REINVENT
FOR GROWTH

TRANSNET PROPERTY REPORT **2023**

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REINVENT
FOR GROWTH

delivering freight reliably property

HIGHLIGHTS

Revenue increased by 139,4% to R2 242,1 million (2022: R936,7 million)

Operating expenses increased by 208,5% to R2 543,7 million
(2022: R824,6 million)

EBITDA decreased by 368,9% to R301,6 million loss
(2022: R112,1 million profit)

Recovery ratio decreased by 23,9% to 11,9% (2022: 35,8%)

BUSINESS OVERVIEW

Transnet Property is the custodian of a diverse and strategic property portfolio consisting of residential, retail, commercial and industrial properties. This strategic and sizeable portfolio has over time underperformed with below-market growth and returns. This has been, in part, due to neglect, a lack of adequate capital investment and limited portfolio management skills within the division.

As a means of addressing the underperformance of the Company's property portfolio, an optimisation strategy which aims to achieve commercial self-sustainability, is being implemented to achieve the mandate of maximising the returns from the property portfolio and grow the asset base using best practice asset management principles. This strategy places greater emphasis on executing strategic investment on selected assets within the portfolio which will enable the realisation of sustainable and market-related commercial returns in line with the ambition to enhance overall contribution to the Company. However, given the overall constrained financial position of Transnet, Transnet Property is required to undertake innovative measures to raise the capital required for the strategic portfolio investment projects.

To achieve this, Transnet Property has adopted a dual approach, which will has a self-funding element, achieved through the completion of several disposal transactions for non-core properties particularly within the residential portfolio, which includes houses, lodges, and line camps, among other properties. In the second element, Property is accelerating its collaboration with private sector property partners to either jointly develop commercial opportunities or to offer its assets for private development; this will focus on its retail, industrial and commercial assets.

It is envisaged that the nature of interventions contained within Transnet Property's strategy will limit the portfolio's exposure to underperforming assets, particularly within the residential space, that have historically resulted in value leakage. It will also enable the attraction of private capital investment required to refurbish and improve competitiveness of assets and in doing so enable the repositioning of Property as a sustainable and strategic asset manager for internal and external customers.

Therefore, Transnet Property continues with its commitment of servicing the needs of the Operating Divisions as well as aggressively seeking out third-party business and offering expertise in the field of asset management, which encompasses property development, property management, facilities management and other specialised services

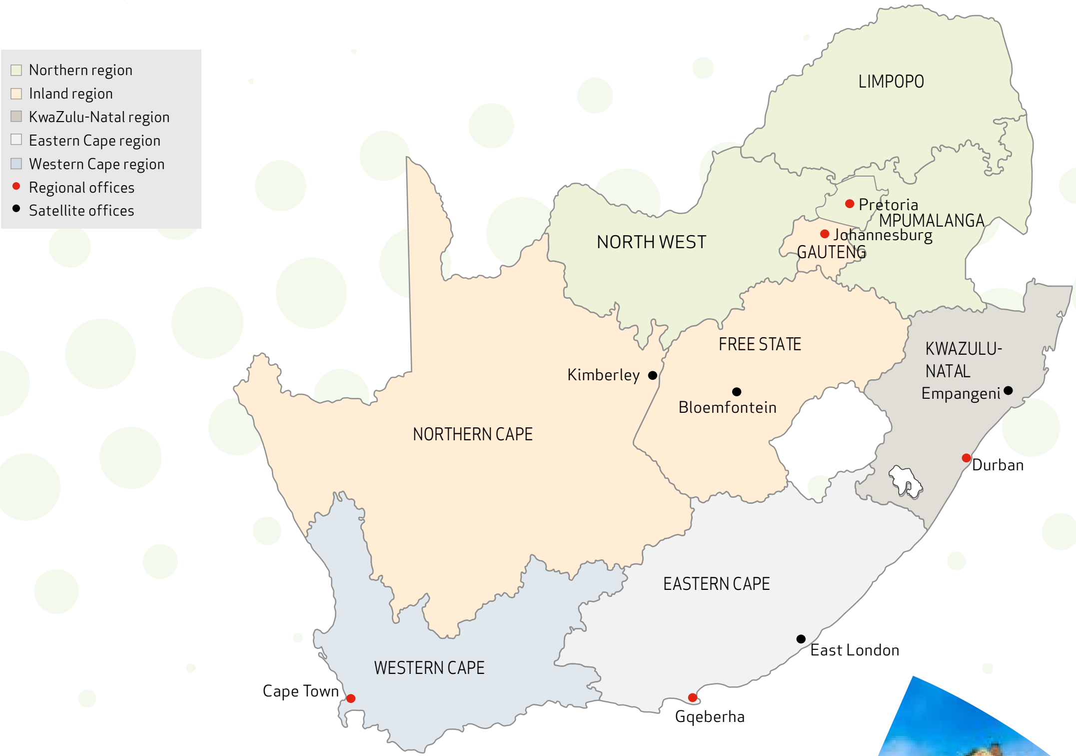
Asset Management	Developments	Property management
• Investment portfolio construction • Market analysis • Performance management and benchmarking • Investment strategy formulation • Performance reporting • Oversight of property management • Valuation and geospatial services	• Manage all developments 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

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. Disposing of the residential portfolio will pave the way for more investment in the commercial portfolio as well as reduce the holding costs.

WHERE WE OPERATE

The portfolio is spread across South Africa and is divided into five regions, i.e. KwaZulu-Natal, Eastern Cape, Western Cape, Northern and the Inland regions. The Northern Region comprises Limpopo, North West and Mpumalanga provinces, (excluding Tshwane), while the Inland region is made up of Gauteng, Free State and the Northern Cape provinces (including Tshwane). The head office of Property is located in the Carlton Centre, Johannesburg.



REGULATORY ENVIRONMENT

South Africa has regulatory requirements which impact 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, and 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. Transnet Property currently has several run-down 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.

In addition, the other key regulations that directly impact Transnet Property, relate to spatial planning and land use management, building regulations and standards, eviction of unlawful occupiers, management of contaminated land and asbestos, as well as lifts and escalator installations. Moreover, for the disposal of non-core properties, Transnet Property has to comply with the Public Finance Management Act (PFMA), No 1 of 1999, as well as the Department of Public Enterprises Disposal Guidelines, which may impact the ability for the division to be as agile as other property players in the private sector.

OPERATIONAL PERFORMANCE

PROPERTY INDUSTRY OUTLOOK

During FY 2022/23, the property market began recovering, showing signs of rebounding to pre-Covid19 levels. The market generally experienced growth in rentals, a reduction in vacancy rates and a reduction in bad debt s the economy began to show recovery from the pandemic.

Several factors, such as the critical energy shortages and growth in interest rates, dampened the market's recovery rate. Although the property market has shown signs of recovery, the market was still under strain and has not fully recovered from Covid-19.

Property owners across all sectors are under pressure to retain current tenants and protect existing income streams, all the while battling defaulting tenants and rising operating and administrative costs. Arrears continue to be high due to lengthy outstanding contractual disputes with some major tenants, a 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 85% in the prior year to the current 62%.

INDUSTRIAL PROPERTY

Fundamentally, industrial property is still in the best position compared to the other non-residential property types due to its few speculative developments, 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 2021 and above 5% rental growth of 2019. Although experiencing fewer headwinds than the office and retail property markets, the slow rental growth shows that the industrial market also feels the effect of the weak economy.

OFFICES

Rode Report 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.

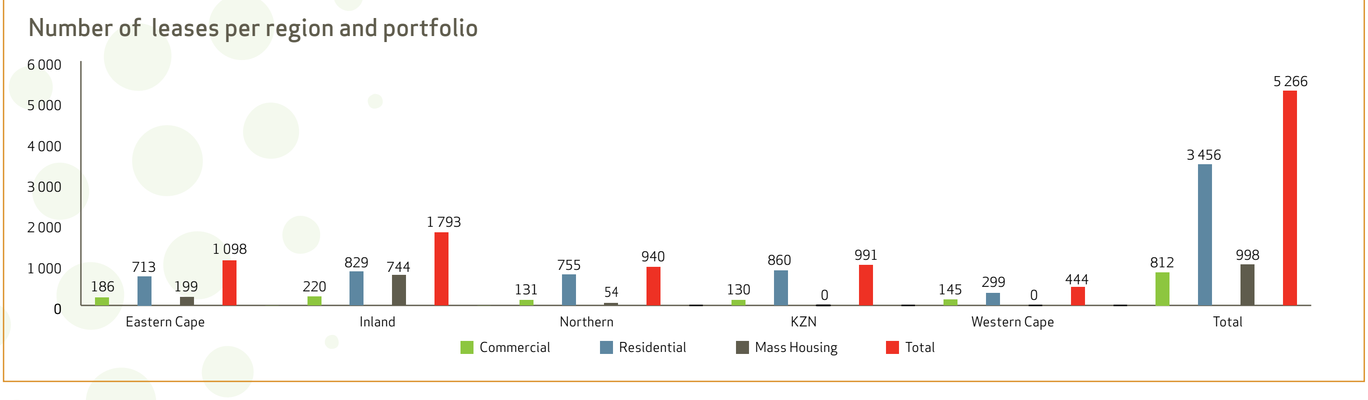
The trend in oversupply in office space continues and is anticipated to outstrip demand while driving increases in vacancies increasingly. Although market corrections have started, the lockdown's total impact on the commercial office sector will likely only show over the next 18 to 24 months.

While the 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 year or two of occupation, in addition to increased tenant installation allowances and rent-free incentives of up to six months.

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%. The year-to-date collection is at 67,1%. Give a current status of the pandemic impact.

NUMBER OF LEASES PER REGION AND PORTFOLIO

There was a total of 5 266 leases recorded as at March 2023, made up of commercial, residential and mass housing portfolios.



CORE INITIATIVES

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

- Negotiated and entered into new leases as well as renewed the expired leases at market related rentals
- Initiated the disposal of certain non-strategic and/or non-performing assets, including hostels and residential houses.
- Developed and implemented a comprehensive non-GLA revenue strategy (outdoor advertising, film locations, fibre) to increase revenue
- Rolled out the Development Leases Reversion Programme to take over the development leases into the Property portfolio upon expiry, in order to grow the balance sheet
- Took over investment property (IP) assets valued at R2.4 billion, which were transferred from Transnet Freight Rail as part of the project to integrate the real estate functions of TFR and TPT
- Commenced with the implementation of key development projects in partnership with the private sector developers. Some of the projects that have either commenced or at advanced planning stages include: 1 Adderley Street, Port Elizabeth Waterfront, East London Waterfront, 96 Rissik Street Office Refurbishment, Automotive Supplier Park development at the Durban Logistics Hub.
- Appointed an external service provider for the execution of the property management solution project, for improving the SAP Real Estate Management System in order to, amongst other things, integrate lease, utilities, and asset management functions; eradicate legacy systems and cleanse property and assets data; automate and standardise the payment of municipal accounts and automate reporting on the property portfolio performance (occupancy and vacancy rates)

OVERVIEW OF KEY PERFORMANCE INDICATORS

Key performance area and indicator	Unit of measure	2022 Target	2022 Actual	2023 Target	2023 Actual	2024 Target
Financial sustainability						
Revenue	R million	1 107	936,7	2 952	**2 242**	3 141
EBITDA	R million	430	(825)	814	**(302)**	553
Operating margin	%	25,7	4,4	25,2	**(15,1)**	16,4
Return on invested capital	%	3,4	3,8	9,8	**(2,2)**	11,1
Revenue per employee	R million	231	1,48	3,72	**3,33**	3,90
Capacity creation and maintenance						
Capital expenditure	R million	41,0	70,3	741,5	**63,6**	569,1
Operational excellence						
Reduction in property operating costs	%	2,00	(2,93)	2,00	**(1,73)**	2,00
Collection index	%	1,05	0,67	1,00	**0,72**	1,00
Recovery ratio	%	69	35,84	20,53	**11,99**	19,48
Sustainable developmental outcomes						
Employment						
Employee headcount	permanent	479	635	794	**673**	806

FINANCIAL PERFORMANCE REVIEW

Salient features		Year ended 31 march 2023 R million	Year ended 31 march 2022 R million	% change
Revenue		**2 242**	937	139
Internal		**1 539**	193	698
External		**703**	744	(5)
Operating expenses		**(2 544)**	(825)	208
Energy costs		**(419)**	(147)	185
Maintenance		**(360)**	(77)	368
Materials		**(1)**	(0)	10621
Personnel costs		**(573)**	(283)	103
Other		**(1 191)**	(318)	274
EBITDA		**(302)**	112	(369)
Depreciation and amortisation		**(38)**	(71)	(47)
Profit from operations before items listed below		**(339)**	41	(924)
Impairments and fair value adjustments		**24**	370	(94)
Net finance costs		**(332)**	(284)	17
Profit before tax		**(647)**	127	(610)
Taxation		**(196)**	204	(196)
Profit after taxation		**(844)**	331	(355)
Total assets (excluding CWIP)	R million	**11 313**	9303	22
Profitability measures				
EBITDA margin[1]	%	**(13)**	12	(212)
Operating margin[2]	%	**(15)**	4	(444)
Return on total average assets (excluding CWIP)[3]	%	**(8,1)**	3,5	(331)
Asset turnover (excluding CWIP)[4]	times	**22**	10	117
Capital investments[5]	R million	**64**	70	(10)
Employees				
Permanent employees		**673**	635	6

1 *EBITDA expressed as a percentage of revenue.*
2 *Profit from operations before impairment of assets, fair value adjustment, net finance and taxation expressed as a percentage of revenue.*
3 *Profit from operations before impairment of assets, fair value adjustment, net finance and taxation expressed as a percentage of total average assets.*
4 *Revenue divided by total average assets except capital work in progress.*
5 *Actual capital expenditure (replacement + expansion) excluding borrowing costs.*

PERFORMANCE COMMENTARY

Financial Sustainability

Revenue for the period under review increased/decreased by 139,4% to R2 242,1 million (2022: R936,7 million).

Looking ahead

To achieve financial sustainability, Transnet Property will aggressively commercialise the property portfolio through the following key initiatives:

- Lease renewals at market-related rates
- Secure new tenants
- Recovery of property operating costs
- Streamlining processes to improve efficiencies
- Disposing of non-core and underperforming properties

Operational performance

Despite the challenging market conditions, we remained focused on executing our business plan in a disciplined and calibrated manner, seeking opportunities to deliver attractive returns.

During the year under review, Transnet Property concluded a total of 147 lease renewals and 56 new leases. The new leases had a total value of R184 million over the entire lease period and account for 323 000 m^2 of lettable area, whilst the lease renewals concluded amounted to a total value of R461 million over the entire lease period, and accounting for 571 000 m^2 of lettable area. A weighted average escalation rate of 7,5% was achieved across all 203 new leases and lease renewals.

Some of the key legacy issues were resolved during the year and such case was the renewal of the lease agreement between Transnet Property and the Department of Public Works for Bophelo House, which had been on holdover since 2017. Although the lease renewal resulted in a decrease in revenue, the tenant is now paying the rentals, and Transnet Property is making strides to recover the historic debt associated with the lease agreement.

We were also able to focus on the collection of outstanding debt from tenants, with notable cases being from the Carlton Centre and PRASA, to name but a few.

Looking ahead

Transnet Property will continue to focus on the implementation of the following tactical initiatives to support Transnet's strategic focus areas by improving operational efficiencies, improving customer service and returns from the property portfolio and enhancing the portfolio's performance:

- Implementing an optimal property management model to increase occupancy and improve collections and enhance facilities management;
- Accelerating the development of commercially viable private sector participation (PSP) opportunities including leveraging other Operating Divisions' properties;
- Accelerating the completion of historical reconciliations and the development of a coherent plan for the collection of all outstanding debts, including Government clients, as part of a broader initiative to improve cash flow management;
- Implementing renewable energy and sustainability initiatives to reduce operating costs on Transnet-owned properties;
- Rolling out a comprehensive non-GLA revenue strategy (outdoor advertising, film locations, fibre) to increase revenue

Capacity creation and maintenance

Capital investment for the year, was R63,6 million, which is 9,6% lower than the prior year (2022: R70,3 million). This Capex was spent on, amongst others, refurbishment of 96 Rissik Street which will be the new Head Office of Transnet, and refurbishment of the lifts at 1 Adderley Street offices.

Looking ahead

Given the capital funding limitations, Transnet Property will aggressively implement private sector partnership (PSP) developments, in conjunction with like-minded partners, with a view to leveraging private sector funding and strengthening the balance sheet.

Sustainable developmental outcomes

Human capital (employment and transformation)

- TP achieved a permanent employee headcount of 668
- Black employees represented 88.60%
- Female employees represented 49.3%
- People with disabilities represented 3.2%

Skills development

- Training spend as a percentage of labour costs was 2.90%%
- Employees trained: 712
- Bursaries: 31

Health and safety

- Transnet Property maintained an LTIFR of 0,26 during the year under review.

KEY RISKS AND MITIGATING ACTIVITIES

Effective enterprise risk management (ERM) plays a critical role in ensuring the successful transformation of Transnet into a focused, high-performance rail, port and pipelines business. ERM is an integrated process of assessing and responding to all risks, including organisational, project or systemic risks that impact the ability of an organisation to meet its objectives.

The Division's key strategic risks are presented in the following table:

Top Risks	Mitigating Activities
Inability to unlock total commercial value from the portfolio	• The new Transnet-wide property strategy is being implemented, and a revised operating model and organisational structure are being embedded. • The revaluation of the investment property portfolio has already contributed to improving the balance sheet and the financial sustainability of Transnet. • The disposal of the residential portfolio and some commercial properties, is in progress, and specific properties earmarked for redevelopment through private sector partnerships (PSPs), have been advertised in the open 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 a strong focus on the collection from the Top 20 debtors, and a more stringent credit assessment for the 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 utilisation 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 COVID-19 infects a significant number of employees	• 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, ongoing 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 occasionally.
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 and 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 reconfiguring the SAP Real Estate System, is at an advanced stage. The implementation of the project will ensure that there is a consolidated view of the 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

- 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 Operating Divisions 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

ABBREVIATIONS

CTCT	Cape Town Container Terminal
GCH	Gross crane hour
ICT	Information and Communications Technology
IMO	International Maritime Organisation's
MPT	Multi-Purpose Terminal
NAAMSA	National Association of Automobile Manufacturers of South Africa
OEM	Original Equipment Manufacturer
PECT	Port Elizabeth Container Terminal
PEMPT	Port Elizabeth Multi-Purpose Terminal
RTG	Rubber-tyre gantry
SWH	Ship working hour
TEU	Twenty-foot equivalent units
VSP	Voluntary Severance Package