

## *Spear REIT: keeping it simple*

*It's no secret that the property market in the Western Cape, and more specifically Cape Town, has been the darling child in South Africa over the last 10 years, attracting many South African residents and businesses who have packed up their bags and moved operations in search of a better quality of life and governance, without wanting to leave South Africa - a trend referred to as "semigration". Cape Town offers spectacular views of the coast and Table Mountain, as well as lower unemployment, buoyant tourism, and more reliable municipal services. This has attracted many new residents and businesses, making it an ideal area to own commercial property. Commercial property companies with operations across South Africa continually report on the strong property rental and value growth across the Western Cape, an opportunity that Spear has capitalized on, given its exclusive focus on that province.*



**Daniel  
Reynard**

Spear REIT is one of the newcomers to the South African listed property sector, having listed on the JSE in November 2016, allowing Spear to take advantage of the trend of a strong Western Cape performance. Overall, Spear is a small fund with 29 properties spread across the industrial, office and retail sectors, currently worth R4.6 billion. All the properties are located in Cape Town and surrounds, including an

industrial development underway adjacent to the airport in George. Spear is looking to expand its investment portfolio to become a medium size fund, having raised R300 million from shareholders at the beginning of this year. Following the successful capital raise, they announced in April that they will acquire 13 additional Cape Town properties from Emira Property Fund. This transaction will add another R1.1 billion of property to the portfolio.



*Spear's Sable Square Centre, Milnerton*

### SPEED READ

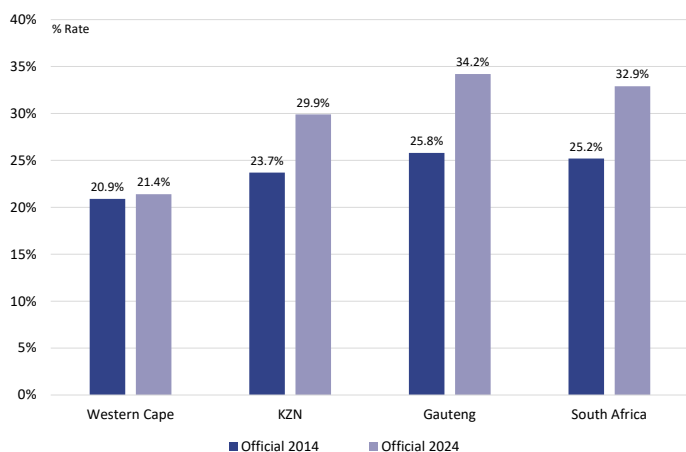
- Spear is a small Western Cape focused REIT, with a straightforward business, balance sheet and distributable income per share.
- It benefits from good governance, large public infrastructure investment and the high quality of life on offer in the Western Cape.
- Spear is currently expanding its property portfolio through the purchase of 13 properties, all based in Cape Town, from Emira Property Fund.
- Distributions have grown since the turmoil of Covid, thanks to disciplined cost management and a hands-on approach to managing each property in their portfolio.

### The City of Cape Town and the Western Cape

The City of Cape Town (CoCT) and the wider Western Cape province have much on offer - beyond just being an international tourist holiday destination - such as larger and more effective government infrastructure spending, better investor sentiment and lower unemployment compared to many other regions in South Africa. That positions the Western Cape for strong economic growth in the future.

The City of Cape Town has large public infrastructure plans, with roughly R60 billion being spent in Cape Town to upgrade water works, roads and electricity to minimize the impact of stage 1 to 4 loadshedding. Spear benefits from these public infrastructure projects as the investment aids tenants' business operations, making real estate in the

## UNEMPLOYMENT RATE PER PROVINCE



*Better governance has led to better growth and more job opportunities, highlighted in a far lower unemployment rate.*

Cape more desirable, which in turn, drives rental growth and property valuations. Unfortunately, the difference in municipal service delivery between Cape Town and other metros – notably Johannesburg and Durban – has become ever starker. Whilst landlords might be charged higher property rates in Cape Town, this is recoverable from tenants who appreciate a well-functioning and clean environment.

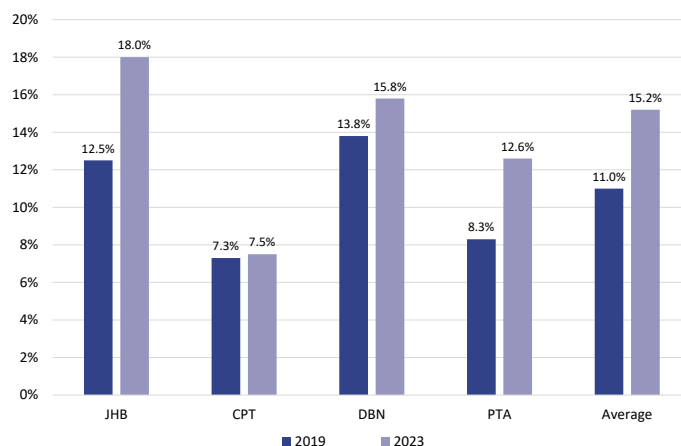
Another positive attribute of the Western Cape is that the official unemployment rate is far lower than the rest of the country and has remained stable over the last 10 years. An employment initiative undertaken by the provincial government at the end 2023, called Jobs Connect, added almost 13,000 jobs, of which, more than 9,000 were business process outsourcing (BPO) jobs, fuelling demand for office space in the city. Office vacancies of 7.5% in Cape Town are significantly lower than the South African average of 15.2%.

The above points have underpinned positive investor sentiment, fuelling a strong investment drive into the Western Cape, with R2.5 billion invested into new commercial properties in 2024 so far, impressive relative to total property investment of R3.6 billion for the whole of 2023.

### Spear's Underlying Property Metrics

Spear's core property metrics – such as rental escalations and reversions – rank amongst the most impressive in the industry. Lease agreements across their portfolio have built-in rent escalations of 7.52% per year, well ahead of peers and comfortably above inflation. This is the basis for distribution growth over time. The rental reversions - the increase or decrease in rent when a new lease is signed - increased 11.0% and 6.1% for retail and industrial,

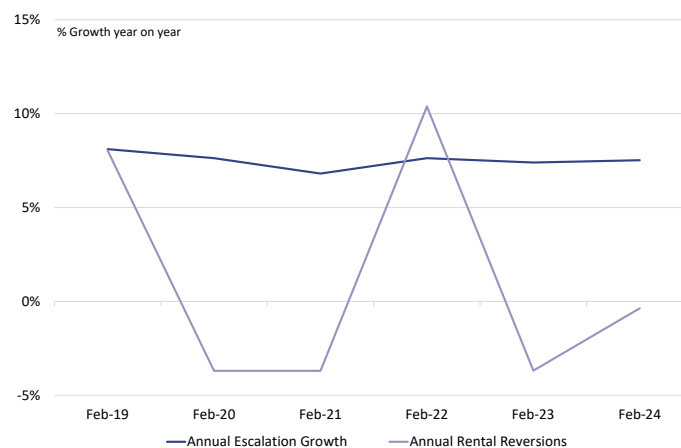
## OFFICE VACANCIES BY CITY



*Cape Town has attracted global firms looking to SA for their call centre operations. Consequently, office vacancies are well below the national average.*

respectively, showing the strong market rental growth in Cape Town for these types of properties. However, the weighted rent reversion across the portfolio was slightly negative as new leases on office properties were -4.7%. A factor that has contributed to achieving these metrics is that Spear manages their daily property operations internally, enabling Spear to understand their tenants' businesses, their needs and determine reasonable rent increases without the risk of significant tenant relocation.

## SPEAR CORE PROPERTY METRICS



*Given its hands-on approach and carefully selected properties, Spear has achieved some of the best operating metrics in the industry. Rentals are escalating at 7.52% per annum, whilst reversions are trending back towards positive territory.*

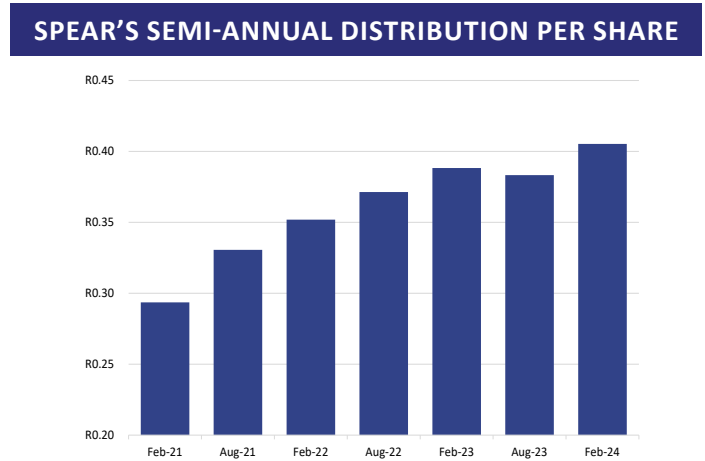
Having successfully navigated the Covid period and loadshedding, whilst bolstering its balance sheet through careful disposals, Spear is now ready to grow again. In April, it announced the acquisition of a portfolio of 13 properties, all in Cape Town, from Emira. It is expected that this acquisition will become effective from December

2024, so the full benefit will only materialise in 2025 and 2026. The properties include five industrial, six office and two health care properties, taking the total portfolio up to 40 properties. The healthcare properties will allow for greater diversification, as these properties tend to be more specialised and demand for healthcare is more defensive. The transaction will not change the current portfolio weighting to industrial, office or retail significantly. Rather, the overall portfolio will grow by 27%, allowing for economies of scale as administration costs are shared across a bigger base.

### Investing in Spear pays dividends

Spear’s historical dividend profile makes us happy asset managers when compared to their industry peers. An attributing factor to Spear’s dividend success is keeping its business straightforward. Spear has maintained a robust balance sheet by avoiding complex business structures and opting to invest only in direct property holdings. Spear’s Loan-to-Value (LTV) ratio will rise to 41.1% after the acquisition of the Emira portfolio. That is manageable and sensible and unlikely to place pressure on the balance sheet. Traditionally, Spear has hedged 60% - 70% of its debt to reduce the risk of higher interest rates. At present, the portion of debt hedged sits at 47%, allowing Spear to enjoy the positive gearing of lower interest rates once the cutting cycle starts, hopefully later this year. Spear has also avoided using complex currency and interest rate hedging derivatives, which can boost income in the short term, but which can cause large adjustments to distributions on expiry. Therefore, Spear’s historical dividend profile has

reflected an unhindered exposure to the favourable Cape Town property market.



*Spear is one of the few REITs to successfully grow their dividend consistently since Covid*

In conclusion, the underling property portfolio has performed well, reflecting the rewards of betting on the continuing growth of the Western Cape while remaining simple at its core. This focus has been rewarded by an increase of 17% in the share price since over the past twelve months. The acquisition of the Emira portfolio and lower interest rates are expected to give Spear further tailwinds and dividends into the future.



*Spear's Blackheath Park, Blackheath*



By the time of our next Insight seminar, our election will be out of the way. We will take the opportunity to review market performance for the first five months of the year, and look ahead to what the second half might hold.

Please note that we will be hosting both a morning and evening presentation in Cape Town. The venues will be communicated once finalised.



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**Topic:** **Taking Stock: Mid Year Update**

### Natal Midlands

**Date:** 20 June, 2024  
**Venue:** Christ Church Howick, 23 Mare Street, Howick  
**Morning Time:** 10am for 10.30am  
**Evening Time:** 5.30pm for 6pm

### Johannesburg

**Date:** 11 June, 2024  
**Venue:** Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham  
**Time:** 7am for 7.30am

### Cape Town

**Date:** 13 June, 2024  
**Venue:** SSISA Conference Centre, Boundary Road, Newlands, Classroom 1, 3rd Floor  
**Time:** 7.30am  
**Venue:** ABRU Motor Studio, Lourensford Wine Estate, Somerset West  
**Time:** 5.30pm for 6pm



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Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax. Performance fees do not apply to any funds managed by Harvard House. The manager does not provide any guarantee either with respect to the capital or return of the portfolio. A schedule of fees, charges, and maximum commissions are available on request from the manager.

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