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MEETING WITH NEDBANK

OPEN SESSION

DATE: 2017-11-01

VENUE: CSIR Pretoria

CHAIRPERSON: Ms L Mtanga

COMMISSION MEMBERS

Ms S Grimbeeck	:	Principal Economist
Mr T Khumalo	:	Senior Legal Counsel
Prof Halton Cheadle	:	Apology / Absent

ON BEHALF OF NEDBANK

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Mr Bongane Sibanyoni

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COMPETITION COMMISSION AND NEDBANK

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PROCEEDINGS ON 1 NOVEMBER 2017

CHAIRPERSON: Ladies and gentlemen, good afternoon, and welcome to Nedbank who will be making their submission at this public hearing. My name Lulama Mtanga. I am a panellist in this retail inquiry.

I am chairing these hearings because the Chairperson who is appointed to chair this inquiry is not available due to circumstances beyond his control or those of the commission. I would like to ask my colleagues to introduce themselves and thereafter I would also like your delegation to introduce yourself and also anyone who will be answering questions.

We, we are not a very formalistic, it may come across that way but the intention is not to make it a formalistic hearing. So if anyone wants to chip in and answer questions, feel free to do that and therefore whoever will be answering questions from you delegation, we would like them to place themselves on, on the record. Thank you.

MS GRIMBEECK: Good afternoon, my name is Sunel Grimbeeck. I am principal economist at the Competition Commission and I am leading the technical team that is working on the retail inquiry.

MR KHUMALO: Good afternoon, my name is Thabo Khumalo, a senior legal counsel working on the retail inquiry.

MR SIBANYONI: Good afternoon, I will introduce my team, including myself. My name is Bongani Sibanyoni, I am a senior legal adviser for Nedbank and I am mostly responsible for the interactions with the commission. On my left I have Natalia Lopes who is our counsel. She is a partner at ENS and on the far left I have the gentleman who drew the short straw, he will be making most of the submissions today. His name is Rob Lockhart-Ross. He is the head of our Commercial Property Finance but he has been in the credit space as well, so he will be answering most of the questions. Natalia and I will chip in now and again if we need to.

The rest of my panel members, just in case I get into trouble for not introducing people: I have Tryone Willey, he is also one of our colleagues and external counsel of ours. I have Zanele Mngadi, she is the Head of Legal for our Corporate Investment Department and that is where our commercial property finance basically sits and I have Ava Kanaye, she is the Head of Legal for the Corporate Commercial Property Finance Division. So this is the Nedbank team as it were. Rob, I will hand over to you.

MR LOCKHART-ROSS: Thanks Bongane. Thanks Madam Chairperson, we appreciate the opportunity to come and engage with your, your panel this afternoon and we do understand that we are here principally to deal with your objective number 2, which is the impact on competition of the, the long term exclusive lease agreements signed between developers and the national supermarket chains and the, and the perceived role of financiers in those agreements. This is the, the third submission I guess, that we will have made to the Competition Commission. The first dates as far ago as April 2010, where we made a written submission into inquiry which I think was the predecessor of your current inquiry and that is, that is file and we are happy to, to discuss that and, and to address any issues that might have risen out of that. The second submission to, to your panel was a letter form Nedbank, dated 23 August 2016, we answered further questions and referred back to the letter we had submitted in April 2010.

So I guess today is a, a third submission, actually, the, the verbal exchange that we will have today. We did receive from, from the commission a letter dated 13th of October 2017, with a list of, of questions which were follow-ups to the first two submissions that we previously made. We, we have chosen not to submit upfront written submissions to, to those questions but we have prepared, we have done our preparation to come and discuss any issues that, that might come out of, out of that letter.

Please understand, I am, I am confortable to discuss most of those in open forum but I, but I would ask perhaps if we start dealing with issues around our internal practices and policies, details of our, our loans book and any client particulars, that, that if we could kind of take those off line and deal with those then in *camera* and I will signal to you when, when I get to that point. And of course, following today, we will be quite happy to make written, written responses and provide further written explanations or supplement information that you might, might require.

So I am not supposed to make a big presentation up front but if you do not mind my just leading off with a couple of introductory comments, just, just to set some kind of context here for ourselves, Nedbank Property Finance as financiers in this, in this commercial property space and retail shopping centres in particular. [Intervened]

CHAIRPERSON: Sorry, sorry, Sir. Before you proceed, I just want to make one correction. I am, I know the information, you said this the third submission that you have made…

MR LOCKHART-ROSS: Yes.

CHAIRPERSON: There, there is a difference between what was the investigation then and what, and what this inquiry is doing. So that was an investigation which is basically looking at whether or not there was a prohibited practice in terms of the act, whereas the function of the inquiry is much broader.

It is almost like a fact-finding mission to, to understand how this, how the [indistinct] retail sector works, all the parties, stakeholders that interact with the, how they interact, who, who, who is who in the sector and how they interact with each other.

So that is completely different and I also want to make note that we, as this inquiry we do not have direct access to any submissions you may have made in 2010. Therefore we will only have access to what you have provided to this inquiry. I just want you, you to understand that. Thank you.

MR LOCKHART-ROSS: Thanks Madam Chair, thanks for that clarification. I stand corrected. Just to give you some, some context, we will give you a sense of the, of the scale, the size of the commercial property sector, private sector owned commercial property is valued round about R1.3 trillion.

That is according to a report that was compiled by an independent research institute called MSCI and it was done in July last year for the purposes of the, the Property Sector Council. So 1.3 trillion, the value of commercial property estimated in the hands of the private sector, within that, retail commercial property, shopping centres of various scales and type, roundabout R530 billion of value.

So that is the first contest. [Intervened]

CHAIRPERSON: Sorry, can you repeat that figure? The, the retail…

MR LOCKHART-ROSS: Retail?

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: Retail 530 billion of an estimated 1.3 trillion.

Second point of, of, of context: According to a relatively recent report done by and independent research group, called Urban Studies, a guy called Douw Prinsloo, report that came out in 2016 and was done for the SA Council of Shopping Centres, there were at that point in time 1942 shopping centres in South Africa representing 29, sorry 23 million square metres of retail space, which put South Africa at number 6 in the world in terms of supply of formalised retail space in our country. That is second point of context.

Third point is, to give you a sense of, of bank, commercial bank lending into the commercial sector: Total commercial mortgage bonds per SA Reserve Bank returns, roundabout R400 billion.

That is into the entire commercial property sector. I cannot tell you how much of that is into, into retail property. The Reserve Bank returns do not go down to that level of detail. So that is just the first, the first issue of context.

Second issue of context I would like to put in place really is that the commercial property as a whole, in its nature is both capital intensive and expertise incentive.

So because we are dealing with, with property here of, of scale which require significant capital investment, it does require that any would be developer, owner, investor does come with a significant amount own equity to invest in the development or in the, in the centre. It also does require that the would-be owner, developer, investor has some expertise and some experience relevant to, to retail property in particular.

So that is the generic comment around commercial property. In my own view, retail property in particular, I think, is the most complex and the most demanding of all the commercial property types and I think there is some dynamics at play in, in retail property that are not necessarily in, in the office properties and industrial type properties, for example.

And there is a very dynamic interplay in the case of retail property between the landlord, the tenant and the shopper, the consumer that one has to take into account and one has to manage and that is to a great extent than other commercial properties. Retail property is, is very…

Success of retail property is very governed by its location, access, its design, the flow of the centre, the tenanting of the, of the centre. It is also in its nature, retail property, far more management intensive than other types of commercial properties.

You know, you just think of the workload and the through put and the feet that travel through a retail centre by comparison to an office block or a factory, *et cetera*, in, in itself, and of necessity means that management is more intensive, hence therefore the need for experience and expertise in that particular type of property. That is the second point I would make.

Third point I would want to make is, is… Just in case we kind of talk past each other when we talk about malls and shopping centres and retail centres, and I am sure we will at some point in the, in the afternoon, is just that to kind of give you a, a sense…This is not a, an *imaginous* class that we, we are talking here. Shopping centres, retail centres, whatever phraseology you want to use, vary quite widely.

Where obviously, one might categorise them, there are obviously CBD, inner city type shopping centres or retail centres, there are suburban malls such as we are all accustomed to, and then there are peri-urban centres that would be, I would say in a former township areas, and then there are out-and-out rural centres in the, in the, in the outer lying areas. So, those have different characteristics and different dynamics in and amongst themselves.

That is one way of perhaps classifying centres and then there is a fairly standardised way of classifying centres according to size and number of shops and I am sure the terminology has come up, ranging from at the, at the smallest end of, of the scale, a so-called convenience shopping centre, ranging all the way up in size and convenient shopping centre and we can go through those in more detail later on.

A convenient shopping centre would be typically 1 5000m² and have radius of between five and 20 tenants right up to a super-regional mall such as the Mall of Africa or Benlin just down the road here which would typically be about, it would be more than 100000m² and typically have more than 250 shops. So quite… I mean a broad span of, of retail offerings, retail properties that we tend to classify under, under the label of shopping centres.

And then there is obviously a third element is the, is the ownership and management of, of centres can vary quite substantially from small, independent entrepreneurs, investors who might own a single centre through medium size unlisted corporates, unlisted trusts, *et cetera*, right the way up to, to the listed property funds who would probably own several if not a portfolio of shopping centres within their overall funds. So, again that introduce another dynamic into, into the whole equation.

Just the fourth point of context I would like to give you is, we as Nedbank Property Finance are financiers of retail centres across that whole scale. We are not owners, we are not landlords and we are not managers of, of shopping centres.

However, we are significantly invested in shopping centres. I 'use invested' in inverted commas, to the extent that typically we will provide a significant proportion of the cost of a centre by way of loan funding over a long period of time.

So we are in for a big amount of money and we are in there for a long period of time. So, it is obviously in our best interest and the interest of our shareholders and the deposits at the bank to make sure that we only fund shopping centres that we believe will work. And we can go into that a little bit more later. And when I say a shopping centre that will work, what I mean, and perhaps from my own selfish perspective is that the centre will generate sufficient cash flows for the landlord through the rentals that he is collecting from his tenants to enable him over time to repay my loan.

That is also obviously that the centre will generate sufficient cash flows to give the developer, the owner, investor a return on his capital, similarly to give the retailers a return on their investors because clearly retailers invest a lot in opening shops in all of these shopping centres and it is important too, that a centre succeeds for the impact on the broader community and not only the consumers but the local authority and the broader community, that often will be, will feed off a shopping centre.

Our attitude when we fund shopping centres is really to look beyond the bricks and mortar at the impact the shopping centre will have on the local economy and the local community in terms of provision of jobs, access of, of improved facilities for the local community.

Often an upliftment of their environment and quite often a shopping centre will serve as a catalyst to attract further development in and around a shopping centre and you will have seen it quite often how other developments spring up around a mall. So that is a, that is a fourth point of context.

And then just perhaps right up front, given that we are, are dealing with objective number 2 around the long term leases, I, on record I would like to state that in order for a centre to work for us as a financier, we do require long term leases from so-called anchor or magnet tenants. We do require those as a, as an important criteria in our, in our funding package but we certainly do not require exclusivity clauses in any of those leases. We have, it is not a requirement of our lending and we have never been party to any such exclusivity clauses that might have been negotiated between developer and, and tenants.

So Madam Chair that is a kind of opening, opening context setting remark from myself I am happy to be led by the panel now if you want to raise questions that purport that 13th of October letter or to field whatever questions, discuss whatever issues that you might want to, to… I am in your hands from here.

CHAIRPERSON: Just from your introductory remarks, would you be able to just take us through what are some of the dynamics that you have identified as Nedbank in relation to the different types of retail property?

You mentioned CBD or inner city, but then, and then you said peri-urban or township and then you said rural and… What, what would you say are the, are the dynamics that, that you..., that exist in each in each type of property to, as you, for you as funders.

MR LOCKHART-ROSS: *Ja*, no sure. So perhaps it link, it links into the point I make around what make a shopping centre work. Okay, and so perhaps I can answer your question in a, in a different way. What we look at as a financier in forming a view around whether a centre will work, and as I said, a centre works from our perspective that it generates sufficient cash flows, so a sustainable basis over time to enable its loan to be serviced, the capital to be repaid and a return to be given to all the parties that are depending on the centre.

So I think the essence of a, of a shopping centre and the requirement for success, regardless whether that is CBD or rural, it has to be tailored and catered for, for the needs and demands of the community it is intending to, to serve.

So, what, what we would look for at a very high level around what, what will make a centre work would be first off, off the node in which the centre is proposed to be developed, the broader node. Then the particular location of the, of, of the centre. I mean in terms of ease of access, location to, to key points of consumer activity in the town, location closer to point of transport, taxi ranks *et cetera*. So micro location of the, of the centre would be, would be important for us.

Also the, the positioning of the centre if I could phrase it as such, let me explain what I mean by positioning. Is this going to be a, a food dominated mall? Is it going to be mixed type mall? Is it going to be fashion dominated mall? The different types of centres. So, and then what is the positioning of the centre. Often the design of the centre is, is very important. You know, how, who the foot traffic and flow within a centre. I am sure we have all been into, into centres which you know, just intuitively are poorly designed.

You know, you go in at one end and you have no reason to go to the other end and so, you know, you tend to find concentration of shoppers at one end and the tenants at the other end kind of suffers. The design is very important.

And then management of a centre is, is very important, you know. Making sure that it is clean and tidy and the security is good and, you know, and the parking work, *et cetera*. So, you know, the dynamics would, would, would change again according to the, to the consumer base and the population base that it, that it serves. And we look to make sure that proposal being brought to us, takes a lot of those factors into account and then we would form a view based on that as to whether we think the centre is sustainable over time and therefore whether it is an investment the borrower should be making. And more importantly whether we should be lending into that, that particular centre.

CHAIRPERSON: In respect of the centres… I know this is a, this is quite a broad question that I am asking but I think I would like to ask it anyway. In relation to the centres where Nedbank has provided lending, given that you, your first look at the application and whether it is a centre that will work, whether it is a centre will create sufficient cash flow and all the things that you told, how many of these centres that you funded… You, you, you would have made obviously, you have been comfortable with all these things and tick them, and then you tend out to be wrong. How many of them…, where this decision turned out to be wrong, in a percentage, even if you give us a percentage whatever you have. You can, just a split there, 70/30, 50/50, or all of them, you virtually have been spot on? You funded something and it, it was successful?

MR LOCKHART-ROSS: Madam Chair, I, I do not have statistics off the top of my head.

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: And I certainly would not profess that we are perfect in our credit assessment and our, our loan granting. So we have had failures, shopping centres that we have funded that have failed. I can think of two in particular. There was one in Gonubie in the Eastern Cape and, and one in Port Elizabeth, two in Port Elizabeth in point of fact that, that failed. But our, our success record is, is fairly good and I would say the better part of 98%, I would guess, and I am guessing of, of the centres that we fund have proved to be successful.

CHAIRPERSON: And, in the cases where you have been successful what have you, in hindsight, if you are able to, what would you attribute that success to? I would like to know for example, I know some of your team members were here and listening through some of the submissions during the course of the week.

On, on the issue of selection of an anchor tenant, you know that you are happy with the anchor tenant that is, whoever is anchoring the, the development, and then the line tenants and the, the market sides, all those kind of things.

So, with these things, is it, what would you say has been the, the best marker or the best differentiators for you as, as a lender to say, you know what, we know if this exist, if this applies, this is going to be a successful shopping centre.

There is a reason that I am asking you this question and, and I will explain it to you after you have answered.

MR LOCKHART-ROSS: Okay. I will answer your question but perhaps the better way for me to answer it, to start off is, more lessons are often learnt form funding the shopping centres that fail than the ones that work.

CHAIRPERSON: Yes, yes.

MR LOCKHART-ROSS: So, you know and I think certainly as a former credit person [intervened]

CHAIRPERSON: I actually wondered if I should ask you about the failures or should I ask you about the successes? So either way I am happy.

MR LOCKHART-ROSS: So, and as a credit person one…, one learns over time the importance of a, of a long memory, not to repeat, repeat mistakes but…

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: If I could, if I could broadly categorise the reason for say failure of those particular centres that I mentioned; in the first instance the, the developers themselves were inexperienced retail developers.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: They had come through the commercial property cycle, started off doing single standalone industrial warehouse where they, they built a warehouse which is, I mean quite frankly, just a box and is quite easy to construct and relatively easy to manage.

You have got one or two tenants and you collect one or two checks a month. So management is easy. They moved from there to developing some offices, multi tenanted offices which are a bit complex and then thought they would get into, into retail which, which I said is, is far more, far more complex.

CHAIRPERSON: Complex.

MR LOCKHART-ROSS: And quite frankly they did not had the experience and the expertise to, to, one deliver the centre and then to, two manage the, the centre. And we were probably a little bit overoptimistic in estimating the expertise and experience they built up through that cycle. They were not, they weren't really ready to do retail and we, never the less, we still backed them.

Second lesson would be the, their choice of location was poor. In the one in Gonubie in particular, they sort of owned a centre that was anchored by an existing food retailer who had two other outlets in and around the, the town. So there was too much competition and the centre failed for that reason. Another, another element common to those three was the, the scale of the centre developed, it was too big for the, the market. There was certainly a need for a further centre in the particular market, the scale of which they developed it was too big to support the tenants that were put into to that centre. And, and that is often, that is often a crucial point.

And then quite frankly they were poorly and poorly managed and, and really just put the shoppers off. I mean you know it is like you often will go the opening of a brand new shopping centre and you kind of had one or two bad experiences with the parking or the service or whatever and it puts you off, and it puts you off for an extended period of time particularly if there is new competition in the, in the broader nodes. So those will be some of the lessons.

CHAIRPERSON: *Ja*.

MR LOCKHART-ROSS: From, from what failed, we, we have got a terminology we would use in credit talk about, all the retail fundamentals are met. So, what would we mean by that, is the, is the, the developer or the owner of the centre has a proven track record in developing and owing centres. So he has been there and he has done it before and I suppose one of the golden rules of banking is support people who have a track record and had been there and done it before. So that would be the first point.

The second point would be around, that goes to the borrower, and that is obviously, that is obviously one of the elements. We look not only at the property, we look at the borrower. So has the borrower got expertise?

The second issue you would have a look at is: Has the borrower got sufficient capital invested in the, in the centre and I am sure we will talk about it later on but obviously it is important from our point of view as a banker that the owner, developer put some of his own money as equity into, into the transaction and that we are not expected to fund all of the cost of the shopping centre, for two reasons I suppose; the one is that, kind of equity invested up front, means a far greater commitment from the developer and owner to ensuring the success of the development over time. You know if we are going to be expected to fund a 100% of the centre, we might as well develop and own it for ourselves. That is the one element.

The second element is, separately you will need to put some equity in the transaction because certainly at the outset a centre will not be able to support, in terms of cash flows and rental levels early on, will not be able to support a 100% lending. So those elements you look around, so we look closely at the borrower. Is he a person of expertise and experience? Is he a person or a company of, of financial substance and then we look at the property.

Is it located in an area where there is proven retail demand in terms of population in the immediate area. You would have heard, terminology used about the immediate primary catchment area. Typically that will be the sort of circle of, say within five to 10m, 10km around the centre and then the secondary catchment area which will be further afield. People who might come and, and visit the centre and shop at the centre. So location is really important and then I said design, scale of the centre. Is the, the design and the scale of the centre appropriate to the market that it is seeking to, to service?

And a third critical element obviously is, is it appropriately tenanted? Is the proposed tenant mix that the developer is, is banking on for his centre. Do we believe that it is appropriate to have a, to generate sustainable rental flows over, over time.

Just to go on record, we do not dictate to a developer what his tenant mix should be. You know we certainly will go to a developer and say we, we will require before we, we will fund your centre, we will want to see what we call your rent roll, which is really a list of all the shops and the proposed tenants that you are going to have in the shop and, in each shop and the proposed length of the lease and the proposed rental levels and we will scrutinise that to see if that will work.

Clearly within that mix of tenants we will want to see that there are, there is a, a reasonable proportion, appropriate proportion to the market of, of so-called anchors.

I want go on record those anchors might well be food anchors but they might not be. They could also be fashion type anchors and, and other similar type, type offerings and we would want to make sure that those, those tenants are in place.

So we do not dictate the tenant mix but we certainly do have a look at it and see whether we believe it will work or not and we might make some suggestions back to the developer to say, no, we think you are heavy or fashion and light on food or we think you, you need a pharmacy in there for this thing really to work. Those are the kind of suggestions which is really for him to actually, or the company, to decide how they want to populate their centre for want of a, of a better word.

So those, those would be broadly the retail fundamentals; the borrower, the location of the property, the design, scale, positioning of the centre and then the, the tenanting. The mix and duration of leases.

CHAIRPERSON: On, on, on the proven track record, how would you…, how would you, what would you be looking for, looking for as a proven track record in relation to a developer? What, what would qualify a developer as, as one with a proven track record from a bank’s point of view or Nedbank’s point of view? Do you have any…?

MR LOCKHART-ROSS: No, no, no, very simplistically, someone who has developed and managed and owned and run a shopping centre successfully in the past.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: And, and or who has a portfolio of shopping centres currently under his ownership or management, so that there is evidence we could, for example go and visit the centres to see how well they run, to see how well they are built, *et cetera*. So, that is what we mean be a track record.

Someone who has built a centre before, owned a centre before and run one before. As I said to you right up front, development, ownership and management or retail property, particularly complex, it is not something you would want to do as your first time property venture.

CHAIRPERSON: Okay. I am trying to have a sense here of ... Okay, on this question ... what happens when you have a developer without proven track record? They come to you, they get funding, and then the development goes on.

And then, what happens when they want to sell a development half way through the funding period? Are they prevented from doing so, or would you be looking for the same kind or requirements from the next purchaser, as a bank?

How do you make sure that the successor is entitled in relation to that development, keep this proven record that you as a bank still have capital invested in?

MR LOCKHART-ROSS: Okay.

CHAIRPERSON: Or may still have capital invested in.

MR LOCKHART-ROSS: Okay, perhaps to answer the first part of your question, certainly if, let us say five years after development of a centre.

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: Five years into a ten year loan that it's been divided in, the original developer, the original owner wants to sell the centre, of course he's free to sell the centre.

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: What happens at that point in time, he simply has to settle the then outstanding balance on our loan.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: And hopefully the centre is a success and the proceeds of the sale are more than sufficient to settle the loan and for him to get a return. So that is the first point.

Let me just roll back a little bit. Let me distinguish between, from my perspective as a bank, the funding of a new development and then the funding of an existing shopping centre development.

CHAIRPERSON: Sure.

MR LOCKHART-ROSS: There is clearly for us as a bank more risk in funding a brand new development. A shopping centre that has yet to be constructed, because the way, and perhaps if I can really go around the bush here, the way it works in practise, we would have a would-be client of ours, maybe existing client that comes to us with a proposal to develop a shopping centre of that nature and that scale in this particularly location, they will have done their homework, they make the proposal to us, and we will commit to funding the centre.

Any shopping centre of any scale is going to take you 12 to 18 months to develop, so we commit to funding, and what happens is the client puts his or their equity upfront, which is a certain proportion of the costs, and then we pay. Over the development, we pay the contractor and the project manager, and all the professionals over a period of time, through to completion.

Bear in mind, at that point in time what we will do, before we commit to funding, is we will want to know all the fundamentals are in place. For example, is the property zoned for retail? Does it have the right rights? Is it zoned for retail as opposed to offices or residential or something else, otherwise the building is contrary to the town planning regulations.

Does the size of the centre meet the town planning requirements? Because typically in your zoning, there will be a maximum size of centre that can be developed on a particularly property.

Does it meet local authority requirements, for example around the number of parking bays that have to be provided?

So we go and look at all of those sorts of things. We will go and look at, you know, is the team that the developer has put together in terms of the professionals – the architect, the quantity surveyor, all the engineers – are these guys experienced and have they developed centres of that sort of scale and complexity before? So they can manage through the process property.

Is the project manager ... Has he developed shopping centres before? So we will make sure all of that is in place. Importantly too, what we will ask for is proof of pre-lets. In other words, that on completion the centre will be let up to an appropriate level. Pre-lets, by that I mean lease agreements that are signed upfront from the tenants, that they will take occupation and pay rentals from the occupation date.

So bear in mind, that's what we ask for upfront, and then we disburse. And that could take 12 to 18 months before the centre is completed. But after that period of time is what we call 'delivery risk'. You know, there might be a hiccup in the development of the centre, such that the centre isn't completed on specification, i.e. as it was designed. That it isn't completed on budget, there is costs overrun due to some unforeseen circumstances in the development. For example, you know, in doing the foundations you might have rock, or you might have water. And that would cause both a cost overrun and a delay.

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: You know, there is obviously a risk then, if there is a delay and if the delay is quite significant, often what the developer will have to do to the would-be tenants, is commit to an opening date.

And if he's running six to 12 months behind, that would give the would-be tenant an opportunity to resign from the lease, and move on to another development.

So we check all of those things. So, right upfront, we're going in on the map and say during that period while the centre is being developed, there is delivery risk for us. Will it actually eventuate as it has been proposed? So that is high risk for us. And then we have to look very carefully around, has this developer done this before, and has this developer got the right professional team and the right contractor. Sorry, I forgot to mention that. Involved in the job.

Once the centre is open, and trading, and the leases are streaming, the tenants are in and the rentals are being paid, the risks shift somewhat. The risks vary really around, manage the centre correctly.

Manage the centre correctly. Looking after the tenants, looking after the cleaning and the maintenance and the security and the parking and all of that sort of stuff, so inherently the risk is lower once the centre is up and running.

So therefore there is a different type of expertise that's required to run an existing centre that to develop one, a Greenfields one from scratch.

So we look for perhaps different kinds of skills and expertise than someone who buys that centre five years into life. We there look for proof of someone who's run a centre and knows how to run a centre before, as opposed to someone who knows how to build it.

And the reality is, some players in the market, who are very, very good developers, but not particularly good managers, and vice versa. Some are very good managers, but would not get into development in their own right. So we would look for different skills.

Just one more point around that. Obviously, where we assess the risk that is inherent in a shopping centre … It is easier for us to assess the risk in a centre that has been up and running for five years, that has a trading record. We can see what the track record [intervened].

CHAIRPERSON: Where the failures are.

MR LOCKHART-ROSS: We can see what the foot count is, how many shoppers are there. We can see from published reports what the so-called trading densities are. I know that term's come up. Trading density is published by an outfit called the IPDE.

The turnover that the retailers get per square meter of space. So what I mean by that is, it would say a particularly tenant in a shop, a particularly type of tenant, and the tenant let's say occupies $100m^2$ of space and might be doing R1 million of turnover per year, and trading densities would be the R1 million per year … Sorry, per month, divided by the $100m^2$, and you assess the success of a centre … Obviously the higher the trading density, means they are squeezing more sales per square meter out of their shop. That is an indication of success.

The existing centre that's been running for five years, someone comes and wants to buy that, wants us to fund it, we have got a sense of how well the centre's been doing as opposed to a brand new centre. We're taking a view of how well the centre might trade, or will trade, once it's complete and once it's open and trading. That's more difficult.

CHAIRPERSON: Sure. On your pre-letting requirement, we now come to understand that it is important for our finances to … It is important for the developer to have secured an anchor tenant. And I just want to understand, are there are features or requirements that Nedbank looks for in an anchor tenant, that would make you feel comfortable that this is a development with the right kind of anchor tenant?

MR LOCKHART-ROSS: Yes. So invariably, we will require that a certain percentage of a centre be pre-let prior to our committing, or as a condition of our loan. And the level of the pre-let will depend on the centre. The scale of the centre, the location of the centre, and we can certainly go into specifics of that. I prefer to go off camera, because that is a matter of internal policy guidelines.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: But we have specified. 70% let's say.

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: Of a centre needs to be pre-let to an appropriate mix of tenants before we commit to the funding. And we would want – I think all banks would want – is a significant portion of that pre-let percentage to be to so-called anchor or magnet tenants.

And on long term leases. And the reason for that is really to secure sustainability of the cash flows over a period of time. You know, quite simplistic, the probability of an anchor or a magnet or a national retailer being able to meet the rentals for the full ten year term of the lease, which happens to coincide with the ten year loan, the probability of that scale of tenant meeting their rental obligations for the full term is obviously higher than a small independent, and what we call in the industry, line shops. You know, the biltong shop that you might see in there.

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: That's a independent trader. So that's what we're looking for. As I said to you earlier on, we're in there for a big chunk of money, and we're in for a long period of time, so we want to know that a significant proportion of the centre is let to tenants who are able to meet their obligations over the duration.

So, what would I look for an anchor or national? I think the terminology is relatively commonly used across the industry. I said earlier on, anchors and magnet tenants all come in different categories, so certainly there will be food anchors, and there will be the big food retailers obviously, some of whom I see that you are engaging with.

But we will also look for, in a centre that there be some fashion anchors as well, and that would be the big fashion chains. The likes of Truworths, Foschini's and Mr Price. Mr Price in particular probably would be regarded as an anchor. I will come back and make another point now.

But there could also well be the other anchors outside of food and fashion, in things like pharmaceuticals and more and more so, the likes of Clicks or Dischem could well be seen as anchors. Because they draw feet into the centre. That's the point.

That's the point from our perspective as a lender, we're looking for those anchors and the magnets. Obviously what they do is, they'll sign long term leases. They'll probably just hide that they'll pay the rentals right throughout the duration of the lease, and therefore the duration alone.

More importantly too, from the developer's perspective, those anchors will draw customers to the centre, will draw shoppers and feet to the centre, draw spending power, and that enables the other medium sized and small sized tenants in the centre, similarly to succeed. And that is also important from our perspective.

CHAIRPERSON: Okay. And then, are there supermarket chains out there that in Nedbank's perspective do not qualify to be anchor tenants?

Or does it depend on the context or the location of the development?

MR LOCKHART-ROSS: Yes, it would depend. So, obviously the big five major retailers, and I would say the Shoprite-Checkers, Massmart, Pick n Pay, Spar, and Woolworths, I think would be universally accepted by all the banks as being anchor or magnet tenants. And I think their presence in a centre would be perfectly acceptable from any banker's perspective.

CHAIRPERSON: When you say Massmart, you mean the Game store?

MR LOCKHART-ROSS: Game and Makro.

CHAIRPERSON: Related to grocery?

MR LOCKHART-ROSS: Ja. Game and Makro. The big retailer.

CHAIRPERSON: Okay, sure.

MR LOCKHART-ROSS: But there will also be other retailers, probably not of that sort of scale, whom we'd also accept as being anchors. Depending on the centre, and particularly the location of the centre.

CHAIRPERSON: Ja.

MR LOCKHART-ROSS: So, without naming names, we can go in camera to name particular names, but there'll be certain retailers that are strong in particular geographies. And if we are looking at a centre in the North West or Limpopo, there are a couple of retailers. One in particular who trades in that node, and is strong in that node. And would be just as good in that node, from our perspective, as one of those other names I've just given you.

So what we call those … And the other couple I could mention to you in camera, around, there are some strong retailers in the Free State. We would accept those as anchors and again in KZN as well.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: In our terminology, we refer to those as 'regionals'.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: Who in respect of centres in their particular region of establishment, for want of a better word, we would regard as being equivalent to a national in a centre in that particular region.

CHAIRPERSON: Okay. You mentioned that when you look at funding an existing centre, one of the things you look at is the foot count or trading density. Is there a difference between foot count and the trading density?

MR LOCKHART-ROSS: Yes.

CHAIRPERSON: Or is it one thing?

MR LOCKHART-ROSS: No. In a successful centre, they should be pretty much the same. You know, theoretically, the more feet, the more people visiting your centre, should lead to higher trade. It should work in tandem, most of the time. It doesn't necessarily do so. But certainly, those are statistics that all of the developers and owners of a shoperty [shopping property?] will track, and they track it over time.

How many people are visiting their shopping centre over time, and from month to month? And this time this year versus this time last year. And they certainly all track the trading densities of their various clients.

And as I said, there are statistics that are published by the IPD, the Investment Property Database, which [intervened].

CHAIRPERSON: What is that? IP …?

MR LOCKHART-ROSS: IPD.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: You can access IPD reports, at the top of my head I can't remember how readily they come out.

CHAIRPERSON: Are they in the public domain?

MR LOCKHART-ROSS: Public domain.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: They periodically publish reports of norms. Norms, for example, a grocery retailer in a suburban centre should be trading … the average trading density would be *x* rand per square meter, and that would be set according to groceries, or fashion, or pharmaceuticals, or jewellery, or whatever. It is fairly broadly based.

And so there are industry norms, and the shopping centre developer and owner will track the performance of their centre against those norms, and we do too, when we assess the centre.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: You know, as soon as you find that one of two things would perhaps be warning signs, the foot traffic into the centre is down this year by comparison to last year, maybe there's an issue with the centre, there's a problem with its trading or something needs to be fixed up.

Of if trading densities are down from last year. Or if they are below what the industry norm would be, what that would tell you is that particular tenant in that shop is struggling, by comparison to the industry norms or the country-wide norms.

And at the centre, if that particular retailer, let's say is a food retailer, has a trading density that's significantly below the national average, it is warning signal that that retailer could well fail, so the Rand would end up with a problem and we potentially might end up with a problem. There'd be a hole in the landlord's income.

So certainly they would track that over a period of time.

CHAIRPERSON: Would you say … Would it be fair for this inquiry, for example, if we wanted to determine whether a centre is a successful one, by just looking at the figures that are provided by the IPD, the foot count, or the trading densities? And use that as the measure or the barometer for the success of a shopping mall or a centre that we are looking at?

MR LOCKHART-ROSS: So it would be one of the indicators that you would look at.

CHAIRPERSON: One of it.

MR LOCKHART-ROSS: Ja, one of the other … I'm just thinking, we'd look at vacancy levels, you know. Because that's the crunch.

CHAIRPERSON: Oh, okay.

MR LOCKHART-ROSS: So, let me put it this way. So foot count and trading densities would be a leading indicator.

CHAIRPERSON: Yes. Yes.

MR LOCKHART-ROSS: You know, if those are falling off, kind of the probability is that you might have tenant failure.

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: So those are trends. There is also a statistic that gets measured in the industry, is rental to turnover. And again, depending on what type of retail's involved, there is, retailer by retailer, there is just so much of a retailer's total turnover that he can afford to pay in the form of rental before he gets himself into trouble.

CHAIRPERSON: Ja.

MR LOCKHART-ROSS: So certainly the industry will track those statistics as well. If those leading indicators, kind of if those continue to deteriorate, what do those evidence themselves in? Actual vacancies.

So certainly, kind of, if you want to measure, is a centre working or not, ultimately I guess you should go and measure the vacancies. And again, vacancies, national, geographic, by property type. Vacancy statistics are publicly available. They're published, I think certainly by SAPOA, the South African Property Owners Association, you can publicly get information around what norms are for vacancies in centres spread across the various geographies.

And you could probably access information around that from the South African council of Shopping Centres, which also makes public, information on all of the shopping centres that exist in South Africa and that are registered with the council.

CHAIRPERSON: Thank you. And then, where could we … Is there, other than asking the actual tenants, is there … Where else could we access the rental – turnover information? Is that available anywhere else?

MR LOCKHART-ROSS: I can only share with you the sources that we use, it's that we use IPD, we use SAPOA Statistics.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: We use SA Shopping Centre Council [intervened].

CHAIRPERSON: Okay, so it's only there [intervened]

MR LOCKHART-ROSS: Oh no, there are some other independents as well. There's a report by Independent Property *Corren School Rhooder*. You can get the Rhooder Report on an annual basis, and they publish all of these statistics around trading densities, vacancy levels, rental levels, escalation rates, all of those sorts of things. There's a wealth of information out there, that one can use to test one's centre and how it's performing against it's peers of a similar type and a similar geography.

CHAIRPERSON: Okay. My colleague is just alerting me to something that he would like me to cover.

MR LOCKHART-ROSS: Sure.

CHAIRPERSON: Are you comfortable in proferring your view on what you think is the purpose of exclusivity clauses by anchor tenants? Why would anchor tenants require ... As a funder in the space, what have you come to understand to be the purpose? Or can you speculate on that at all?

MR LOCKHART-ROSS: I could, but I would prefer not to. In the sense it is really not my role.

CHAIRPERSON: Ja.

MR LOCKHART-ROSS: As a financier to express a view on that.

CHAIRPERSON: A view.

MR LOCKHART-ROSS: That is a matter as between the developer and the tenant.

CHAIRPERSON: The tenant. Okay.

MR LOCKHART-ROSS: So that would be Nedbank's formal response to that. I would also prefer not to express a personal view. I might profess a personal view at a dinner party, but I certainly wouldn't in this forum.

But I can give you a view on whether exclusivity clauses, if they were to exist in a lease, would be of any importance or any impact on us as banks. I can give you that view.

CHAIRPERSON: Okay, can you go ahead?

MR LOCKHART-ROSS: So, our view would be that an exclusivity clause in a lease would not be beneficial to a bank. In fact, could be harmful to a bank.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: As a financier. And let me explain that to you by way of example. This is a theoretical example. I cannot tell you that this has happened to us in any particular instance.

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: But let me tell you, for example, a prospective developer opens a new shopping centre in a rural node. Where there is clearly demand in terms of population, and under-serviced in terms of the existing offering.

Establishes a shopping centre and procures one of the big food retailers as the tenant. And that such big food retailer insists on an exclusivity clause.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: And we fund the centre, and we fund the centre, not because of the exclusivity clause, but because there's a long term lease, and an appropriate tenant mix for that particular centre.

Roll forward over a period of time, that centre trades particularly well, there's big demand for it, to the point where one of the other big retailers in the country decides that they want to trade in that particular rural town as well, and come along to my client, the centre developer, and say, "I'd very much like to come into your centre, and I'm prepared to sign a long term lease, for you to let me into your centre. Either displace an existing tenant or more likely expand your centre to accommodate me".

And my client, the developer, because of the exclusivity clause, cannot do so. The risk for me then, is that such big retailer finds another prospective property developer, and says, "Go and find another piece of land just down the road from the existing centre. I'll sign a nice big long-term lease with you, go and develop a competing shopping centre, I'll be the anchor there, and go into competition with the existing centre".

And that would prejudice the trading and therefore the value and serviceability of the centre that I funded.

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: So, you know, to the extent that there are exclusivity clauses in the existing leases, I guess we have to live with them, but they're certainly not beneficial to the bank from a funder's perspective, because of that theoretical example I have given you.

CHAIRPERSON: Thank you. On the purpose that could be served by exclusive leases, would you be comfortable to, as Nedbank, to deal with that in a closed session? Just to give us [intervened].

MR LOCKHART-ROSS: No, Nedbank's not going to express a view on that.

CHAIRPERSON: You don't want to express a view on that? Okay.

I just want to find out, as a bank, do you have a situation where ... You have already commented that exclusive leases do not serve any purpose for you as a bank, that we understand.

But in a situation where you're buying into an existing development, which has been pre-trading therefore, and you have to fund a developer, whoever is going to buy into that, and then the existing developer is exiting that development.

Have you ever made it a requirement for the new developer that's coming in, make it a requirement for them to approach the anchor tenant for consent? Or just to be approved by them, in order for you to go ahead and fund a development?

Because we've had a situation where someone said, where a developer went through that. Where they were told they qualified in every respect, and then a bank told them, 'Well, can you go and check if the anchor tenant is going to be happy with you?' And yes, they qualified.

From your perspective as a bank, would that be a practise of Nedbank?

MR LOCKHART-ROSS: Sorry, I don't understand the question. That the anchor tenant would be uncomfortable with the property developer, I don't know.

CHAIRPERSON: No, no, no.

MR LOCKHART-ROSS: Where it changes hands? When somebody new comes in?

CHAIRPERSON: There's a change of ownership on the development itself, on the property, in which an anchor tenant is operating.

MR LOCKHART-ROSS: Yes.

CHAIRPERSON: And then, as Nedbank, you now have to fund this new owner.

MR LOCKHART-ROSS: Yes.

CHAIRPERSON: And then, when they come to you, they'd seek everything that you've given us today. And then you require them to go and ask, over and above them meeting all the requirements for funding, you ask them to go and get some kind of approval from the anchor tenant, just to make sure that the anchor tenant is comfortable with who they are.

Is that a practise of Nedbank?

MR LOCKHART-ROSS: No, it certainly won't be a practise of ours.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: To the best of my knowledge, it would be very rare for there to be a clause in a lease agreement between the original developer of the centre and one of the retailers that would give the retailer a chance to exit the lease if there was a change in ownership of the centre. I've personally never seen one of those.

CHAIRPERSON: Ja.

MR LOCKHART-ROSS: I've seen that in other contexts, but not in retail.

CHAIRPERSON: In retail.

MR LOCKHART-ROSS: So it wouldn't be – I qualify my answer now – It wouldn't be a concern of ours that if the ownership of that centre changes from ABC (Pty) Ltd to XYZ (Pty) Ltd, that that in itself, that in itself, in terms of the lease would give the anchor tenant a chance to exit the lease. That wouldn't be usual.

Kind of, having said what I said, qualify my answer is, obviously if we were looking to fund the purchase now XYZ, we ourselves would have to satisfy ourselves that the centre could be properly managed.

So we ourselves, would have to satisfy ourselves that XYZ is an appropriate purchaser, all the reasons I mentioned earlier, in particular that they would continue to manage the centre.

Because there might well be clauses in the lease that do protect an anchor tenant to the extent that there could be clauses that said, 'In the event that a vacancy is above *x* % in the centre, kind of, the anchor tenant or any of the other tenants have a right to reduce their rental payments, withhold their rental payments, or to withdraw from the centre.

But a change in ownership? Not an issue I've seen in a lease before, and certainly not an issue that we would be writing into a loan approval, that's for sure.

CHAIRPERSON: Thank you. As the bank when you do funding to a developer, do you ever require, when is it a process of the bank to require deposits from the developer? Under what circumstances would you require security or a deposit.

MR LOCKHART-ROSS: Okay, so let me break that into two parts.

CHAIRPERSON: Yes.

MR LOCKHART-ROSS: So deposit in the context of commercial property would have been equity own money that the developer or owner has to put in upfront and the response to that is, always. We always require that a would be developer or owner puts some of his or its money in upfront and … [intervened]

CHAIRPERSON: Can I, it does not matter who you are? Whether you are Resilient, you are Growth Point, you are a listed fund or not?

MR LOCKHART-ROSS: I will come to Growth Point and Resilient if you do not mind. Outside of the listed property funds, a conventionial unlisted developer or owner, across the whole income scale and across the whole of that property cash vacation, we will always require that the would-be developer or owner puts some of his or her money in upfront.

How much they put in will depend very much on the nature of the centre, the sustainability of the cash flows and how much debt the income from the centre can support.

The excess over that debt, has to go in by way of equity or deposit to your term and it is an invariable rule of bankers that you must put your money in as developer/owner before you put in as equity or your deposit, before we will put our money in as a loan. I mean that is kind of basic.

You need to be committed to the thing before you can expect me to be committed to the thing. So that deals with equity or deposits.

In respect of a big listed property, there are two elements to funding of a centre developed by such as those. We in those cases, lend to the fund as the borrower. You know those big listed funds have substantial balance sheets and we are really looking at the borrower rather than the property sitting inside of the borrower.

So in the case of a big listed fund conceptually, we might fund a 100% of the shopping centre because they have this massive balance sheet, because they have a whole portfolio of centres that sit within in the fund as opposed to, the first example I was telling you, whereas we are funding a developer/owner on the strength of the property in isolation without reference to any other assets that that developer might have.

Which brings me to the second question around security and the second question is, when do we take security for our loan and the second response thereto is, always.

We will always take a mortgage bond over the property that we are funding, at least to the value of our loan, we will always take that and that is what we would call a banking speak, primary security and we would then, on top of that, sometimes call for what we call, suretyship which is a form of guarantee from the investors or sponsors or bankers often talk about the jokeys, the people behind the centre, we would ask for them to stand corporate or individual guarantees for the debt, over and above the bond.

How much those suretyships might be worth, be require, will again depend on circumstances, economic transactio.

CHAIRPERSON: Okay. Would you say, my colleague does not want me to ask this question directly, so then, would you say it is a challenge for the bank to find or ones, let me ask it this way, what is the challenge for the bank to find developers who come from previous disadvantaged groups because surely there must be challenges, coming from that group, given the history?

Lack of funding, lack of assets, lack of asset ownership. So what would you spell out as challenges for your as Nedbank and how do you deal with those kind of situations as Nedbank?

MR LOCKHART-ROSS: Okay, let me frame it this way, let me frame it this wat, if you do not mind, it is a challenge for us to fund any new entrant into the commercial property sector, regardless of whether they are from a disadvantaged background or not.

Obviously it is more complicated if you come in from a disadvantaged background, I said upfront, commercial property and retail property in particular, is capital intensive and it is expertise intensive.

So it is very difficult for me as a bank, to find any commercial property if you come to the bank and you have no capital of your own and you have never done it before.

So that is a starting point. However, there are some, we can sometimes go beyond role, out and out role of a financier and help address some of those shortcomings.

So, the shortcomings, I mean no offence in that word, but again no, so we looked for has this particular developer/owner got some capital of his or her own. If they short on capital, what we can so is, is suggest that they go and find themselves a funding partner, an equity partner and there are private equity players and other equity providers out there in the market.

There are also some develop financing institutions, IDC of the like, who might be prepared to put, what we call, risk capital in, of a nation, hybride of debt and equity.

So we would maybe suggest to go and do that and in certain circumstances we, the bank, might be prepared to put in some of that equity ourselves. There is a separate unit within Nedbank called Property Partners, where, which is really effectively a private equity, property private equity outfit and we will provide equity into certain projects which we believe have merit, for our clients where our clients are short on equity.

So that would be around supplementation of the capital. That is the one element. The other element is a new entrant who lacks experience.

So what we could well do, there is, is refer that new entrant who has a totally disadvantaged background or not, to another player in the market and go and suggest: Why don't you go and partner with one of the bigger players in the market who would be interested in your project and would be happy to put some capital in which would address the first point and you can also supplement your expertise.

So that we could certainly do and not on camera but certainly in camera. I can give you some examples of some of the established players in the market who do do that and have done that and have made projects possible for some of our clients from historically disadvantaged backgrounds who have started off small and who are really proper players in the industry now. I can give you those examples, I won't do so on camera.

So that is one avenue here. Refer them to someone to go into partner or joint venture with someone who has the capital and expertise.

The other thing we could do, if they have some capital and they are short on particular expertise, is make sure they have surrounded themselves with the right professional team. Have they got an architect and a quantity surveyor and engineer who can look out for them and kind of make sure that that professional team makes up for shortcomings in terms of track record and experience.

And similarly that they pick a contract and a project manager who have been there and done it before and we could direct them without kind of dictating to them, could direct them to people that we have used in the past and that have a track record in the industry.

And beyond that, when you get to past the development of centre to running of the centre, we could also suggest to them that they go and pick and appropriate letting agent and an appropriate property manager.

A lot of the letting agents, I mean a lot of the property owners don't do the letting themselves and don't do the property managing themselves. They outsource all of that to the likes of Broll and JHI, et cetera.

So we would suggest to them that you don't have skills internally, these are the sorts of people you should engage and bring onto your team. So that is the direction that we could give to someone who seeks to get into this game and that there I suppose, that goes beyond a narrow role of the financier towards trying to assist people to get into this industry, without … [intervened]

CHAIRPERSON: Chasing them away.

MR LOCKHART-ROSS: Ja, and also without tredding onto toe, we don't belong as a financier.

CHAIRPERSON: Okay. I think we are ready to, my colleague wants met to ask that question 11 which basically says: does the bank require participation arrangement, i.e., in the event that the developers sells the mall, is that developer required to pay the bank a certain percentage of the sale price?

MR LOCKHART-ROSS: Generally no.

CHAIRPERSON: Sale proceeds, I think that is the sale proceeds.

MR LOCKHART-ROSS: So the straight answer to that would be no, not for providing senior debt, no.

CHAIRPERSON: Okay.

MR LOCKHART-ROSS: And what I mean by senior debt, is normal conventional lending at market related levels.

CHAIRPERSON: Yes. You would not require that?

MR LOCKHART-ROSS: Not a profit share. If , in order to facilitate the project, we lend beyond that, we make, I refer to them as senior debt which would be the debt that can be supported by the centre. Just as an example, a 70% level might be a market norm. If, as a means of facilitating the centre, we lend more than that, on a bad debt there would be called a mezzanine debt and that would carry a different interest rate and a profit participation.

Those instances are very rare but they do occur from time to time but if you have come on on a conventional project and you have got a conventional amount of equity and we provide simply senior debt, there is no profit participation.

CHAIRPERSON: Okay thank you. I think at this point I would like us to go into the closed session, just to deal with a couple of questions that you said you are comfortable dealing with them.

MR LOCKHART-ROSS: Of course.

MR TILLEY: Before we go there, I mean there is one other question that ... [intervened]

MR LOCKHART-ROSS: Of course.

MR TILLEY: How long on average does it take for a developer to pay back the loan?

MR LOCKHART-ROSS: Sit again it will, it will depend on a case by case basis but the minimum duration of a loan will be ten years. I could go on further if you would like me to.

It will depend on a couple of things. First of all, it will depend first of all on how much he borrows upfront. How much equity he puts in and how much debt he puts in.

So if you have an example, a centre might cost R100 million, if the developer puts R50 million in of his own money and we put a R50 million loan, clearly you can repay that loan faster than you could if the developer put on 20 million of his own money and we lend 80 million. So it depends on the level of lend upfront.

It depends on the profitability of the centre and the rentals that come out of it. It also depends on what we in the industry call the yield on the centre. Let me explain that t you. A yield on a shopping centre, is if you take the total nett rental income of the centre and express that as a percentage of the cost of a centre.

So typically now a new shopping centre will give you a yield of perhaps somewhere between 8% and 11%, depending on the location and the design and the construction of the centre. That would mean on a R100 million cost centre and 8% yield would give you nett rental income of R8 milllion. A 11% yield will obviously give you R11 million per annum.

So that will depend on the yield. Compare that to the interest reate. Current prime interest rate is 10¼ . So, you know if your centre yields 8% and your interest rate is 10½ %, you have got yourself in a little bit of a trap and that is going to dictate how I structure the loan. On the other hand if your centre is yielding, the nett rent income is more than the interest income, that should enable you to have a more aggressive, shorter repayment profile.

But as a rule, kind of given where retail shopping centres, what their yields are compared to interest rates in the current environment, it is going to take you at least ten years to pay off a centre and the probability is that it will be longer than that. It could be 12 to 15 years.

So we will, our loans are typically ten years long and they might then pay down to nought at the end of the ten years or there might still be a balance that is left at the end of the ten years which you could pay back as a lumpsum or which at the end of the ten years, you could ask me to refinance, to stretch and repay over the remaining period.

MR TILLEY: So the location of the development, whether it is in a township or rural area, does not really affect … [intervened]

MR LOCKHART-ROSS: No, so we have got internal policy guidelines and we have got a risk assessment process and we apply that, we are agnostic really, where the centre is located. You know the location of the centre, whether it is CBD or suburban or rural, the location per se doesn't dictate whether the centre is going to be a success or not. So we will apply broadly the same criteria, regardless to where the centre is located and our credit terms will be broadly the same, regardless of where the centre is located.

CHAIRPERSON: Just one last question before you go into the closed session, would you say, is it possible for there to be a difference in determining what is successful shopping centre develoment, whatever by a bank, by the property developer or by the anchor tenant, could there be different views coming out of these three?

Could Nedbank be saying this is a successful development and the anchor tenants are thinking no, this is a not a successful development at all and is that possible and therefore is it possible to have different measurements or indicators of what is a successful shopping centre, between these three or amongst the three, that being the developer, the source and the tenant?

MR LOCKHART-ROSS: Okay. So I wouldn't want to express the answer as being anchor tenant. I would rather use the word: tenant and I will tell you why. My own view would be, the interests of the tenants and the developer, landlord and the financier should all be aligned.

A successful centre is a centre that draws the customers and the shoppers to come and shop, that it is located in the right, that it does act as a draw. That its designed and its flow and it is managed so that people do come and people do spend.

The people do come and the people do spend. The tenants, not just the anchor tenants, they should be profitable. If they are profitable, they can pay their rentals. If the tenants pay the rentals to the landlands, the landlord can pay my loan, I am a happy chappy. The developer is a happy chappy and hopefully the tenants are all happy chappies and most importantly, the customers are all happy chappy because they will come back again and again and again.

That is the importance of the shopping centre. So there might well be rare occasions where those interests get out of alignment but broadly speaking, the interests of the stakeholders should all be aligned and a centtr, it is very unlikely that a centre that has clearly failed and is no longer attracting shoppers, it is unlikely that that is likely to be perceived by any of the parties as being a success from that perspective.

CHAIRPERSON: Thank you very much. We are now ready to go into the closed session. I am not sure if we still have the same people as we had before.

At this point we will require that only the Nedbank delegation and the people from the Competition Commission remain behind, as well as the team of transcribers.

We also request that the media streaming is switched off. Thank you.

HEARING ADJOURNS