SEDCO Capital REIT Fund

Risk Assessment - Annual Report 2022

December 2022

Risk Assessment

The Fund's activities expose it to a variety of different risks factors that are exogenous such 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 Manager monitors on a regular basis the fluctuation and changes in the overall economic environment, local real estate markets including cap rates, inflation rate, taxes, valuations, competition from other available premises and various other factors. Given these factors, the Fund 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 profit/interest rate, leverage related to refinancing risks. Profit/interest rate risk is the potential for financial loss arising from increases in profit/interest rates and ultimately adversely impacting the financing terms of the Fund.	The Manager uses debt with the objective to enhance investor returns. Based on the expected trend of profit/interest rates, the Fund Manager may consider other financial instruments to manage/hedge this risk. Leveraging may also further exacerbate any losses. Additionally, while increasing profit/interest rates may be a challenge, real estate investments can perform well in a rising rate environment due to variety of factors, such as increasing rent revenue, demand, and prices.
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 industrial and 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 Fund 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 Fund Manager also aims to mitigate this risk through management of the contractual framework of the properties.
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.	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. The Fund Manager has established processes to identify, monitor and manage operational risks associated with day-to-day management and maintenance of the Fund's properties. Internal audits are also carried out periodically to review compliance with processes, and to identify and rectify any lapses in procedures. A business continuity plan is in place to mitigate the business continuity risk of interruptions or catastrophic loss to its operations. Service providers and counterparty performance is regularly monitored.

Risk Assessment – Cont.

Main Risks	Description	Assessment
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.	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. Therefore, the Fund 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. Any decline in liquidity in the Saudi real estate market may affect valuations. Any exit below acquisition cost (including transaction cost) can lower the returns.
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. Examples include new taxation, building code requirements, energy efficiency standards, Operational improvement requirements, etc. Changing regulations can add substantial time, risk, and cost to completing development projects and can also impose new and often burdensome operating restrictions on existing properties.	The Fund Manager has implemented processes to monitor regulatory requirements in all fund management functions, such as Compliance and Risk Management aiming to provide another layer of assurance that proper controls are in place to avoid any non-compliance.
Legal Risk	Risks involved in legal arrangements, contracts, agreements and obligations.	The Fund Manager has dedicated Legal and Compliance departments, who are responsible to provide guidance to ensure that all regulatory and compliance matters are adhered to. Regarding legal suits, any adverse ruling may potentially have a negative financial impact on the Fund.
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 the company's information resources and may result in financial losses.	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.
Valuation Risk	Risk that the valuation is notably incoherent from actual market prices.	Two independent appraisals are performed for asset valuations. The 3rd 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.	There is risk mitigation currently since the Fund has deployed its capital. Nevertheless, any portfolio rebalancing actions may create future deployment and/or reinvestment risks.

Risk Assessment – Cont.

Main Risks	Description	Assessment
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 Fund Manager.
Environmental, Social and Governance (ESG) Risks, in Particular Climate Risk	Environmental, Social, and Governance (ESG) risks refer to the three factors of 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). 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 prohibitively expensive.	The Fund Manager assesses ESG risks in the analysis of investment opportunities and in its monitoring according to its responsible investment policy. In the Fund Manager's experience, ESG assessment can complement traditional financial analysis and due diligence. 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.
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.	The escalation of geopolitical conflicts, such as the Ukraine war, may be reflected in the risk premia of global risk assets and thus may impact the Fund, too. Given the fact that these events are highly uncertain and unpredictable and therefore the Fund as well as the Fund Manager may be negatively impacted by the occurrence of any such event.
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.	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. The Manager has implemented necessary processes to mitigate insufficiencies related to property management. Particularly, increasing energy costs may bring heightened focus on the energy efficiency of buildings, because of the impact on tenants' bills.
Inflationary Pressure / Supply chain issues	Risk that production and supply chain bottlenecks likely to lead to unexpected inflation level.	While inflation is a risk factor, there is some mitigation of inflation through rent escalations in lease agreements. Based on historical data, REITs provide reasonable protection against inflation because rents are not as sticky as other prices. The alleviation of pandemic restrictions may ease some supply chain bottlenecks that have been a cause of inflation.

Risk Assessment – Cont.

Main Risks	Description	Assessment
Pandemic Risk	Threat of new waves of infections, impacting overall economy negatively.	Manager recognizes that the emergence of the new infections/variant of COVID-19 looms all aspects of economy. However, since the start of the pandemic more resilience has been established. An increasing number of countries have even waived all or substantially eased pandemic restrictions. Expectations is that more countries will follow regionally and globally.
Concentration Risk	Risk of a scenario where too much investment capital has been put into a single property type or geographical location.	Manager recognizes portfolio diversification to manage concentration risk involves spreading investment capital across different property types as well as different geographical locations. Tenant diversification is an important factor considered by the Manager. This practice can reduce concentration risk and reduce exposure to market volatility or asset devaluations.

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