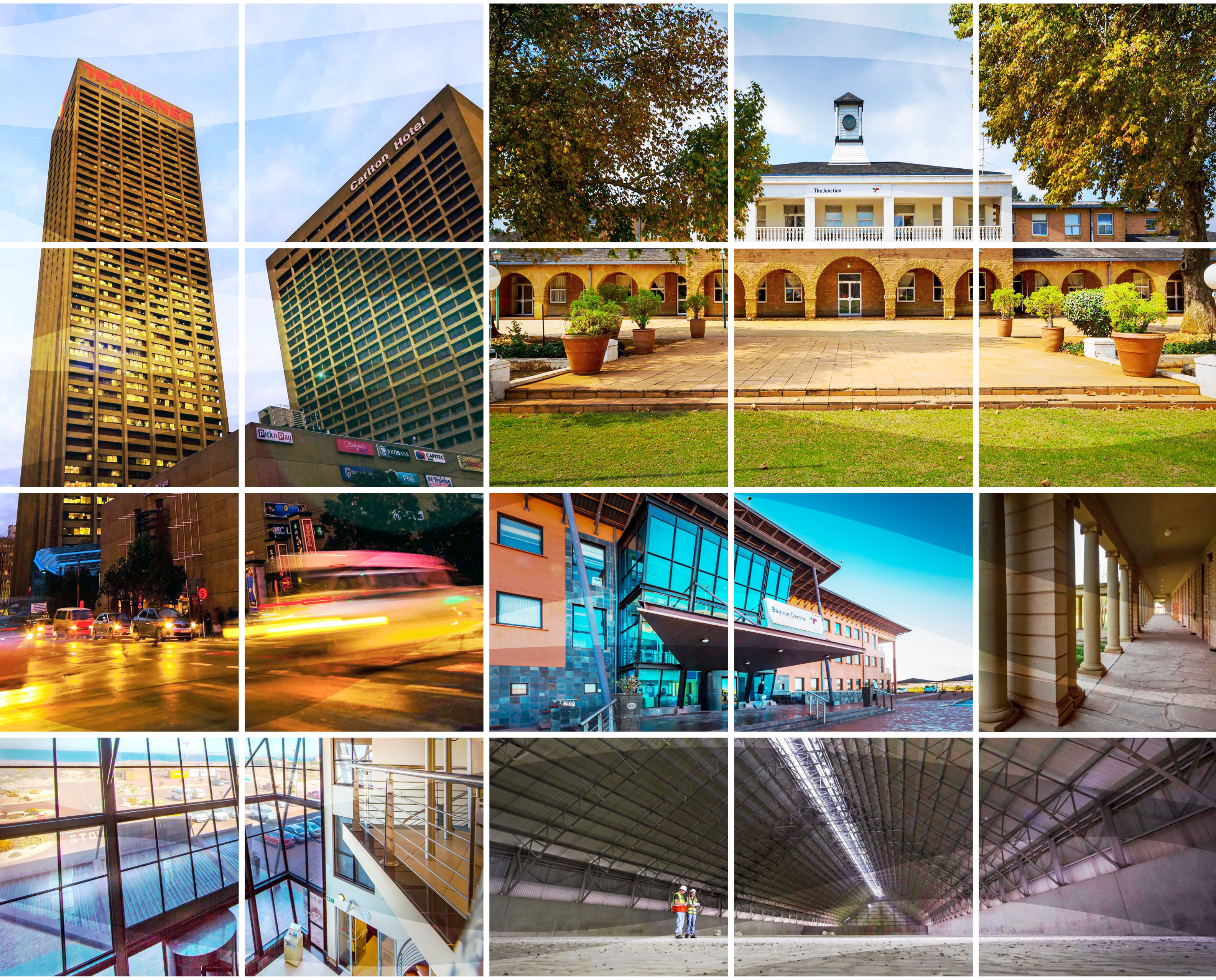
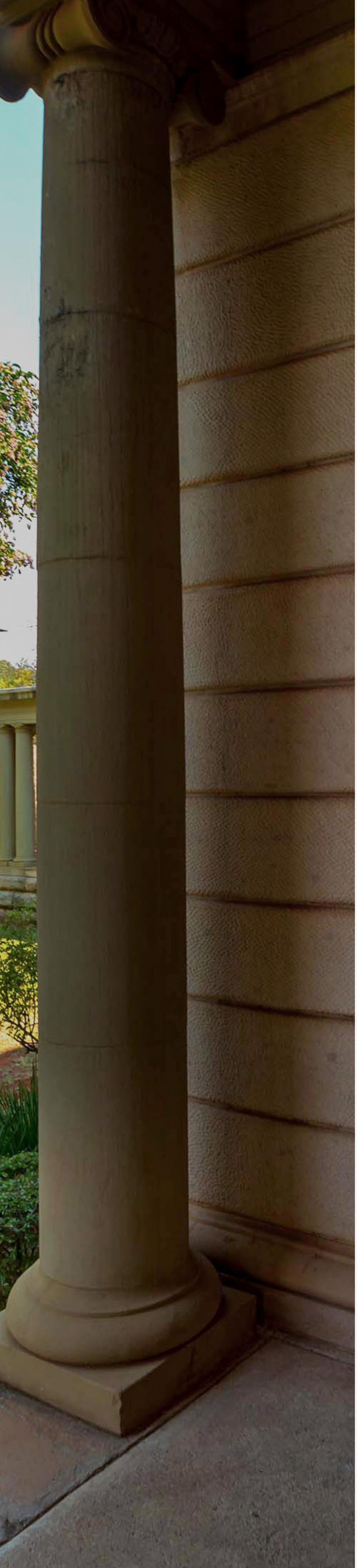
TRANSNET

PROPERTY REPORT **2022**





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Highlights

Revenue decreased by **7,5%** to **R937 million** (2021: R1,0 billion)

Operating expenses increased by **5,9%** to **R825 million** (2021: R779 million)

EBITDA decreased by **52,2%** to **R112 million** (2021: R234 million)

Recovery ratio decreased by **44,7%** (2020: R58,1%)

Business overview

Transnet Property (TP or Property), an Operating Division of Transnet, currently manages the commercial and residential properties on behalf of the Transnet Group. The remainder of the property portfolio is managed by the respective Operating Divisions (ODs). A new strategy, premised on a change in the operating model, has been approved by the Transnet Board of Directors. This strategy is expected to bring about a significant shift towards the consolidation of the property portfolio.

Due to the pressure on freight volumes arising from the economic downturn, it has become essential for Transnet's non core properties to be developed and managed more efficiently to maximise their potential. Historically, Transnet has alienated land parcels before they were developed or left them underdeveloped and underutilised. In these cases, development profits accrued to third parties and not Transnet. To date, Transnet has also struggled to achieve market related rentals on its properties due to the poor state of repair of these properties.

These properties are also constantly in need of working capital to comply with statutory requirements and to fund increasing holding costs such as rates and taxes, electricity and other operating costs. Given these challenges, a new approach to managing property assets was considered, which will see Transnet Property become a hub for immovable property issues within the Group. The new strategic direction has been endorsed by the Group Executiive Committee and a decision taken for Transnet Property to become a fully-fledged OD.

The proposed solution will see Transnet benefit from best commercial property practice and professional expertise, and there will be a shift from basic property management of the non-core properties to a full-scale asset management approach of Transnet's entire property portfolio. Given Transnet's current challenges with access to capital, partnerships with the private sector will play a pivotal role in some of the property developments, resulting in additional benefits such as a positive contribution towards broad-based black economic empowerment (B-BBEE), property charter objectives and social enhancement.

TP will continue to have both an internal and external customer focus cementing its commitment to servicing the needs of the ODs, as well as aggressively seeking out third third-party business and offering its expertise in the field of asset management, which encompasses property development, property management, facilities management and other specialist services. In order to achieve this, a new operating model is being implemented to roll out the new property strategy. This will ensure that the Transnet property portfolio yields maximum returns.

The following depicts the key focus areas that TP will embark on to optimise the property portfolio:

Asset	Developments	Property management
• Investment portfolio construction • Market analysis • Performance management and benchmarking • Investment strategy formulation • Performance reporting • Oversight on property management • Valuation and geospatial services	• Manage all developments on behalf of clients (including professional teams) • Deliver developments within 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

Asset base and facilities

The property portfolio currently consists of commercial and residential assets. The commercial portfolio consists of offices, warehouses, retail buildings and land. Residential property consists of vacant stands, houses and mass housing comprising hostels, lodges and line camps. The disposal of the residential portfolio will pave the way for more investment in the commercial portfolio.

Where we operate

The portfolio is spread across South Africa and is divided into five regions, i.e. KwaZulu Natal, Eastern Cape, Western Cape, Nor thern and the Inland region. The Northern region comprises the Limpopo, North West and Mpumalanga provinces, including Tshwane, while the Inland region is mad e u p of Gauteng, Free State and the Northern Cape provinces. The head office of Property is located in the Carlton Centre, Johannesburg.

Figure 1: Transnet property's geographic spread

Regulatory environment

South Africa has regulatory requirements that have an impact on how property owners operate within the sector. Some of these relate to by laws tailored to regulate the issue of dilapidated and often abandoned buildings that may pose health and safety risks to the public in general. The by laws prescribe the regular inspection of buildings, the serving of notices and warnings on land owners as well as the repair or demolition of dilapidated structures. The by laws authorise local authorities to take such steps to repair or demolish these structures at the owner's expense. TP currently has a number of dilapidated properties spread across the country and while there are plans to demolish some of them, in certain cases this must be done in compliance with the National Heritage Resources Act, No 25 of 1999.

Operational performance

Property industry outlook

South Africa's depressed macro economy, worsening property fundamentals, inflation, increase in interest rate and the impact of COVID-19 continue to put pressure on occupancies, rentals, and costs across our property sectors. All key performance areas are showing negative trends due to the economic weakness and deteriorating positions experienced across our customer base.

With commercial and residential property being directly related to economic growth, and the health of South Africa's shrinking economy still being a major concern, it is expected that companies will generally not take up more office space but will rather downsize or worse still go into liquidation. Retailers are struggling to stay afloat and new shops are scarce. Manufacturers are still suffering and new industrial outfits looking for space are also rare.

The first issue of Rode' s Report on the South African Property Market for 2022 shows that the office market remains the riskiest due to a swelling vacancy rate as a result of the work from home trend and an oversupply of commercial space built during the last few years when the economy was already struggling.

On the positive side, industrial property is still doing well due to its superior fundamentals, while house prices are performing better than expected.

Industrial property

Fundamentally, industrial property is still in the best position compared to the other non residential property types due to its few speculative de velopments, low vacancies and recovering rental growth. In the second quarter of 2022, nominal rentals for prime space of 500 m^2 grew by 5,4 year on year nationwide. This is better than the 2,2 growth achieved in 202 1 and above 5% rental growth of 2019. Although experiencing fewer headwinds than theoffice and retail property markets, the slow rental growth shows that the industrial market is also feeling the effect of the weak economy.

Offices

Rode's office market survey indicates that commercial landlords' worst fears have been realised. Market rentals are still dropping further due to a growing oversupply as employees continue to work from home. No major city recorded above-inflation office rental growth, with rentals for decent realised Grade A space decreasing by 1% compared to the previous year.

The trend in oversupply in office space continues and is anticipated to increasingly outstrip demand while driving increases in vacancies.

Although market corrections have started taking place, the lockdown's full impact on the commercial office sector is likely to only show over the next 18 to 24 months.

While quality industrial stock remains the preferred real estate asset class of choice, rentals are anticipated to compress by at least 10% to 20% over the medium term, resulting in the sector starting to experience fundamental corrections similar to those in the commercial office sector. Landlords have started offering escalation-free periods for the first y ear or two of occupation, in addition to increased tenant installation allowances and rent free incentives of up to six months.

Operational performance

Property owners across all sectors are under pressure to retain current tenants and protect existing income streams, while battling defaulting tenants and rising ope rating and administrative costs. Arrears continue to increase at alarming rates due to long outstanding contractual disputes with some major tenants, the protracted eviction process and a significant number of undesirable and financially unsound tenants still occupying our properties.

This has been exacerbated by the global impact of COVID-19 on individuals and companies alike, as evidenced by the decrease in the collection from 78% in 2019/20 to 62%. Year-to-date collection is at 67,1%.

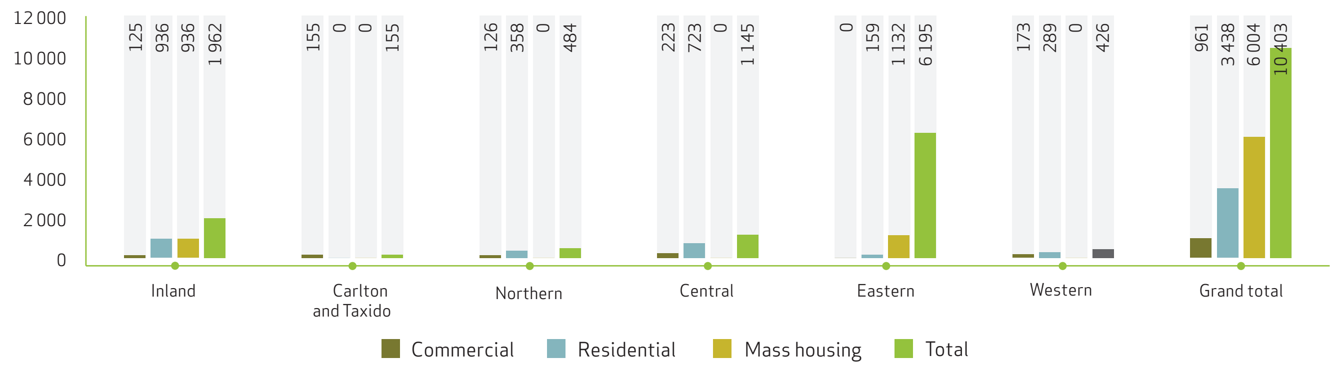
There is a total of 10 403 leases recorded for March 2022 made up of commercial, residential and mass housing portfolios.

Core initiatives

TP's key focus areas during the year under review were:

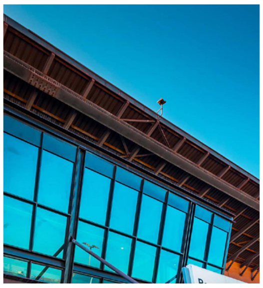
- Development of a new property strategy and operating model
- Reviewing and updating of the leasing policy
- Upkeep of the property portfolio through a planned maintenance regime
- Continued engagements with municipalities and other government entities for the disposal of the hostel's portfolio and other properties to the municipalities

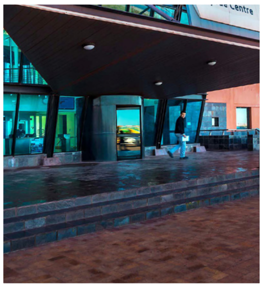
Number of leases per region and portfolio



Overview of key performance indicators

Key performance area and indicator	Unit of measure	2020 Actual	2021 Actual	2022 Target	**2022 Actual**	2023 Target
Financial sustainability						
Revenue	R million	1 077	1 013	1 108	**937**	2 952
EBITDA	R million	309,2	234,9	429,7	**112,1**	814
Operating margin	%	14,7	10,1	25,7	**4,4**	25,1
Return on invested capital	%	2,1	1,4	0,7	**16**	3,4
Revenue per employee	R million	2,55	2,31	1,71	**1,4**	3,7
Capacity creation and maintenance						
Capital expenditure	R million	165,4	166,2	103	**70,3**	741
Operational performance						
Volume and revenue growth						
Collection index	%	0,85	0,61	68	**67,0**	>100
Recovery ratio	%	64,5	58,1	68	**44,7**	74,6
Energy saving	%	7,3	9,9	6	**(20,8)**	10
Sustainable developmental outcomes						
Employment						
Headcount of permanent employees	number	423	439	649	**668**	795
Health and safety						
DIFR	index	0,10	0,04	0,75	**0,03**	N/A





Financial performance review

Salient features		Year ended 31 March 2022 R million	Year ended 31 March 2021 R million	% change
Revenue		**937**	1 013	(8)
– Internal		**744**	726	2
– External		**193**	287	(49)
Operating expenses		**825**	778	6
– Energy costs		**147**	132	10
– Maintenance		**79**	73	8
– Materials		**0**	–	
– Personnel costs		**(283)**	(258)	9
– Other		**882**	831	6
Earnings before interest, taxation, depreciation and amortisation and items listed below (EBITDA)		**112**	235	(110)
Depreciation, derecognition and amortisation		**(71)**	(133)	(87)
Profit from operations before items listed below		**41**	102	(149)
Impairments and fair value adjustments		**370**	(512)	238
Net finance costs		**(284)**	(199)	30
Profit before taxation		**127**	(609)	580
Taxation		**204**	171	16
Profit after taxation		**331**	(438)	232
Total assets (excluding CWIP)	R million	**9 303**	7 458	20
Profitability measures				
EBITDA margin[1]	%	**12**	23	(11)
Operating margin[2]	%	**4**	10	(6)
Return on total average assets (excluding CWIP)[3]	%	**0,5**	1,4	(0,9)
Asset turnover (excluding CWIP)[4]	times	**0,11**	0,14	(0,0)
Capital investments[5]	R million	**54**	166	(1,6)
Employees				
Permanent employees	number	**668**	439	0,3

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 revenue.*

3 *Profit from operations before impairment of assets, fair value adjustments, net finance costs and taxation expressed as a percentage of total average assets excluding capital work in progress.*

4 *Revenue divided by total average assets excluding capital work in progress.*

5 *Actual capital expenditure (replacement + expansion) excluding borrowing costs.*

Performance commentary

Financial sustainability

In terms of overall financial performance and prior to the impact of COVID-19, TP was tracking well to meet an improved performance in the 2022 financial year relative to the previous reporting period. The direct impact of this pandemic on our business during the year was the inability to attract new tenants, increased arrears, and an ongoing decline in occupancy.

Revenue decreased by 7,5% to R937 million (FY2021: R1,01 billion). TP reported a 110% decrease in EBITDA of R112 million (FY2021: R234,8 million), attributable to increased vacancy rates and poor recoveries of property-administered costs from tenants. The net profit for the year before taxation is R1 526 million (FY2021: R569,7 million), due to an increase in the value of investment properties.

Looking ahead

Property's new strategy will see Transnet benefit from best commercial property practice and professional expertise and there will be a shift from basic property management of the non core properties to a full scale asset management approach of Transnet's entire property portfolio.

TP's sectoral strategies will cover the following key property segments industrial, offices, retail, residential and special purpose properties as well as land banking.

To achieve financial sustainability, TP will commercialise the property portfolio and strengthen the balance sheet by embarking on the following key initiatives:

- Conducting a market analysis to gain insights into the property industry and the opportunities available in the market.
- Disposing of hostels, residential houses and demolish unwanted properties to minimise holding costs.
- Developing and implementing a comprehensive non GLA revenue strategy (i.e. outdoor advertising, film locations and fibre) to increase revenue.
- Rolling out the Development Leases Reversion Programme to take over the development leases in the property portfolio upon expiry, and growing the balance sheet.
- Consolidating and standardising head office and regional office space in Transnet wned properties to save costs, optimally utilise Transnet assets and standardise the look and feel of facilities.
- Implementing the following key development project, namely Carlton Centre, 1 Adderley Street, Port Elizabeth Waterfront, 96 Rissik Street, Durban Logistics Hub, Culemborg and Maitland to optimise portfolio returns and strengthen the balance sheet.

Capacity creation and maintenance

Capital investment of R63,7 million for the year was 61,7% lower than the prior year (2021: R166,3 million).

Sustainable development outcomes

Human capital (employment and transformation)

- TP achieved a permanent employee headcount of 668
- Black employees represented 87,2%
- Female employees represented 49,6%
- People with disabilities represented 5,2%

Skills development

- Training spend as a percentage of labour costs was 1,2%
- Employees trained: 81
- Bursaries: 31

Health and safety

- TP maintained a DIFR of 0.03 during the year under review

Key risks and mitigating activities

The top ten risks below were identified during the year under review with appropriate mitigating plans:

Key risks	Mitigating activities
Inability to unlock full commercial value from the portfolio	• The new Transnet-wide property strategy is being implemented, and a revised operating model and the organisational structure is being embedded. • The revaluation of the investment property portfolio has already contributed to the improvement in the balance sheet and the financial sustainability of Transnet. • The disposal of the residential portfolio and some commercial properties, is in progress, and certain properties earmarked for redevelopment through private sector partnerships (PSPs), have been advertised in open the market.
Inadequate lease management processes	• The revised leasing policy is awaiting approval by the relevant governance structures. Some of the revised standard operating procedures are already being implemented.
Increase in rental arrears/bad debts	• There is strong focus on the collection from the Top 20 debtors and a more stringent credit assessment for on-boarding of new tenants is being applied. Also, a business decision to adopted to cease the provision of ancillary services to tenants that are not paying, and tenants in single tenanted buildings are encouraged to procure services themselves, where possible.
Inadequate maintenance of the portfolio	• On-going rollout of ad-hoc and scheduled maintenance plans and appointment of maintenance service providers, and utilization of beneficial occupation to allow tenants to invest own CAPEX for maintenance and refurbishments. • Statutory building inspection programme to ensure compliance with regulations. • The facilities management policy and standard operating procedures have been revised.
Business interruption in the event that a significant number of empl oyees are infected by COVID-19	• Implementation of Transnet COVID-19 Protocols covering, amongst others, the management of COVID-19 cases; screening of employees, contractors and visitors; implementation of a remote working policy; social distancing protocols, on-going risk assessments etc. • As the COVID 19 cases subside, the division continues to monitor and revise the protocols, guided by the Transnet Protocols that are communicated from time to time.
Capacity challenges impacting the delivery of business objectives	• Recruitment and placement of sufficient competent workforce into the new structure with priority in placing leadership roles. • On-going consultations with the relevant internal stakeholders regarding the integration of the real estate employees from other operating divisions into Transnet Property.
Illegal occupation of properties	• Eviction of illegal occupiers following the legal process. • Monitoring of potential illegal occupation cases by increasing site visits and posting security personnel, where feasible.
Regulatory non-compliance with legislation and regulations applicable to the property environment	• Continuous monitoring of the regulatory universe and exposures. • Regular site inspections, condition assessments & maintenance programme to ensure effective building compliance. • Ensuring that the implementation of Combined Assurance activities incorporates compliance monitoring
Lack of an integrated property management system resulting in no consolidated view of the property portfolio	• The procurement of a service provider for the reconfiguration of the SAP Real Estate System, is at an advanced stage. The implementation of the project will ensure that there is consolidated view of property portfolio and automated reporting.
Poor contract management resulting in inefficient delivery of services	• Implementation of operational Service Level Agreements to manage existing and future service providers. • Transversal contracting for common services to ensure value for money. • Capacitation of the contract management function to improve controls.

Opportunities

- Reduction of high holding costs through the disposal of the residential portfolio and a focused approach to management of r ates and taxes for the entire Group
- Cost reduction through consolidation of ope rations in Transnet-owned buildings
- Diversification of the service offering to maximise returns from the property portfolio
- Ability to leverage Transnet scale to embed cost saving synergies and gain a procurement edge
- Unlocking value through private public partnerships
- Implementing an integrated organisational structure to eliminate duplications and improve efficiencies
- Improving billings currently under-collected by approximately 10% (minimum)
- Addressing housing needs of ODs at strategic sites