

Ekurhuleni Metropolitan Municipality Strategic Land Parcels

Phase 2 Deliverable: SLP 8.1 – JP Bezuidenhout



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Dear Sir/Madam

Phase 2 Deliverable: SLP 8.1 – JP Bezuidenhout

Attached please find the phase 2 report in respect of the above-mentioned SLP.

The report highlights important features from the Development Framework provided by DeltaBEC, provides an overview of the highest and best use from the valuation report provided by Spectrum as well as the results of the financial model.

Supporting documents are attached hereto as annexures and can be consulted for detail information.

Kind regards.

Yolande Baron
Associate Director

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1. Approach

Deloitte was appointed by EMM to assist in the release of certain Strategic Land Parcels (“SLP’s”) to the market for development. The primary goal of this project is to use identified SLP’s to stimulate economic growth and development in line with strategic EMM objectives.

The project approach is depicted as follows:

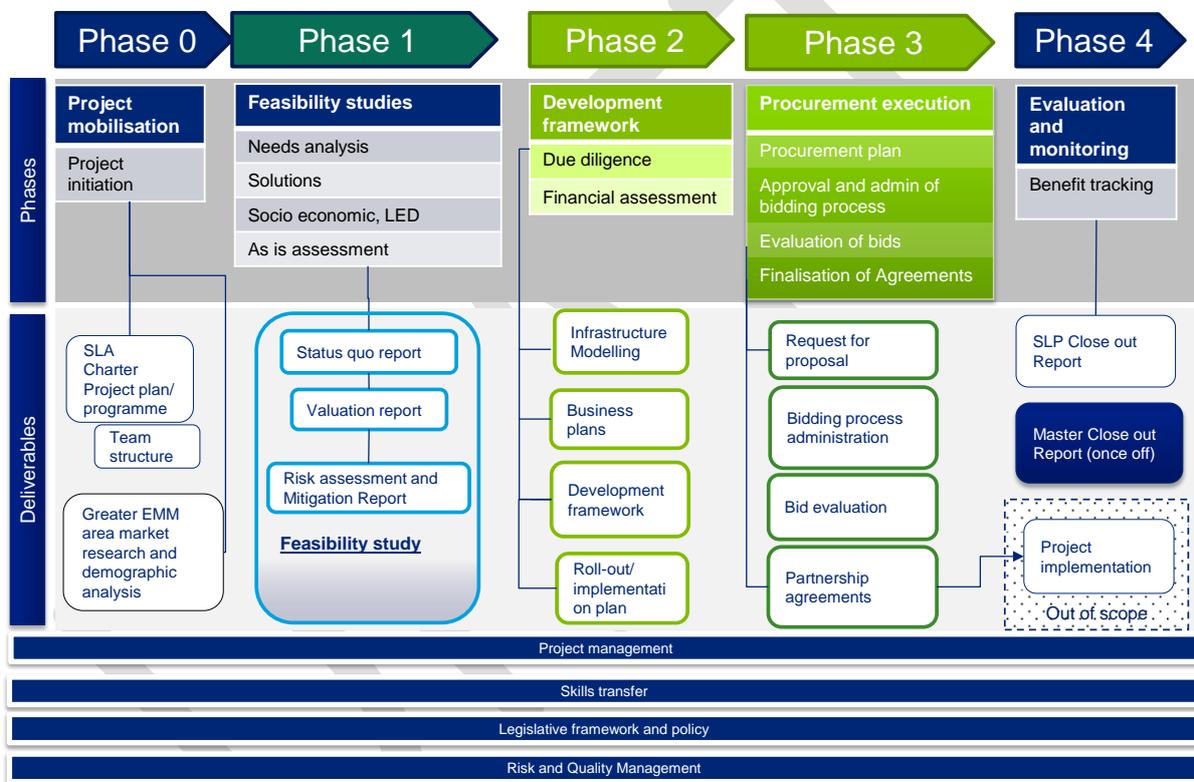


Figure 1: Project approach

Phase 0 has been concluded with the delivery of the Inception Report.

A **phase 1** report summarising the deliverable which included the Demographic Assessment, the Technical Assessment as well as a Valuation Report were made available concerning this SLP.

This **phase 2** report addresses the following:

- The Development Framework
- The highest and best use value as provided by the professional valuer
- The financial model is introduced and outcomes relating to the financial indicators are discussed

The specialist reports relating to the above are attached hereto as annexures and can be consulted for detail information.

1.1. SLP description

This report covers SLP 8.1 : JP Bezuidenhout.

The area of interest comprises the following properties:

- Remainder of Portion 305 of the Farm Rietfontein 63-IR
- Remainder of Portion 8 of the Farm Rietfontein 63-IR
- Portion 545 Township Eastleigh-IR
- Portion 546 Township Eastleigh-IR
- Portion 9/581 Township Eastleigh-IR
- Portion 10/581 Township Eastleigh-IR
- Portion 11/581 Township Eastleigh-IR
- Portion 12/581 Township Eastleigh-IR
- Portion 38/581 Township Eastleigh-IR
- Portion 39/581 Township Eastleigh-IR
- Portion 40/581 Township Eastleigh-IR. ,

The full extent of all the above properties is approximately 52,92Ha. The SLP area is however in extent approximately 21,7Ha

It should be noted that all the portion 581 properties indicated above, which are representative of the residential properties, are registered in the name of the City of Johannesburg. This however also falls within the environmentally sensitive floodline area, and is classified as area with constraints and is therefore excluded from the actual SLP area.

2. Development framework

Following the status quo assessments previously conducted, the purpose of this report is to provide a proposed Development Framework for the JP Bezuidenhout SLP.

The following highlights Implementation considerations and recommendations pursuant to the highest and best use study.

2.1. Implementation considerations and recommendations

This section is presented under the following sub-headings:

- Influencing Factors;
- Proposed Phasing; and
- Way Forward

2.2. Influencing Factors

The following factors will influence the incentive for the disposal of the SLP.

2.2.1. Legal

As earlier mentioned, a subdivision application will be required, in order to define a specific lease area, in order to define a specific lease area to attract the market.

The DF proposes that area on which the new facilities and parking will be located be kept as “Public Open Space”, but formally subdivided from the rest of the SLP. This will enable a ring-fenced approach to be applied by EMM on this separate portion of land.

Gautrans has earmarked a portion of the SLP for the widening of Homestead Street. This portion of land will allocated a temporary land use of parking, to service the new facilities and new area.

2.2.2. Geotechnical

The following geotechnical related considerations will have an influence on the development of the site:

- Development within the flood lines of the water courses must be avoided.
- Geotechnical investigations must be conducted for the urban development of the site.
- Detailed investigations must be conducted for all multi-storey buildings or settlement sensitive structures. It is not possible to provide a cost estimate for these investigations as it is dependent on the details of the proposed development.
- A geotechnical investigation is required on the fields to the east of the SLP that was formerly used as a land-fill site, if this portion of the SLPs used is to be converted to other uses later.

2.2.3. Bulk Services: Sewerage Line

The bulk infrastructure is currently indicated to be at capacity and will require upgrading in order to cater for additional demand.

2.3. Proposed Phasing

The phasing is not applicable for this SLP.

2.4. Way Forward

The following activities must be recommended as part of the development process:

- Demarcate an area as per the Development Framework Plan to be released for private sector investment
- Subdivision of identified land parcel to enable a ring-fenced approach
- Detailed overall site development master planning
- Upgrading of bulk services in particular sewer and connector services.

Table 2-1: Follow-On Projects, Time and Cost Estimate

| ACTIVITY | ESTIMATED PROJECT TIME | ESTIMATED COST |
|-----------------------------|------------------------|----------------|
| Subdivision Application | 5 Months | R 50 000 |
| Geotechnical Investigations | 6 Months | R 105 000 |

It is recommended that part of the SLP on which the new facilities are proposed, be released for development the purpose of running a public indoor sports fitness centre with ancillary uses/club and gym. The development of additional facilities is promoted to enhance the appeal of the club and thereby to expand membership and visitors to the club. It is also recommended that the areas subject to subsidence due to the apparent presence of an old landfill site be subjected to geotechnical investigations with recommendations on potential development alternatives for future implementation.

It needs to be noted that an actual subdivision will not be required if a leasehold transaction is concluded. Leasehold diagrams can be compiled and approved for the purpose of the transaction.

The detailed Development Framework is attached as **Annexure A**.

3. Highest and best use study

The highest and best use study reveals that the SLP is most suitable for the current use which is sports and recreation facilities.

3.1. Highest and best use valuation value

The market value based on the Highest and Best Use as per the development framework is determined to be R23 694 098. The valuation was determined in accordance with the concept plan as indicated in paragraph 4.1 and reflected in figure 4.1 of the Development Framework. The land value (based on comparable sales) and discounted replacement cost of improvements is the method of valuation used.

The annual market rental value was determined to be R1 010 636.

Refer to **Annexure B** for the detailed valuation report.

4. Financial model

4.1. Model output

A single model is applicable to the JP Bezuidenhout SLP. The envisioned development is Greenfield and relates to the development of a Sports and recreation facility. The general inputs of the model are depicted below where the land parcel type is defined as “Sports and Recreation” and the transaction type is defined as “Lease”:

Table 4-1: Sale of greenfield residential property

| General Inputs | |
|--------------------------------------|-------------------------------------|
| Land Parcel Type | Sports and Recreation |
| Sale/Lease | Lease |
| Greenfield | <input checked="" type="checkbox"/> |
| Further Development | <input type="checkbox"/> |
| Sale using 10 year comparator | <input type="checkbox"/> |
| User Inputted Lease Start Date | |
| User Inputted Lease Start Date Month | Jul |
| User Inputted Lease Start Date Year | 2015 |

Since the development is greenfield, the “Greenfield” option is selected. The start date of the model is assumed to be 1 July 2015, implying that hypothetical lease payments as well as rates and taxes, without further development, are expected to start immediately. The assumed total time required for development is assumed to be 24 months, therefore, hypothetical lease payments start on 1 August 2017. The user-defined start date allows for the model user to input a different expected lease start date but since the option is unselected, the start date is assumed to be 1 August 2017. Since the transaction type is a lease, the assumed lease horizon is 30 years.

The model assumes that the developer bears the full development cost which takes the form of the development CAPEX and bulk service contribution paid to the municipality. The impact of the development will have a direct effect on the future cash flows of the transaction in terms of:

- A direct cash inflow from the payment of bulk services from the developer to EMM;
- The increased value of future rates and taxes due to the increased value of the property through further development.

Table 4-2: SLP 8.1 financial inputs

| Financial Inputs | EMM (%) |
|----------------------------|-------------|
| Highest and Best Use Value | R23 694 098 |
| Municipal CAPEX | 100% |
| Bulk Services Contribution | 0% |
| Further Development | 0% |

The rates inputs for the model consider the following standard assumptions:

- In a “sale” scenario, the selling value of the SLP is reinvested at a rate that yields a return equivalent to that of inflation and the benefit of the reinvested income accrues to EMM;

- In a “lease” scenario, EMM foregoes the rates and taxes on the property;
- The land category in terms of rates and taxes is assumed to be “Business and Commercial”;
- The model is based on the tenet that the capital budgeting decision to sell (lease) is always compared on an opportunity cost basis to leasing (selling). Therefore, in a selling scenario, the model requires inputs regarding the possible lease payments foregone. Using best comparisons, the rental yield on the property is assumed to be 3.88% and the lease escalation value is set at 4% per annum;
- The weighted average cost of capital (“WACC”) is assumed to be 11%;

In order to evaluate the strategy envisioned for the land parcel, dashboard output in terms of Financial Benefits, Sensitivity Analysis and Economic Benefits will be displayed where each will describe the following salient metrics:

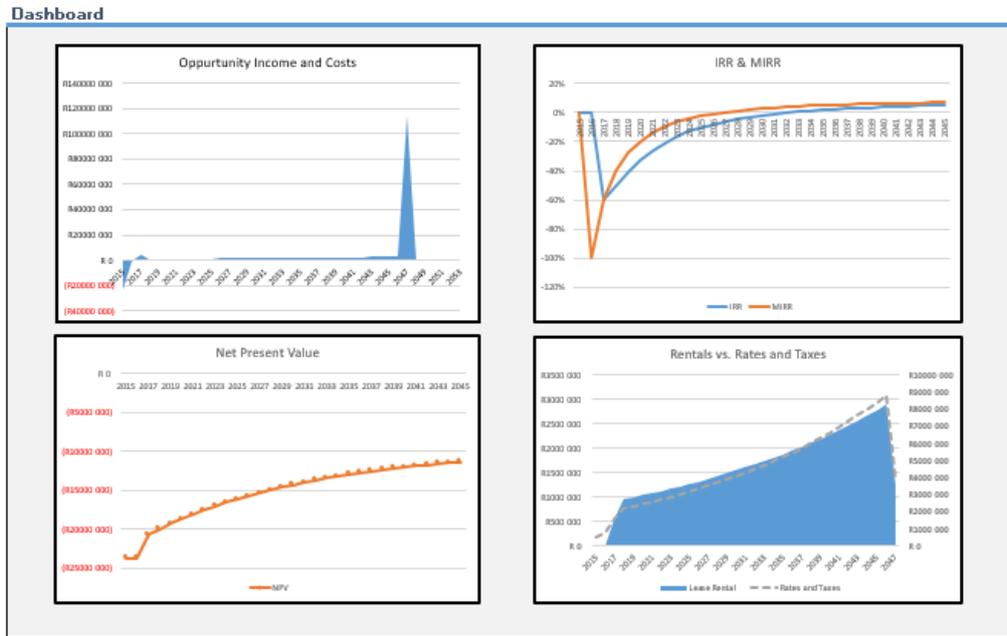
- **Financial Benefits**
 - Net Present Value (“NPV”), Internal Rate of Return (“IRR”), Expected Opportunity Cash flows and Rates and Taxes.
- **Sensitivity Analysis**
 - Effect on NPV due to time delay as well as changes in WACC, Rental Yield and Lease Escalation
- **Economic Benefit**
 - Indicative job creation metric based on property definition and value of development CAPEX assumed to be spent.

SLP 8.1: Greenfield Sports and Recreation Facility lease

| CORE OUTPUTS | |
|-----------------------------------|---------------------|
| IRR | 8.68% |
| MIRR | 6.74% |
| Annual ROI | 23.39% |
| NPV | R -7 115 074 |
| Profitability Index | 0.70 |
| Target Rental (Monthly) | R 76 622 |
| Target Rental (Annualised) | R 919 464 |

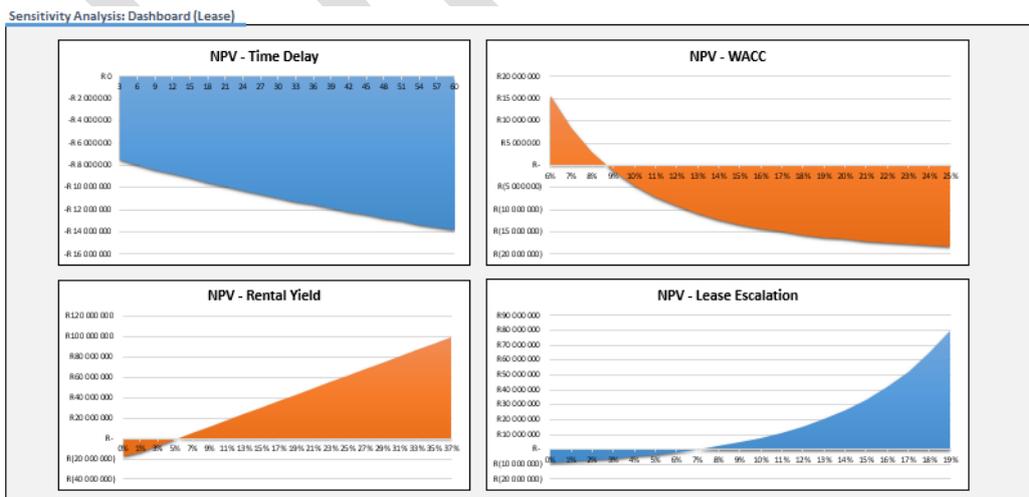
The core outputs above depict the “Greenfield” lease of the SLP. Since the choice of lease results in opportunity cash flows that are initially negative and then turn positive, the transaction will result in economic benefit when the IRR is greater than the WACC. The core metric to focus on is the NPV of the transaction, which is negative and equal to –R7.12m, implying that the lease of the SLP would result in value destruction for the EMM. In order to determine the required rental yield that would result in the lease being value neutral for EMM (implying an NPV equal to zero), a solver macro was run. The break-even rental yield was calculated as 6.65%, implying an annualised lease payment of R1.58m per annum.

Table 4-3: Financial Benefit Dashboard – SLP 8.1



Per the dashboard output, the expected incremental cash flows indicate an initial cash outflow, due to the forgone sale of SLP 8.1 as well as the opportunity incomes (cash inflows) represented by the bulk service contribution, rental income and the residual value of the property at the end of the lease period. As mentioned, in a lease scenario, EMM is expected to forego rates and taxes on the property contributing negatively to the NPV.

Table 4-4: Sensitivity Analysis Dashboard– SLP 8.1



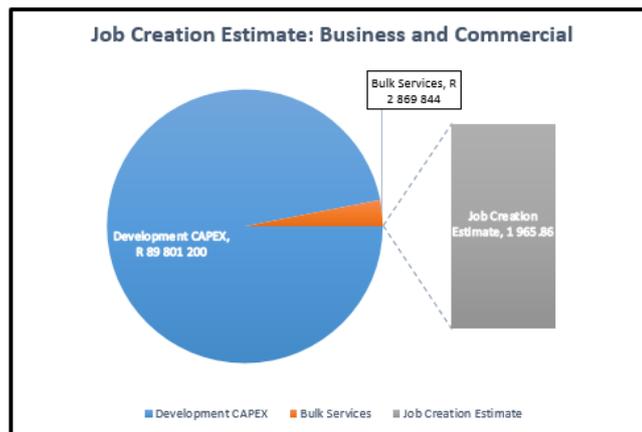
The sensitivity analysis dash board above depicts that effect of a time delay on the NPV of the strategy. A time delay will have a further negative impact and result in value destruction as the increasing size of the time delay further drives down the NPV.

Since the scenario is reminiscent of investing (late cash flow stream where cash flows are initially negative and turn positive thereafter), the lower the WACC, the better the NPV. The relationship predicted indicates that a WACC above 8.68% will make the NPV negative and value destroying.

In terms of rental yield and lease escalation, a leasing scenario is highly sensitive to both inputs. As mentioned previously, the lease of the SLP will only produce a positive NPV, implying value creating, when the rental yield is above 6.65%. A similar relationship is seen with the variation in the lease escalation variable as a lease escalation rate above 7.1% will result in the NPV being positive and therefore value creating.

Table 4-5: Economic Benefit Dashboard – SLP 8.1

| User Defined Inputs | |
|-----------------------|-------------------------|
| Development CAPEX | R 89 801 200 |
| Bulk Services | R 2 869 844 |
| Total CAPEX | R 92 671 044 |
| Land Category | Business and Commercial |
| Job Creation Estimate | 1 965.86 |



The economic benefit dashboard is linked to the type of zoning assumed on the land parcel as well as the total CAPEX contribution required for development. The assumptions of the job creation model are based on the combination of development and zoning, creating permanent and temporary employment. Unfortunately, limited data does not allow for the determination of the split between temporary and permanent employment, rather attempts to predict a base estimate of total increased employment due to further development on the SLP. Using a simple economic relationship, the model calculates an assumed job creation figure. Based on the total development CAPEX of R92.67m, the expected number of permanent and temporary jobs created is 1966 which can be defined as a best guess estimate using the relationships defined.

Refer to **Annexure C** for details of the model.

5. Recommended Next Steps

The highest and best use of the SLP is the current use. The current letting scenarios should continue on a market related basis.

In order to improve on the current use it is recommended that the current developable bulk be increased. This will allow the release of the existing underutilised skateboard area to the market. The area should be surveyed in accordance with the bulk recommendations and the surveyed area offered to the market in the form of a leasehold with a minimum lease term of 30 years. This will enable the developer to let out the improvements and recoupe the development costs while providing an acceptable return.

DRAFT

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