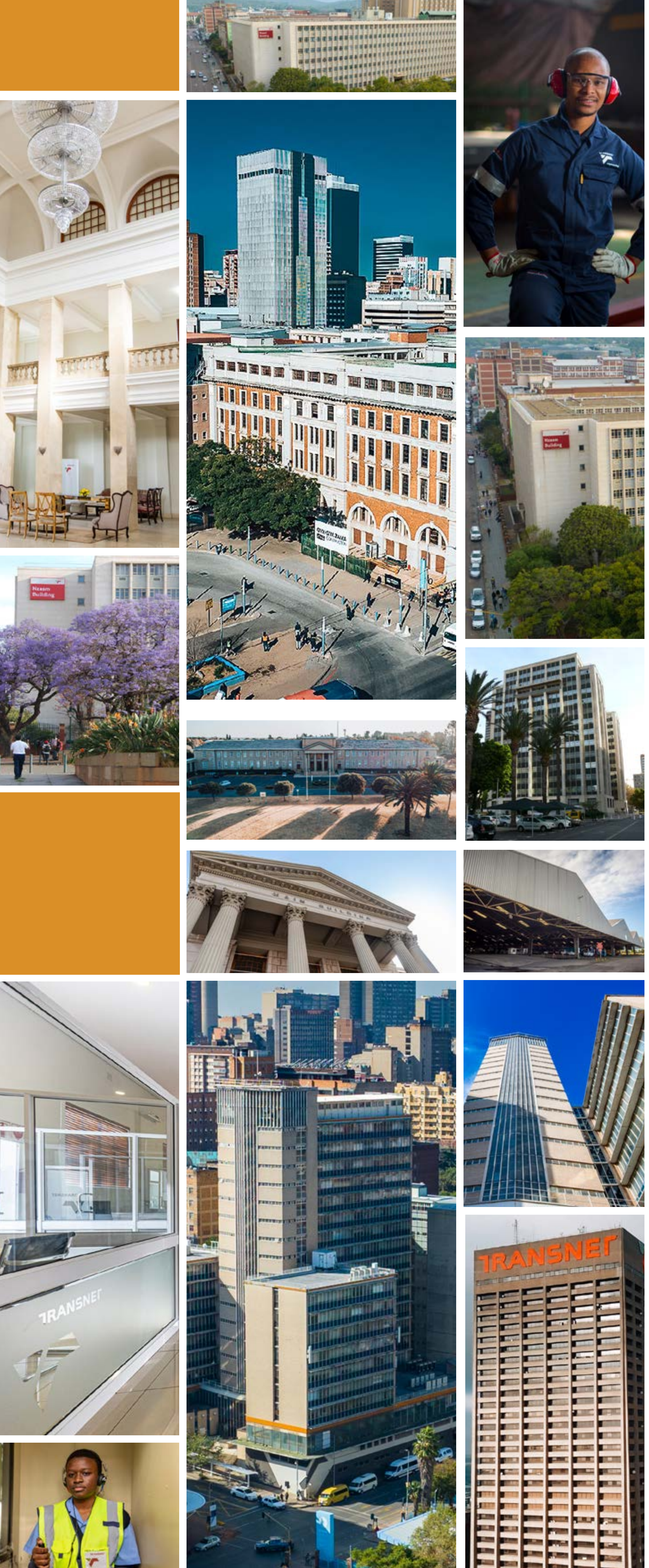
TRANSNET

property

TRANSNET PROPERTY 2024



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HIGHLIGHTS

- Revenue declined by **31%** to **R1,6 billion**
  (2023: R2,2 billion)
- EBITDA rose by **181%** to **R246 million**
  (2023: -R302 million)
- Operating expenses decreased by **49%** to **R1,3 billion**
  (2023: R2,5 billion)
- Recovery ratio increased to **36%**
  (2023: 12%)

BUSINESS OVERVIEW

Property currently manages a portfolio of commercial and residential properties, with a mandate to maximise returns from the Transnet Property (TP) portfolio and growing the asset base. The respective Operating Divisions (ODs) manage the balance of the portfolio. During 2023/24FY, TP concluded its integration with the real estate functions of Freight Rail (TFR) and Port Terminals (TPT), with TP providing property management services to these divisions.

Property's capabilities include strategic asset management, property development, and property management.

Asset management	Developments	Property management
• Investment portfolio construction • Market analysis • Performance management and benchmarking • Investment strategy formulation • Performance reporting • Oversight of property management • Valuation and geospatial services	• Manage all developments on behalf of clients (including professional teams) • Deliver developments within the approved budget and time • Manage development risk • Meeting landlord and tenant requirements • Development lease management	• Leasing management • Financial management (including billing, collection, payment of services and reporting) • Property marketing management • Facilities management • Non-GLA revenue

The **commercial** portfolio comprises:

- Offices
- Warehouses
- Retail buildings
- Land

The **residential** portfolio comprises:

- Vacant stands
- Houses
- Mass housing

Mass housing comprises:

- Hostels
- Lodges
- Line camps

Disposing of the residential portfolio will pave the way for increased investment in the commercial portfolio and will reduce holding costs.

BUSINESS OVERVIEW CONTINUED

TENANTS PER CATEGORY

Transnet Property has various tenants in office, retail, industrial and warehousing.

Types of tenants in various categories:

Category	Tenants
Office	Free State Department of Health Hawks City of Cape Town Passenger Rail Agency of South Africa (PRASA)
Industrial and Warehousing	Shoprite Rovos Rail Tours Grindrod Intermodal Newlyn Investments Defy Aspen Pharmacare Access Freight MSC Solwethu Marine Services
Telecommunications	MTN Vodacom IHS Liquid Telecoms American Services Company
Retail	Carlton Shopping Centre (flagship) Pick n Pay Woolworths Timberland Edgars Mr Price Kids Absa Fabiani Clicks McDonald's Nando's KFC

STRATEGIC CONTEXT

To address the underperformance of TP's portfolio, an optimisation strategy (currently implemented) aims to achieve commercial self-sustainability. The strategy emphasises strategic investment on selected assets in the portfolio – enabling sustainable, market-related commercial returns. This approach seeks to enhance TP's contribution to the Company. Given the Company's constrained financial position, TP must undertake innovative measures to raise the required capital for strategic investment projects. To achieve this, TP adopts a dual approach with a self-funding elements by completing several disposal transactions for non-core properties. This occurs, particularly, in the residential portfolio, which includes houses, hostels, lodges, and line camps (among others).

TP is accelerating its collaboration with the private sector property partners to develop commercial opportunities or offer assets for private development. Focus is placed on retail, industrial, and commercial assets. It is envisaged that the nature of interventions contained within Property's strategy aims to limit the portfolio's exposure to underperforming residential assets that have historically resulted in value loss. It will also attract private capital investment needed to refurbish and improve asset competitiveness, positioning TP as a sustainable and strategic asset manager for internal and external customers.

TP's strategic focus areas align with Transnet's goals for optimising its portfolio returns. During the 2023/24FY, as part of the Board and Shareholders' initiative, TP developed a Recovery Plan (aligned with the Transnet overall plan) to ensure financial sustainability and balance sheet growth. Key initiatives include, among others:

- Growing revenue from new leases and restructuring existing development leases;
- Disposing non-core and underperforming properties across the portfolio to generate revenue and, reduce holding costs, and limit reputational exposure;
- Implementing a utilities cost-management programme that uses digital tools such as smart meters to reduce property costs and enhance utilities management and collections from customers;
- Improving cash flow through strengthened debt collection efforts;
- Accelerating private sector participation (PSP) opportunities – leveraging other OD properties;
- Growing the asset base through property revaluation; and
- Implementing renewable energy and sustainability initiatives to reduce operating costs.

Some of these initiatives are in progress and milestones have been achieved, such as commercial and residential properties being advertised for disposal. The disposal of residential properties, which TP has opted to disinvest remains a challenge, particularly hostels, despite offers made to government entities. As part of the Recovery Plan, TP is seeking exemption from certain state regulations to reduce the disabling bureaucracy and enhance its competitiveness in the property industry.

WHERE WE OPERATE

The portfolio spans South Africa and is divided into five regions, namely KwaZulu-Natal, Eastern Cape, Western Cape, the Northern region and the Inland region. The Northern region comprises the Limpopo, North West, and Mpumalanga provinces, including Tshwane. The Inland region is made up of Gauteng, Free State, and the Northern Cape provinces.

REGULATORY ENVIRONMENT

Regulatory requirements influence property owners' operations in the sector. Many laws relate to regulation of dilapidated and abandoned buildings that pose health and safety risks to the public. The by-laws prescribe regular building inspection, serving of notices and warnings on landowners, and repair or demolition of dilapidated structures. Under the by-laws, local authorities may take steps to repair or demolish structures at the owner's expense. Property has many dilapidated properties that are being demolished, but others before carrying out all demolitions, the Heritage Act must be considered and applied.

OPERATIONAL PERFORMANCE

PROPERTY INDUSTRY OUTLOOK

In 2024, South African commercial property returns remained steady, with investment property returns surpassing inflation rates after a decline in 2020. Income returns contributed most to total returns, with capital growth having only a marginal impact. The property returns dipped slightly compared to 2022. This is attributed to reduced capital growth despite capital growth having shown positive growth for years following three-year depreciation. Against the backdrop of ever-increasing operating costs, an income return above inflation (driven by increased net operating income) was recorded. Improved occupancy rates bolstered income returns, whereas rising interest rates negatively impacted capital growth. Overall, the sector shows signs of improvement and healthy fundamentals.

INDUSTRIAL PROPERTY

The industrial property market, the strongest performing in the commercial property sector, is showing signs of slowing. Reduced rental and land value growth align with economic pressure on manufacturing and retail sectors, with the ongoing electricity crisis being a continued negative factor. After accounting for building cost inflation, real-term rentals continue to decline.

Despite this slowdown, industrial vacancy rates remain low. This could be attributed to landlords incentivising continued occupancy through rental reversions and showing leniency towards tenants facing additional costs from the electricity crisis, such as the cost of diesel for generators. Load shedding has severely impacted the manufacturing and retail sectors – both major drivers of the industrial property market.

OFFICES

Improving occupancy rates indicate increasing demand, but negative real rental growth suggests lowering vacancy rates negatively impacts income. Slower development helped stabilise the market, with vacancy rates expected to remain steady until significant economic and employment growth occurs.

Sluggish economic growth suggests a modest office space uptake. During the latter part of 2023, the City of Johannesburg (CoJ)'s office vacancy rate was 18.0%, the highest among major metros. The City of Cape Town, reported the lowest recorded the lowest office vacancy rate at 7.5% as of December 2023. High vacancy rates, attractive rental prices, low employment growth, and
sub-letting activities have reduced new office developments.
High pre-let rates reflect caution among developers. Rental rates are likely to remain flat as landlords focus on retaining and attracting tenants to fill vacancies.

RETAIL

Trade in South Africa's major shopping centres further slowed in the latter part of 2023, reflecting South Africa's sluggish economy, high interest rates, and persistent unemployment. The ongoing loadshedding further affected both business operations and consumer activity. Despite increased foot traffic, shopper visits remained below pre-pandemic levels. However, there was growth for the sector, however, in the average spend per person, fewer multi-person visits, and increased spending per visit.

Retailers' cost of occupancy may stabilise in the coming year as vacancy rates improve and sales growth potentially slows.

Retailers' cost of occupancy may stabilise in the coming year as vacancy rates improve and sales growth potentially slows down.

Many retail categories experienced a reduction in average store size, but this did not necessarily reduce the total lettable area. Tenant failures, right-sizing, active property management, and changing consumer behaviour have significantly changed the composition of total rentable space since the end of 2019.

Number of leases per region and portfolio

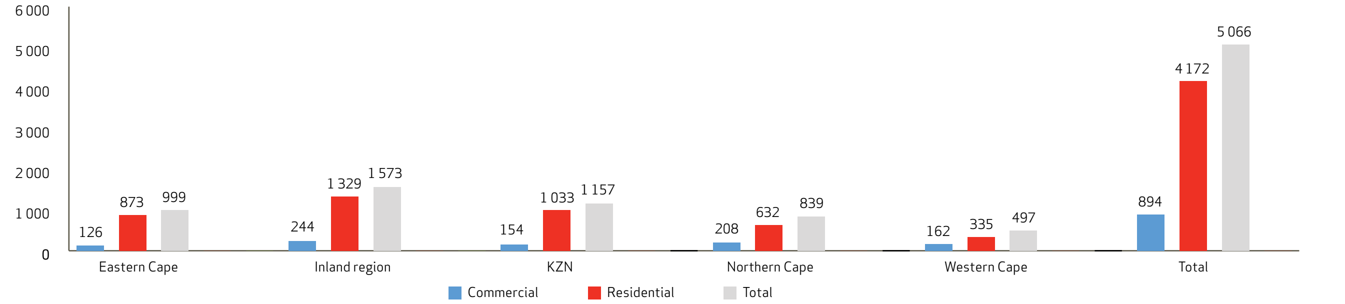

Figure 1: Number of leases per region and portfolio

CORE INITIATIVES

During the year under review, Transnet Property focused on several core initiatives:

- Marketing the portfolio, and fast-tracking the conclusion of new leases to grow revenue;
- Seeking approval to implement confinements for unsolicited bids using a Swiss Challenge methodology, currently undergoing governance approval processes;
- Negotiating the conversion of some development leases into equity participation to increase TP's share of the lease revenues;
- Disposing of non-core and underperforming portfolio assets;
- Increasing our debt collection index by aggressively collecting long-outstanding debts;
- Conducting lease audits to protect revenue and minimise revenue leakage;
- Expedite the implementation of a utilities cost management programme, including the issue of tenders for installing digital tools, such as smart meters, to enhance utilities management and collections from clients; and
- Conducting regulatory compliance audits to ensure safety and protect the Company's reputation.

OVERVIEW OF KEY PERFORMANCE INDICATORS

Key performance area and indicator	Unit of measure	2022 Actual	2023 Actual	2024 Target	2024 Actual	2025 Target
Financial sustainability						
Revenue	R million	937	2 242	**3 141**	**1 552**	4 025
EBITDA	R million	112	(302)	**824**	**246**	1 072
Operating margin	%	4.4	(15.2)	**25.0**	**13.4**	25.6
Return on invested capital	%	3.8	(7)	**11.1**	**(2)**	9.1
Revenue per employee	R million	1.4	3.3	**3.8**	**2.3**	5.8
Capacity creation and maintenance						
Capital expenditure*	R million	70.3	63.6	**569**	**131.7**	519
Operational performance						
Reduction in property vacancy rate	%	–	–	**5.0**	**–**	5
Reduction in property operating costs	%	(2.9)	(1.7)	**2.0**	**(2.7)**	2
Collection index	%	0.67	0.72	**0.82**	**0.81**	0.95
Recovery ration	%	45.0	11.99	**70.0**	**35.8**	75.0
Energy saving	%	(20.8)	–	**2.0**	**–**	2.0
Sustainable developmental outcomes						
Employment						
Employee headcount	permanent	668	673	**806**	**670**	699
Health & Safety						
LTIFR	index	0.03	0.26	**0.70**	**0.82**	0.68

** Capital expenditure excludes capitalised borrowing costs*

FINANCIAL PERFORMANCE REVIEW

Financial performance

		Year ended 31 March 2024 R million	Year ended 31 March 2023 R million	% change
Salient features				
Revenue		**1 552**	2 242	(31)
– Internal		**598**	1 539	(61)
– External		**954**	703	36
Operating expenses		**(1 306)**	(2 544)	(49)
– Energy costs		**(156)**	(419)	(63)
– Maintenance		**(36)**	(360)	(90)
– Materials		**(2)**	(1)	85
– Personnel costs		**(670)**	(573)	17
– Other		**(442)**	(1 191)	(63)
Profit from operations before depreciation, derecognition, amortisation and items listed below (EBITDA)		**246**	(302)	(181)
Depreciation, derecognition, and amortisation		**(38)**	(38)	0
Profit from operations before items listed below		**208**	(340)	(161)
Impairments and fair value adjustments		**(427)**	24	(1 879)
Net finance costs		**(505)**	(332)	52
Dividend income		**6**	4	55
Loss before taxation		**(718)**	(648)	11
Taxation		**442**	(196)	(325)
Loss after taxation		**(276)**	(844)	(67)
Total assets (excluding CWIP)		**14 078**	11 313	24
Profitability measures				
EBITDA margin[1]	%	**16**	(13)	(218)
Recovery ratio[3]	%	**36**	12	199
Operations margin[2]	%	**13**	(15)	(188)
Return on average total assets (excluding CWIP)[3]	%	**(2)**	(7)	(74)
Asset turnover (excluding CWIP)[4]	times	**11**	20	(44)
Capital investments^		**132**	64	106
Employees				
Number of employees	permanent	**670**	673	–
Revenue per employee	Rand	**2.3**	3.3	(30)

[1] *EBITDA expressed as a percentage of revenue.*
[2] *Profit from operations before impairment of assets, fair value adjustments, net finance costs and taxation expressed as a percentage of average total asset excluding capital work in progress.*
[3] *Total recoveries divided property recoverable costs.*
[4] *Revenue divided by average total assets excluding capital work in progress.*
^ *Actual capital expenditure (replacement and expansion) excluding borrowing costs.*

PERFORMANCE COMMENTARY

FINANCIAL SUSTAINABILITY

Revenue for the 2023/24FY decreased by 31% to R1 552 million (2023: R2 242 million), due to a change in accounting methodology. This change ensured that internal recoveries received by TP from Transnet Freight Rail (TFR), together with expenses incurred from TFR properties, are presented in the TFR Income statement. This is in line with generally accounting principles. The net effect of this adjustment on the EBITDA was zero.

Net operating expenses decreased by 49%, largely attributable to the transfer of TFR expenses, ensuring operating expenses are reflected where revenue occurred. Maintenance expenditure decreased significantly as TP incurred substantial costs on 2023 from repairing properties damaged by the floods in KZN during 2022. Consequently, the EBITDA margin and operating margin increased to 16% (2023: -13%) and 13% (2023: -15%) respectively. Return on average total assets (excluding CWIP) rose to -2% (2023: -7%).

Financial sustainability is crucial for organisational success, evidenced by an EBITDA increase of 181% compared to the 2022/23FY, highlighting the positive direction of the Company.

Looking ahead

To sustain financial performance, TP plans to grow lease revenue and diversify revenue streams in the 2024/25FY. TP has a focused plan to improve debt collection. This will enhance TP's financial sustainability.

TP has a focused plan to improve debt collection, enhancing financial sustainability. Management is disposing of non-core and inefficient properties to reduce operating expenses and unnecessary holding costs. These strategies aim to ensure long-term financial robustness.

TP management has a focused plan to improve debt collection and enhance financial stability. Management is disposing non-core and inefficient properties to reduce operating expenses and unnecessary holding costs. These strategies aim to ensure long-term, sustainable financial strength.

TP's key initiatives to commercialise the property portfolio include:

- Renewing leases at market-related rates;
- Securing new tenants;
- Recovering property operating costs;
- Streamlining processes for efficiency; and
- Disposing of non-core and underperforming properties.

OPERATIONAL PERFORMANCE

During the 2023/24FY, Transnet Property concluded 78 new leases and 107 lease renewals, totalling R1,72 billion and R281 million, respectively, over their lease period. These leases covered 473 hectares of land and 240 000m² of buildings, with an average annual escalation rate of 7.3%. The Western Cape Region and KZN regions were the largest contributors to new lease values and conclusion of lease renewals. Most new leases were in the logistics segment, which performs well within TP's portfolio.

Looking ahead

TP aims to continue leasing both directly managed properties and surplus assets to generate revenue and reduce operational costs. This will be achieved through tenant reimbursements, strengthening TP's financial standing by solidifying its portfolio valuation.

Transnet will advertise properties for lease and development in the coming financial year to attract external investment into the TP portfolio.

Areas of continued focus include:

- Implement the Swiss Challenge methodology to fast-tract the conclusion of unsolicited lease proposals;
- Aggressively collect outstanding debt to improve cash flow;
- Reduce costs by recovering property operating expenses from tenants;
- Conduct a customer satisfaction survey to better understand customer needs and requirements;
- Continue to implement optimal property management models to increase occupancy rate;
- Implement a utilities cost management programme, which includes installing smart meters – enhancing utility collections from clients;
- Re-evaluate the property portfolio to improve the asset base; and
- Accelerate the development of commercially viable PSP opportunities including leveraging other OD's properties.

CAPACITY CREATION AND MAINTENANCE

Capital investment for 2023/24FY was recorded at R131,6 million; higher than the previous year (2022/23: R66,6 million).

CAPEX was spent on, amongst others, the refurbishment of:

- 96 Rissik Street (the new Head Office of Transnet);
- Carlton Centre elevators; and
- Rehabilitation of Cambridge yard road surface (East London).

Looking ahead

Due to capital funding constraints, TP will aggressively pursue PSP together with like-minded partners, to leverage funding and strengthening the balance sheet.

TRANSNET PROPERTY

SUSTAINABLE DEVELOPMENTAL OUTCOMES

HUMAN CAPITAL (EMPLOYMENT AND TRANSFORMATION)

- Total permanent employees **670**
- Black employees **588**
- Female employees **348**
- People with disabilities **17**

SKILLS DEVELOPMENT

- Training spend as a percentage of labour costs **1.8%**
- Employees trained **813**

HEALTH AND SAFETY

- Lost Time Injury Frequency Rate (LTIFR) **0.82**

Various initiatives to improve safety awareness and reduce lost time due to workplace injuries will be implemented.

KEY RISKS
AND MITIGATING ACTIVITIES

The top 10 risks, shown hereafter, were identified during 2023/24FY and appropriate mitigating plans were assigned:

	Key risks	Mitigating activities
1	Inability to unlock full commercial value from the portfolio	• Leasing of under-utilised properties and reversion of development leases. • PSP Projects. • Prioritise and implement development projects (refurbishment of properties to house Transnet operations in Transnet-owned buildings).
2	Increased rental arrears and bad debt	• Handover to debt collectors, all debtors >60 days. • Implement more stringent credit assessments for new tenants. • Improve communication with tenants. • Cease provision of ancillary services to tenants that are in arrears.
3	Inadequate maintenance of properties and facilities impacting negatively on the value and compliance	• Audit of current building conditions and maintenance processes. • Procurement of maintenance contracts and use of Roving Maintenance Department. • Utilisation of beneficial occupation to allow tenants to invest own CAPEX.
4	Culture challenges impacting productivity and achievement of business objectives	• Revising and communicating the Employee Value Proposition (EVP). • Leaders back to the Floor (Empower Line Managers to manage their Staff). • Implementation of time and attendance. • Create greater awareness of employee wellness.
5	Unlawful occupation of properties	• Eviction of illegal squatters that follows the legal process. • Disposal of vacant and other non-strategic properties. • Stakeholder management including local Community Policing Forums and Local Councillors.
6	Regulatory non-compliance to primary acts and regulations applicable to the property environment	• Creating general awareness of relevant acts and regulations. • Condition assessments by service provider. • Monitoring of compliance Risk Management Plans (establishment of the Land Use Function to deal with land use matters).
7	Lack of integrated property management system	• Reconfiguration of the SAP Real Estate System for consolidated and automated reporting.
8	Inadequate Asbestos Compliance and Abatement Programme implementation	• Procure services of an Asbestos AIA to conduct the asbestos risk assessment. • Notify relevant authorities of asbestos issues, etc.
9	Lack of Project Management expertise affecting the delivery of projects on schedule, to budget and quality	• Change of contracting and procurement strategy (on-risk approach). • Appropriate resources employed and tasked with project monitoring.
10	Unreliable Energy Supply impacting the achievement of business objectives	• Undertake an energy security study in the context of TP (short- to medium-term). • Formulation and implementation of demand-side management projects (energy management and energy efficiency).

Most material climate change risks	Root causes	How they impact operations	How we will address them
Unreliability of power system (electricity supply)	Transition to low carbon economy.	Power cuts (loadshedding) and downtime costs to operations.	Implement Climate Change Mitigation Strategy: Compile GHG inventory and implement emission reduction plan to meet the net zero target by 2040. Diversify energy sources, i.e. renewable energy sources like PV solar. Provide power back-up system, i.e. UPS and diesel generators.
Unreliability of water supply	Drought and heat waves due to global warming.	Water rationing and associated downtime costs to operations.	Implement Water Conservation and Water Demand Management plan. Diversify water sources, i.e. groundwater and rainwater harvesting and investigating feasibility of technology like reverse osmosis to recycle, and reuse used water. Provide water storage back-up system.
Floods	High intensity and frequency of precipitation (rainfall) due to climate change.	Loss and/or damage to property. Potential litigation by affected parties.	Implement Climate Change Adaptation Strategy. Redesign, construct, and maintain resilient infrastructure, i.e. canals, stormwater drains, etc. Working together with all stakeholders including municipalities.
Asbestos-containing materials and contaminated land	Legacy of asbestos dumps and utilising asbestos containing materials.	Environmental liability and the costs of rehabilitation/ remediation to operations.	Implement Asbestos Management Strategy. Compile asbestos inventory, conduct risk assessment, and compile asbestos management plan for implementation as and when budget is available.

OPPORTUNITIES

- Diversification of the service offering to maximise returns from the property portfolio.
- Ability to leverage Transnet's scale to embed cost-saving synergies and gain a procurement edge.
- More responsive facilities management to internal and external clients through the implementation of an integrated facilities management model.
- Optimised operating model impacting cost base and enhancing revenue propensity.
- Unlocking of value through private-public partnerships.
- Improving billings and collections (currently under-collected by approximately 10%).
- Addressing housing needs of ODS at strategic sites to generate internal revenue.
- Contributing to B-BBEE participation in the property space.
- Fostering rural and local economic and spatial development by availing land to municipalities and developers.

TRANSNET PROPERTY

ACRONYMS

AEL	Atmospheric Emission Licence
CSI	Corporate Social Investment
DFFE	Department of Forestry, Fisheries, and the Environment
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortisation
EPMO	Enterprise Project Management Office
EXCO	Executive Committee
GO	General Overhaul
IoT	Internet of Things
KPI	Key Performance Indicators
MOP	Major Operations Programmes
OEM	Original Equipment Manufacturer
PAEL	Provisional Atmospheric Emission Licence
R&D	Research and Development
RM	Rotating Machine
ROS	Rail Operations Services
RSR	Rail Safety Regulator
SCM	Supply Chain Management
SHE	Safety, Health, and Environment
TE	Transnet Engineering
TFR	Transnet Freight Rail
TNPA	Transnet National Ports Authority
TPT	Transnet Port Terminals
WUL	Water Use Licence

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