NCIB business overview – Property Finance

Brian Kennedy
Group ME: Nedbank Corporate & Investment Banking

Ashraf Patel
ME: Client Coverage
960 clients

Anél Bosman
ME: Markets
#1 Primary Dealer
Best Sales Team – Bonds
#1 Equity options market share

Brad Maxwell
ME: Investment Banking
Market leader in renewable energy
#1 Bloomberg FI league table rankings: SA bonds

Francis Brand
ME: Transactional Services
>20 primary bank wins per annum (since 2013)

Gary Garrett
ME: Property Finance
Market leader with >30%
22 years banking experience of which 13 in Property sector

2 731 employees
R6.7bn
Headline earnings (2018)
NCIB business overview – Property Finance

**Headline earnings, ROE**

- **2008**: HE (Rm) = 800, ROE = 23.7%
- **2009**: HE (Rm) = 660, ROE = 19.6%
- **2010**: HE (Rm) = 501, ROE = 14.1%
- **2011**: HE (Rm) = 629, ROE = 22.3%
- **2012**: HE (Rm) = 716, ROE = 26.1%
- **2013**: HE (Rm) = 945, ROE = 27.5%
- **2014**: HE (Rm) = 1,318, ROE = 21.2%
- **2015**: HE (Rm) = 1,430, ROE = 21.6%
- **2016**: HE (Rm) = 1,540, ROE = 20.6%
- **2017**: HE (Rm) = 1,499, ROE = 17.8%
- **2018**: HE (Rm) = 1,318, ROE = 17.9%
- **H1 2019**: HE (Rm) = 820, ROE = 23.7%

**Key drivers**

- Highly experienced team – specialist knowledge
- Specialisation & key client relationships driving leading market share in SA
- Rest of Africa
- Property Partners

**H1 2019 HE contribution**

- Property Finance: 25%
- Rest of CIB: 75%
Agenda

1. SA property market context
2. Sector insights
3. Nedbank Property Finance
SA commercial property market estimated at R1.3 trillion – banks fund ~30% of this through debt

- **SA property sector**
  - Residential: R3.9tn
  - Zoned land: R0.5tn
  - Public sector: R0.2tn

- **Commercial property**:
  - Retail: R534bn
  - Office: R357bn
  - Industrial: R281bn
  - Hotel/Other: R94bn
  - Sector split

- **Ownership split**
  - Corporates: R789bn
  - REITs: R298bn
  - Unlisted funds: R131bn
  - Life & pension funds: R49bn

- **Commercial property** funded through equity, bank debt & debt capital markets
- Bank debt funding ~30% of the total commercial property sector (R423bn)

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1. MSCI for the Property Sector Charter (July 2016)
2. SARB BA 900 returns (June 2019)
SA commercial property market – Nedbank CIB a leader in commercial mortgages & combined with Nedbank RBB’s market share in residential mortgages our overall property exposure is in line with peers

<table>
<thead>
<tr>
<th>Commercial mortgage market share(^1) (%)</th>
<th>Total mortgage market share(^1) (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>39%</td>
<td>22%</td>
</tr>
<tr>
<td>20%</td>
<td>17%</td>
</tr>
<tr>
<td>7%</td>
<td>11%</td>
</tr>
<tr>
<td>14%</td>
<td>21%</td>
</tr>
<tr>
<td>2%</td>
<td>1%</td>
</tr>
</tbody>
</table>

\(^1\) SARB June 2019 BA 900 returns
SA commercial property market – macro fundamentals & lending observations

**Macro fundamentals**

- Low economic growth environment
- **Rental income under pressure** across all segments of the market – negative rental reversions common
- Property sector lags the broader economy by 12 – 18 months
- Policy uncertainty regarding land reform

**Lending observations**

- Increased competition across lenders to win high quality deals at the top end of the market
- Low levels of speculative lending – pre-let conditions vital
- Predominately originate to hold strategy
- Property sector is a reflection of the broader economy given corporate SA is tenant base
1. SA property market context

2. Sector insights

3. Nedbank Property Finance
### Sector insights

**JSE SA listed property index**

**Listed property – Equity investors**

- **Significant downward correction** in sector experienced over the last 18 months:
  - Difficult economic environment with downward earnings outlook revisions
  - Historically trading at significant premiums to NAV
  - Specific counters declined significantly due to fund specific issues

**Listed property – Debt providers**

- **Largely considered to be the lowest risk segment for lenders**
  - Typical fund level lending covenants:
    - Loan-to-value (LTV): 40%-50%
    - Interest coverage ratio (ICR): 2x
  - Significant levels of equity ranking behind debt
  - Generally diversified high quality portfolios
Source: Sapoa Sector reports

### Sector insights

#### Office space – oversupplied
- Office vacancies remain high but stable at 11.3% across the board
- Rental growth has largely been flat over the last 12 months
- Improvement in vacancies unlikely in the short-term given the economic environment
- New office stock being developed, but activity is at a 13 year low
- 55% of new stock concentrated in 3 nodes:
  - Sandton (25%)
  - Waterfall (16%)
  - Rosebank (14%)
- Co-working or flexible office space a potential new trend

#### Retail sector – largely oversupplied in metros
- Retail vacancies currently at 4.2%, above the long term average of 2.9%
- Retail largely oversupplied in metros
- Some development opportunity exists in outlying & rural areas where there is an undersupply
- Retail likely to remain under pressure due consumer spending constraints – low growth in HCE anticipated for the foreseeable future (1.6% in 2020)
- Changing consumer habits – online retail likely to have a lower impact in SA in the medium-term relative to other markets (currently accounts for 3-4% of sales in SA)
## Sector insights

### Industrial sector – resilient

- Industrial vacancies currently at 3.6%, an improvement from 5.2% in 2016
- Rental growth of 4.6% over the past 12 months
- Further development opportunities for high quality logistics space in key nodes
- Potential load shedding could impact manufacturers – increased vacancies in that segment

### Residential – cautious

- Strong demand for residential product in lower price brackets – purchase price below R1m & monthly rental under R8 500
- Affordable rental stock market buoyant in the current market environment
- Developers more cautious in the current economic environment

*Source: Sapoa Sector reports*
1. SA property market context

2. Sector insights

3. Nedbank Property Finance
Nedbank Property Finance overview – leading market share with well diversified, high quality client base

Strategy – grow in line with market

<table>
<thead>
<tr>
<th>Year</th>
<th>Nedbank market share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>40.4%</td>
</tr>
<tr>
<td>2016</td>
<td>40.8%</td>
</tr>
<tr>
<td>2017</td>
<td>40.5%</td>
</tr>
<tr>
<td>2018</td>
<td>39.1%</td>
</tr>
<tr>
<td>H1 2019</td>
<td>38.6%</td>
</tr>
</tbody>
</table>

Key differentiators

- **Highly experienced team** – deep sectoral & geographic knowledge
- **PF business well understood & embedded within the group**
- **Steady growth & selective origination** – supporting clients throughout cycles
- **High quality client base** with experienced track records and significant portfolios – cross collateralisation
- **Well diversified portfolio** – underlying sectors impacted at different points in the cycle (diversification inherently reduces sector concentration risk)

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1 SARB BA 900 returns

NEDBANK GROUP LIMITED – Commercial Property Finance presentation
Well diversified book – deep knowledge & expertise across sectors

Loan book by property type (%)

- Retail: 26%
- Offices: 25%
- Industrial: 18%
- Multiple Portfolio: 13%
- Vacant Land: 10%
- Residential: 6%
- Other: 2%

Note:
Residential development limit – 5% of total portfolio
Currently below 3%
Valuations methodology

- Internal team of 22 qualified valuers
- Establish our own collateral valuations & base our lending decisions off these
- Listed funds
  - Use their independent valuations as a base & make adjustments to those
  - Generally our valuations are 5% - 10% lower
- Unlisted environment
  - Perform our own valuations on each property we take as collateral
- Frequency of valuations
  - Valuation performed at deal inception
  - Valuations updated at least annually
  - Watchlist items – valuations performed 6 monthly
  - Non performing items – valuations performed on default & at least 6 monthly on a market & forced sale basis
  - A missed payment triggers a valuation review
- Outsource approximately 25% of valuations to an approved panel – every valuation approved by a Nedbank valuer
### LTV by bucket range and sector

#### % of exposure by LTV bucket range (%)

<table>
<thead>
<tr>
<th>Bucket Range</th>
<th>H1 15</th>
<th>H1 16</th>
<th>H1 17</th>
<th>H1 18</th>
<th>H1 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 40%</td>
<td>47%</td>
<td>47%</td>
<td>43%</td>
<td>43%</td>
<td>42%</td>
</tr>
<tr>
<td>41 - 50%</td>
<td>23%</td>
<td>23%</td>
<td>20%</td>
<td>20%</td>
<td>21%</td>
</tr>
<tr>
<td>51 - 60%</td>
<td>19%</td>
<td>19%</td>
<td>17%</td>
<td>17%</td>
<td>18%</td>
</tr>
<tr>
<td>61 - 70%</td>
<td>9%</td>
<td>9%</td>
<td>8%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>71 - 80%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>&gt; 90%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
</tbody>
</table>

#### Average LTV (%)

<table>
<thead>
<tr>
<th>Sector</th>
<th>H1 15</th>
<th>H1 16</th>
<th>H1 17</th>
<th>H1 18</th>
<th>H1 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>40%</td>
<td>40%</td>
<td>40%</td>
<td>40%</td>
<td>40%</td>
</tr>
<tr>
<td>Offices</td>
<td>48%</td>
<td>48%</td>
<td>48%</td>
<td>48%</td>
<td>48%</td>
</tr>
<tr>
<td>Industrial</td>
<td>47%</td>
<td>47%</td>
<td>47%</td>
<td>47%</td>
<td>47%</td>
</tr>
<tr>
<td>Multiple</td>
<td>45%</td>
<td>45%</td>
<td>45%</td>
<td>45%</td>
<td>45%</td>
</tr>
<tr>
<td>Portfolio</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Vacant Land</td>
<td>33%</td>
<td>33%</td>
<td>33%</td>
<td>33%</td>
<td>33%</td>
</tr>
<tr>
<td>Residential</td>
<td>32%</td>
<td>32%</td>
<td>32%</td>
<td>32%</td>
<td>32%</td>
</tr>
<tr>
<td>Other</td>
<td>34%</td>
<td>34%</td>
<td>34%</td>
<td>34%</td>
<td>34%</td>
</tr>
</tbody>
</table>

#### Key points

- 83% of the book below 70% LTV based on Nedbank valuations
- Majority of lending is done on a secured basis – property collateral
- 4% of the portfolio is unsecured lending to large listed funds – market norm for banks to have a component of unsecured funding to listed funds
- Average LTVs reflect risk appetite across sectors – more conservative on higher risk segments
Credit risk reduced

Key points

- Following the acquisition of Imperial Bank, the CLR increased as the Imperial portfolio was higher risk
- The CLR has steadily decreased since 2010
- The portfolio has performed well over a sustained period of time, with the CLR being within/below the targeted risk appetite range
- CLR of negative 8 bps in H1 2019 a result of the resolution of non-performing accounts from prior periods & consequent provision reversals
- Adjusting for the impact of reversals above, the normalised CLR would have been 11 bps
- Key covenants applied:
  - Cash flow – ICR and/or debt service cover ratio
  - Gearing – LTV
Proactive risk management & our quality portfolio has positioned us defensively for this difficult credit environment

### Stage 3 advances (Rbn)

<table>
<thead>
<tr>
<th></th>
<th>Jun 18</th>
<th>Dec 18</th>
<th>Jun 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>2.3</td>
<td>2.1</td>
<td>2.1</td>
</tr>
</tbody>
</table>

### Defaults > R100m by segment (Rm)

<table>
<thead>
<tr>
<th></th>
<th>Exposure balance</th>
<th>Updated market value of collateral</th>
<th>Discounted forced sale collateral value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>263</td>
<td>457</td>
<td>374</td>
</tr>
<tr>
<td>Offices</td>
<td>368</td>
<td>547</td>
<td>457</td>
</tr>
<tr>
<td>Industrial</td>
<td>263</td>
<td>338</td>
<td>241</td>
</tr>
<tr>
<td>Multiple portfolio</td>
<td>205</td>
<td>340</td>
<td>277</td>
</tr>
<tr>
<td>Vacant Land</td>
<td>104</td>
<td>105</td>
<td>59</td>
</tr>
<tr>
<td>Other</td>
<td>86</td>
<td>135</td>
<td>114</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1 290</strong></td>
<td><strong>1 923</strong></td>
<td><strong>1 522</strong></td>
</tr>
</tbody>
</table>

### Coverage ratios (%)

<table>
<thead>
<tr>
<th></th>
<th>Jun 18</th>
<th>Dec 18</th>
<th>Jun 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>11.4</td>
<td>12.9</td>
<td>10.1</td>
</tr>
<tr>
<td>Offices</td>
<td>0.25</td>
<td>0.30</td>
<td>0.37</td>
</tr>
</tbody>
</table>

### Distressed restructures

- A distressed restructure is recognised either where the borrower is in arrears or has defaulted & now requires a restructure or in instances where the terms & conditions were changed in order to prevent the obligor from going into arrears
- Distressed restructures are classified as Stage 3 advances
- These are held in Stage 3 for a minimum period of 6 months to ensure restructure is successful
Conclusion

- Sector will remain difficult in line with the SA economy
- Lag sector – we are seeing difficulties in corporate SA & this will filter through to the property portfolio
- We will likely see an increase in stage 3 loans
- Possible increase in CLR but within the CIB TTC target range
- Continue to originate business that meets our criteria & in line with our strategy
- Diversification through expansion into Africa
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