

SEDCO
CAPITAL



SEDCO Capital REIT Fund
Risk Assessment Report
2020

Risk Assessment

The Fund's activities expose it to a variety of different risk factors that are exogenous such as market risk, credit risk and liquidity risk as well as operational process related risks. Furthermore, there are risks related to the asset class REITs as such.

The Fund's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Fund's financial performance.

Consequently, the risk assessment process focuses on the most significant risk factors, which include but are not limited to:

Main Risks	Description	Assessment
Market Risk	Market Risk arises from external factors such as macroeconomic conditions, competition, supply & demand, political changes, FX etc.	The Fund Manager monitors on a regular basis the fluctuation and changes in the overall economic environment, local real estate markets including cap rate, inflation rate, taxes, valuations, competition from other available premises and various other factors. Given these factors, the Manager believes that the impact of current market factors is mitigated through diversification of assets that adds stability to the portfolio while reducing vulnerability to economic fluctuations. Additionally, vacancy risks are managed through a proactive asset management approach. Market research is conducted to avoid any economic constraints as much as possible.
Risks related to the use of debt	The use of debt results in risks such as interest rate, leverage related to refinancing risks. Interest rate risk is the potential for financial loss arising from increases in interest rates and ultimately adversely impacting the financing terms of the Fund.	The Fund Manager uses debt with the objective to enhance investor returns. Based on the expected trend of interest rates, the Manager may consider other financial instruments to manage this risk. Leveraging may also further exacerbate any losses.
Credit Risk	Credit risk arises from the possibility that tenants may experience financial difficulty and be unable to fulfill their lease commitments.	Credit risk is mitigated by geographical diversification, diversity both in its tenant mix and asset mix and by conducting tenant credit assessments. For new leases, credit evaluation is performed and on an ongoing basis, tenant credit and arrears are closely monitored by the Manager.
Completion Risk	Risk associated with development projects underway include: construction delays and their impact on financial performance, cost overruns which could impact the profitability and/or financial viability of a project; and, the inability to meet revenue projections upon completion. Delays may result in legal risk.	This risk is somewhat mitigated based on the fact that Fund is entitled to invest only up to 25% of the value of its assets in real estate development. The Manager also aims to mitigate this risk through management of the contractual framework of the properties.

Risk Assessment – Cont.

Main Risks	Description	Assessment
Operational Risk	Risk of loss resulting from failure of internal processes, operational procedures, external events, loss of key personnel, service provider and counterparty risk as well as business continuity risk.	<p>The Fund Manager has in place a monitoring framework to manage the day-to-day activities and mitigate operational risks. These include periodic meetings to identify potential operational risks, reviewing and resolving operational issues.</p> <p>The Manager has established processes to identify, monitor and manage operational risks associated with day-to-day management and maintenance of the Fund’s properties.</p> <p>Internal audits are also carried out periodically to review compliance with processes, and to identify and rectify any lapses in procedures.</p> <p>A business continuity plan is in place to mitigate the business continuity risk of interruptions or catastrophic loss to its operations.</p> <p>Additionally, for the perspective of key personnel risk, the Manager had no material changes in the organizational structure during the year. Service providers and counterparty performance is regularly monitored.</p>
Liquidity Risk	Liquidity Risk has many dimensions such as the risk of being unable to meet any payment obligations for exiting properties according to plan.	<p>Cash flow generated from operating the property portfolio represents the primary source of liquidity used to service the interest on debt, fund general and administrative expenses.</p> <p>Therefore, the Manager ensures that there are adequate funds to repay obligation in a timely and cost-effective manner. Additionally, The Fund Manager also has a cash management process in which he has the option to utilize any excess cash in short-term deposits.</p> <p>Any decline in liquidity in the Saudi real estate market may affect valuations.</p> <p>Any exit below acquisition cost (including transaction cost) can lower the returns.</p>
Regulatory Risk	Fund operates within guidelines as set out in the “Real Estate Investment Traded Funds Instructions” from Capital Market Authority. There can be further regulatory risk related to real estate market or public policy.	<p>The Fund Manager has implemented processes to monitor regulatory requirements in all fund management functions, such as Compliance and Risk Management aim to provide another layer of assurance that proper controls are in place to avoid any non-compliance.</p>
Legal Risk	Risks involved in legal arrangements, contracts, agreements and obligations.	<p>The Fund Manager has a dedicated Legal and Compliance departments, who are responsible to provide guidance to ensure that all regulatory and compliance matters are adhered to.</p> <p>Regarding legal suits, any adverse ruling may potentially have a negative financial impact on the Fund.</p>
Risk of Crimes such as Cyber Security Risks	Crimes such as cyber security incident includes any material adverse event that threatens the confidentiality, integrity and/or availability of SC’s information resources and may result in financial losses.	<p>The Fund Manager has implemented processes, procedures and controls to help mitigate these risks. However, these measures, as well as its increased awareness of a risk of a cyber-incident, do not guarantee that its financial results would not be negatively impacted by the occurrence of any such event.</p>

Risk Assessment – Cont.

Main Risks	Description	Assessment
Valuation Risk	Risk that the quality of valuation does not meet regulatory standards.	Two independent appraisals are performed for asset valuations. The 3 rd party valuers are accredited by TAQEEM i.e. Saudi Authority for Accredited Valuers. The Fund Manager uses the average of the two independent valuers for reporting purpose. In case of any material contradiction between the two valuers, the Fund Manager assigns a third valuer.
Capital Deployment Risk and Reinvestment Risks	Risk of delay in capital deployment.	This risk is mitigated based on the fact that Fund is fully invested.
General Risks Related to the Asset Class REIT	General risks of the asset class include among other aspects volatility of the share price, potential deviations between net asset value and the share price in the market, potential drop in share price and liquidity risks.	The market price of the units may be affected by changes in general market conditions, fluctuations in the markets for equity securities and numerous other factors beyond the control of the Manager.
Environmental, Social and Governance (ESG) Risks, in Particular Climate Risk	<p>Environmental, Social, and Governance (ESG) risks refer to the three factors in measuring the sustainability and societal impact of an investment. ESG criteria can help to better determine the future financial performance of companies (return and risk).</p> <p>Any environmental issues of properties, such as the use of hazardous materials, could adversely impact its value. As part of ESG risks, climate risks may result in increased exposure to loss as assets become less liquid, generate lower income or may be subject to environmental regulation. Additionally, Climate change could make insurance too expensive.</p>	<p>The Fund Manager assesses ESG risks in the analysis of investment opportunities and in its monitoring according to its responsible investment policy. In the Manager’s experience, ESG assessment can complement traditional financial analysis and due diligence.</p> <p>The Fund Manager has implemented processes, procedures and controls to help mitigate these risks. However, these measures, as well as its increased awareness of ESG risks, do not guarantee that its financial results will not be negatively impacted by the occurrence of any such event.</p>
Risks Related to Geopolitical Events, Natural Catastrophes, Terrorism and Health Pandemics	Geopolitical events, instability, terrorism, natural catastrophes and events such as health pandemic may negatively impact assets from valuation as well as income perspective.	Given the fact that these events are highly uncertain and unpredictable, therefore the Fund as well as the Manager may be negatively impacted by the occurrence of any such event.

Risk Assessment – Cont.

Main Risks	Description	Assessment
Pandemic Restrictions	Restrictions related to quarantines including flight bans, social distancing, lockdowns and other regulations. Resulting risks may include cap rate volatility, changes in occupancy rates or fluctuations in rental income. An adverse development may lead to a reduction in revenue or an increase in costs.	<p>During 2020, COVID-19 outbreak severely impacted global and regional economies and certain sectors such as retail, wholesale, transportation, distribution, and construction got seriously affected. Social distancing and lockdown restrictions resulted in a lack of utilization of space across all kind of commercial properties such as office, retail and hospitality.</p> <p>Due to a slowdown in business, rent relief requests from tenants to be managed to avoid any significant impact on rental incomes.</p> <p>Construction work may get delayed due to lockdown restrictions.</p> <p>Asset types, regions and sectors may vary in their sensitivity to pandemic restrictions. The effects of Covid-19 are set to have an impact on the market as a whole and in result, nimble management remains important. While many restrictions have been lifted, the duration and severity of remaining restrictions is uncertain.</p>
Lease Receivables	Risk of tenants' failing to make lease payments in a timely manner. Reason of delay may include various reasons including requests for modifications in lease terms.	Due to economic downturn of 2020, some delays in receiving the lease payments have been experienced. The Fund Manager's proactive management improved cash collection. In general, The Fund Manager's thorough screening facilitates tenants' quality and ability to pay.
Property Management Risk	Risk of lower income [i.e., return on investment] due to inappropriate or insufficient property management, resulting in high vacancy rates, high operating expenses and below market rental income etc.	<p>The Fund Manager recognizes that management is essential to success in real estate investment and therefore, mitigates this risk by engaging suitable, qualified, and experienced property managers when outsourcing is done. In this regard, roles & responsibilities are clearly defined and agreed through legal documentation i.e., agreements, contracts etc.</p> <p>The Fund Manager has implemented necessary processes to mitigate insufficiencies related to property management.</p>

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For more information



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