SICO Saudi REIT

Risk Assessment Report 2024

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1. FUND DETAILS

Fund Manager	**SICO Capital Company**
Name of the Fund	SICO Saudi REIT
Type	Sharia-Compliant Closed-Ended Real Estate Investment Fund
Objective	Provide regular income to unitholders by investing in structurally developed income-generating real estate assets of no less than 75% of the total value of the fund. In addition, the Fund may invest in real estate outside the Kingdom of Saudi Arabia up to a maximum of 25% of the Fund's total assets.
Tenure	99 years
Risk Level	High

KEY RISKS	DESCRIPTION	RISK MITIGATION
1. MARKET RISK	Market risk pertains to potential losses arising from unfavorable movements in the market prices of real estate assets. Factors influencing this risk include sector dynamics, supply and demand imbalances, economic conditions, inflation, and interest rates.	The Fund employs several strategies to mitigate market risk, including: - Continuous evaluation of sector and geographic conditions to identify risks impacting asset valuation and tenancy. - Active monitoring of macroeconomic trends and regulatory changes, enabling proactive measures to minimize adverse effects. - Regular independent valuation reviews to assess future trends and their implications for fund pricing. - Detailed examination of interest rate risk, discussed in subsequent sections.
2. COMMERCIAL REAL ESTATE MARKET RISK	The commercial real estate sector exhibits higher volatility compared to residential properties, with economic downturns potentially leading to rapid declines in valuation, rental yields, and tenant payment capabilities.	Given that all Fund assets are commercial real estate, the Fund Manager diligently monitors emerging negative trends to implement timely risk mitigation strategies (if any).

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3. CREDIT RISK	The Fund is exposed to credit risks related to the potential losses resulting from tenants failing to fulfill their lease obligations. This risk is affected by various factors, such as the financial stability of tenants, the broader economic environment, and demand for commercial real estate. Additionally, the Fund faces credit risk from the banks where it places its funds and money market funds in which the Fund invests.	Rental agreements incorporate punitive clauses for late payments, providing a legal framework for addressing defaults. The Fund Manager consistently monitors outstanding receivables and maintains regular communication with tenants. Additionally, the Fund prioritizes relationships with established financial institutions for cash management and investment activities.
4. LIQUIDITY RISK	Liquidity risk can manifest in two primary forms: 1) the Fund's inability to meet financial obligations, and 2) the inability to liquidate assets without incurring capital losses.	To address liquidity risk, the Fund maintains a balanced portfolio with a focus on holding sufficient liquid assets. Regular assessments are conducted to ensure that cash flow is adequately managed to meet ongoing obligations. The Fund also seeks to establish arrangements with financial institutions that can provide support when needed.

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5. INTEREST RATE RISK	The Fund is subject to interest rate risk, which refers to the potential impact on the value of the Fund's investments and income due to fluctuations in interest rates. Changes in interest rates can affect borrowing costs, the financing of properties, and ultimately influence the overall performance of the REIT. The Fund's financing structure includes a floating rate facility based on SAIBOR, and increases in SAIBOR could elevate interest expenses, adversely impacting total returns to Unitholders.	To mitigate this risk, the Fund aims to further diversify its portfolio and employ prudent financial management practices. This approach includes regularly monitoring market conditions and interest rate trends, which helps the Fund make informed strategic decisions. Interest rate hedging strategies will be considered based on cost-effectiveness.
6. COUNTRY RISK	This risk encompasses the potential impact of new government policies and political or social instability, which could negatively affect the Fund's performance and/or its liquidity. In particular, some of the Fund's investments located in Makkah face additional risks, including the potential for property confiscation or changes in regulations that could impact ownership rights.	The Fund is fully invested in Saudi Arabia, where the Fund Manager closely monitors real estate policies and regulatory/tax developments to respond effectively to changes.
7. REGULATORY COMPLIANCE RISK	This risk involves the potential for non-compliance with regulations from various authorities, including CMA, Tadawul, and MoC.	The Fund Manager actively monitors changes in relevant regulations and takes necessary actions to ensure compliance.

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8. CONCENTRATION RISK	Excessive concentration of investments in specific types of real estate, sectors, or geographic locations, which can heighten risk exposure. Currently, the Fund holds four real estate assets, three of which are in Makkah and one in Riyadh. This results in a high concentration not only in terms of geographic exposure but also within the hospitality sector, significantly increasing the Fund's vulnerability to sector-specific and location-specific challenges.	To mitigate this risk, the Fund aims to diversify its portfolio by exploring investments in various property types and locations, thereby reducing the overall impact of adverse developments in any single sector or region.
9. OCCUPANCY RISK	Potential challenges associated with maintaining high occupancy levels in the Fund's real estate assets. Fluctuations in market demand, economic conditions, and competition can affect the ability to lease properties, leading to decreased rental income and overall cash flow. Risks associated with non-renewal or early termination of leases, delays in securing new tenants, or renewals at lower rates can further adversely impact rental income.	To mitigate these risks, tenant agreements include provisions for advance notice prior to lease termination, allowing the Fund Manager time to seek alternatives. In certain scenarios, the Fund Manager may agree to renewals at lower rates due to adverse market conditions, with significant impacts disclosed to stakeholders. Assessments of lease terms should commence at least three months before lease expirations to explore
10. STRUCTURAL DAMAGE RISK	Structural damage from adverse events can diminish a property's income-generating potential and negatively affect its valuation.	Regular preventative maintenance and inspections are conducted to ensure properties remain in optimal condition.

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11. RISK OF NOT UTILIZING MARKET OPPORTUNITIES	The Fund Manager’s failure to identify attractive market opportunities may hinder the Fund’s ability to achieve desired returns.	The Fund Manager consistently analyzes market conditions and leverages reputable research reports to uncover new investment opportunities aligned with the Fund's objectives. An established credit line with a Saudi bank provides additional flexibility for seizing favorable investment opportunities.
12. NEW ACQUISITION GENERAL RISK	To achieve target returns, acquiring profitable and undervalued properties is essential. Due diligence must encompass comprehensive cash flow analysis, tenant financial assessments, acquisition financing costs, and exit strategies.	The Fund Manager adheres to a policy of conducting thorough feasibility studies and legal/financial due diligence before any acquisition, carefully analyzing market conditions and the Fund's capacity to meet investment objectives.
13. DISTRIBUTIONS VOLATILITY RISK	The risk of failing to meet periodic distribution obligations as outlined in the Fund's Terms and Conditions.	The REIT maintains a policy of distributing at least 90% of its net profit annually, excluding profits from asset sales. The Fund Manager engages regularly with property agents and operators to monitor asset performance.
14. PROPERTY MANAGER RISK	Early termination of the property manager’s contract may disrupt operations and affect performance.	The Fund Manager stipulates a minimum three-month notice period for contract termination from either party, allowing time for alternative arrangements.
15. DEPENDENCE ON KEY PERSONNEL	The potential loss of key team members can impact the Fund's operations.	The Fund Manager ensures that the Real Estate unit is staffed with experienced professionals, and vacancies are filled promptly with qualified candidates.

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16. CONFLICTS OF INTEREST RISK	Conflicts of interest between the Fund Manager and Unitholders may arise.	The Fund Manager continuously monitors for potential conflicts and discloses/report them in accordance with applicable regulations.
17. OPERATIONAL RISK	Operational risks may arise from internal and external factors, including control failures, technological disruptions, and unforeseen disasters.	The Fund Manager implements robust controls and processes across all Fund operations, including insurance renewals and adherence to best practices. Where necessary, specialized activities may be outsourced to reputable service providers.
18. FUND MANAGER RISK	Unitholders may not have adequate participation in the Fund's decision-making processes, which could affect performance.	To mitigate this risk, the Fund Manager emphasizes transparency in its operations and decision-making processes, ensuring that unitholders are informed and engaged. Regular communication and reporting can help foster trust and encourage unitholder participation in significant decisions that may influence the Fund's direction and performance.
19. RISK OF INVESTMENTS UNDERPERFORMANCE	The risk that the underlying assets may not perform as anticipated due to factors such as tenant delinquency, increased capital expenditures, or elevated vacancy rates.	To mitigate these risks, the Fund Manager employs strategies including: Establishing Med-term contracts with tenants that include provisions for rental increases. Ensuring a financially robust and diversified tenant mix. Regularly monitoring asset performance and maintaining open communication with property managers/operators to identify and address potential issues.

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20. REAL ESTATE VALUATION RISKS	Inaccurate property valuations may lead to financial and reputational losses.	Valuations are conducted by averaging assessments from two independent valuators accredited by the Saudi Authority for Accredited Valuators (TAQEEM), taking into account factors such as location, sector, property type, and economic trends.
21. DEVELOPMENT RISK	Risks associated with real estate development projects include the potential for inexperienced developers and inadequate project oversight, leading to cost and time overruns.	The Fund has a development cap of 25% of total assets, with no current projects underway. Development initiatives are pursued only after comprehensive technical, financial, and legal due diligence has been performed.
22. LEVERAGE RISK	The risk that the Fund may fail to meet bank financing covenants or repayment schedules, potentially triggering default.	The Fund Manager closely monitors Debt repayment commitments (if any) and ensures sufficient cash flow availability by regularly assessing projected cash flows from each property and the overall Fund.
23. LITIGATION RISK	The Fund may face contractual disputes or legal claims, which could impact income and cash available for distribution.	The Fund Manager takes proactive measures, including legal actions, to safeguard Unitholder interests.

24. CONCLUSION

Investment in real estate funds is categorized as high risk. The Fund manager takes steps to mitigate these risks, however, these cannot be eliminated. The above-mentioned risks are not exhaustive as there may be other risks and uncertainties that are not currently known to the Fund Manager, or the Fund Manager may consider to be currently insignificant, and which may have a negative impact on the Fund's income or valuation. No guarantees can be made that the Fund will be able to achieve the investment objective or that investors will receive a return on their capital.