Pillar 3 Disclosure

PATRIZIA Financial Services Limited

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Table of content

1. Introduction

PATRIZIA Financial Services Limited ('PFSL') is authorised and regulated by the Financial Conduct Authority ('FCA'). Due to the activities PFSL carries out, including MIFID activities, PFSL is deemed to be a BIPRU €50k licenced firm. As part of the Capital Requirement Directive ('CRD') PFSL is required to carry out an Internal Capital Adequacy Assessment Process ('ICAAP') and the ICAAP is prepared for PFSL taking into account the suggested guidance from the FCA for small investment firms (BIPRU 2.2.25). This Pillar 3 disclosure represents an overview of the firm's current ICAAP.

The capital requirements for firms such as PFSL has been enacted in the United Kingdom through the FCA Handbook and particularly within the FCA Prudential Sourcebook for Banks, Building Societies and Investment Firms ('BIPRU'). To comply with the regulatory capital framework the rules built on 3 Pillars have to be followed:

- Pillar 1 is a variable capital requirement which for firms such as PSFL i.e. BIPRU 50K as covered by GEN PRU 2.1.45 which states that it is a minimum of €50k, subject to the higher of 13/52 annual fixed operated costs as defined by GENPRU 2.1.54 or the sum of market (GENPRU 2.1.52) and credit risk (GENPRU 2.1.51). A firm must maintain at all times capital resources equal to or in excess of the amount specified and of the type or quality specified also.
- Pillar 2 requires each firm, and in certain circumstances the FCA as supervisor, to review whether additional capital should be held against risks not covered in Pillar 1, to instigate additional controls to mitigate such risks or a combination of these two approaches.
- Pillar 3 requires firms to publish certain details of capital and risk management and to review and update this information at least annually.

Under the Pillar 3 rules a firm may omit one or more disclosures where the information provided by such disclosure is not regarded as material and a firm is further permitted to omit information which is proprietary or confidential in nature.

The purpose of Pillar 3 is to encourage market discipline by developing a set of disclosure requirements which will allow market participants to assess key pieces of information on a firm's capital, risk exposures and risk assessment process. The disclosures are to be made public for the benefit of the market.

This disclosure forms the firm's compliance with Pillar 3 disclosure requirements as detailed in BIPRU 11 of the FCA Handbook as at 31 December 2019. The next review will be in December 2020 unless it is deemed necessary for one sooner.

2. PATRIZIA Financial Services Limited

PFSL is a 100% subsidiary of PATRIZIA UK Limited ('PAT UK'), which in turn is ultimately a 100% subsidiary of PATRIZIA AG which is listed on the German DAX since 2006. The PATRIZIA group of companies, which is a real estate investment and asset management platform with €43.2bn in funds under management as at year end 2019 and over 900 employees.

PFSL acts as operator of four funds where the mandate is limited in scope but the fees by comparison have been sufficient to cover the running costs.

PFSL's mandates during 2019 comprised the following:

- Winnersh Holdings LP (set up in 2013),
- Aviemore Holdings LP (set up in 2014),
- Citruz Real Estate Investment LP (set up in 2014), and

- Plot 5 First Street Limited Partnership (set up in 2016).

These mandates have come to the end of their investment periods and are likely to be wound up during 2020/21 as the underlying vehicles are wound up. PFSL has agreed to charge fees until the wind up is completed. It should be noted that, in accordance with expectation, a fifth mandate, Plymouth Sound (UK) Holdings LP was wound up during 2019, resulting in the termination of the operator agreement. The four operator roles require limited oversight since it is the operator of the holding company in each structure and the work here is infrequent as the majority of the work is as at the operating level.

To date PFSL has no direct liabilities towards staff, office costs or other expenses as these are covered by PAT UK. Hence it does not need to have extensive capital to cover liabilities although has taken into account a figure in relation to 'group reliance' for costs, neither has it been charged any fees in the past.

As at the date of review, no new clients are anticipated in the short term. PFSL also only deals with professional clients and is not permitted to act for retail clients. These Pillar 3 requirements only apply to PFSL and no other regulated entity in the group. This Pillar 3 disclosure reflects the latest circumstances for PFSL and those going forward. The Pillar 3 also reflects the nature of the firm's activities and risks including that it does not operate a trading book.

3. Risk Management Objectives and Policies

The directors of PFSL consider the risk appetite of the firm yearly and the statement of the risk is low. PFSL acknowledges that it is required to carry out an Internal Capital Adequacy Assessment Process ('ICAAP') at least annually in accordance with BIPRU 2 of the FCA rulebook and this has also been updated for year end 2019. The ICAAP is used as a tool in PFSL's risk management procedures. This Pillar 3 disclosure reflects elements of the current ICAAP as documented as at 31 December 2019.

Market Risk

The PFSL operator fees has come from four different deals hence the risks are mitigated in that if one fund was to fall away or be sold there would still be income from the other 3. There is no particular weighting to any of the four mandates. As PFSL exists from these structures as an operator, it will need to seek group support for funding or utilise existing cash reserves, the head room being £495k as at 31 December 2019.

Business Risk/Operational Risk

In analysing other potential risks the directors have considered other threats and have set these out below:

- Risks arising outside the control of PFSL – Recent years have demonstrated that risk exists at all times. The UK economy had to navigate through a Scottish independence referendum, Brexit and currently the Covid-19 global pandemic. All these events can adversely affect any business in the UK, including PFSL. In mitigation, PFSL has a strong financial position with limited exposure to manage on its contracts. PFSL expects these contracts to be closed down in the near to medium term future so its objective is to manage through this process and to arrive at an orderly wind down thereafter. The directors have determined that PFSL has sufficient cash reserves and PI insurance cover via its ultimate parent entity, PATRIZIA AG, to successfully continue in business.

- Key person risk –The 3 directors have an integral knowledge of the UK business but if one was to fall away a new director from the UK business could easily step in and take over that role due to the nature of the business being all UK mandates. The directors also have extensive involvement in the wider group's activities such as transactions, fund management and fund services. Whilst this may create a perceived key person risk in relation to resources, it does ensure that involvement is happening both at PFSL and the wider UK level in respect of this business.

- Fraud – all the team working on PFSL activities are experienced staff who have worked for PFSL for some time. PFSL holds no client money and any client requests made to transfer money within the investment structures involved would always be done in conjunction with one of the local accountants, senior management and/or property managers hence there should always be two people checking transactions. Furthermore, the processing and payment of purchase invoices is managed out of the group wide SAP system in Germany with multiple authorisation points prior to releasing payment. The directors believe that the chances of fraud are substantially minimised through control procedures and the authorisation processes in place;
- Bribery – PATRIZIA has a group wide compliance manual that sets out the policies and procedures around bribery with a view to ensuring that it does not happen anywhere within the business. From a PFSL perspective, the risk is low as there are limited purchases (professional fees only) and sales are contractually based, usually referred to by other entities within the group who provide other services such as asset management or development management services.
- Business continuity – PFSL has a documented business continuity plan as part of the wider group arrangements. The London office has a backup system run through the head office system in Augsburg and this system has its own back up procedures. In the event of a permanent interruption to the offices all staff can work from home and log into the system remotely. Most staff work from laptops and commonly spend some time working from their homes minimising reliance on office premises. The business continuity plans also comprises guidance to cover events where longer term access to their main place of work is disrupted or stopped.

Other Risks

- Counterparty risk – the market risk section above sets out the risks of not being paid due to a significant change in circumstances of its clients. On the overall counterparty risk side the directors model the funds cashflow hence know that it should have the cash to pay the ongoing costs and costs are covered within the PATRIZIA group.
- Group risk – the PATRIZIA group of companies is large hence has considerable capacity to support its subsidiaries. There is therefore very low risk that any of the UK subsidiaries will be exposed without the financial backing of the ultimate parent.
- Pension risk – there are no pension obligations;
- Currency risk – Other than a Euro denominated bank account, PFSL has no Euro denominated assets or liabilities and all its income and expenditure are Sterling based. As a result, there is limited currency risk;
- Remuneration risk – PFSL has no staff and hence no remuneration risk. With respect to staff bonuses firm wide bonuses are generally discretionary. Bonuses are paid on consideration of the wider group performance hence not linked to the underlying performance of any one PFSL client.
- Liquidity risk – PFSL has no assets other than the fees from client activity and its assets are cash based ensuring there are no liquidity issues. It does have significant cash reserves to comfortably cover its cost base and is not reliant on income flows which are forecast to reduce in 2020.

4. Business Strategies

PFSL has had four operator contracts which have been picked up during 2013, 2014 and 2016 and the extent of the work on these is limited hence the fees more than cover any work required. The business plan is to manage existing contracts to completion and then to consider whether there are additional business opportunities for the firm. It's worth noting that PATRIZIA's operations within the UK and Irish markets are on behalf of German Funds which utilise their own licenses (mainly AIFMD).

Also, the 2018 acquisition by PATRIZIA in Germany of Rockspring in the UK has further reduced income capabilities as Rockspring is also FCA registered and has more mandates than PFSL. Therefore, it is likely that future business is managed with the support of the Rockspring FCA licence and there appears to be limited opportunity for new business within PFSL. Consequently, the most likely outcome at the point of writing this report is an orderly wind up of PFSL.

5. Material Risks

Two of the current directors of PFSL are also directors of PATRIZIA UK Limited (the UK holding company for the PATRIZIA Group) whose staff are tasked with supporting the management of these mandates. There is a seamless and constant line of communication between all staff who work on PFSL business and this also helps with the level beneath management keeping management constantly up to date with any issues that arise.

PFSL is covered within the group wide PATRIZIA PI cover and having cover in excess of £10m is a requirement of the management contracts. Cover is retained of €30m with full reinstatement and this is placed through PATRIZIA's German brokers Funk. The lead underwriter is A+ rated.

6. Capital Planning and Stress and Scenario Tests

The firm does not have any set cost base and the current income from the four operator contracts is easily enough to make the structure profitable. The capital resources for the firm are therefore strong and the capital requirements are very limited.

The firm does not carry out any further capital planning or cashflow analysis since this is not necessary bearing in mind the income and expenditure.

A downturn in the market, a reduction in the value of the underlying real estate assets or any changes in the wider macro market do not affect the income stream of the firm due to the nature of the operator contracts agreed. Therefore maintaining the minimum Pillar 1 capital requirement of at least €50,000 will not be impacted notwithstanding the wider support to the company and the whole UK business from the PATRIZIA Group which currently has €43.2bn of assets under management as at 31 December 2019.

Requirement	Details	
Base Capital requirement	€50,000 (conversion sterling amount £42,716 at 31 December 19 of £1: €1.17051)	
	Pillar 1 Minimum Capital £'000s	**ICCAP** Additional Pillar 2 Capital £'000s
Base Capital	**43**	n/a
Credit Risk (CR)	0	0
Market Risk (MR)	0	0
FOR	0	10
Operational Risk (OR)	0	0
CR + MR	**0**	0
Additional capital	**n/a**	0

Pillar 1 Total (highest of CR+MR, FOR and €50k))	43	
Pillar 2 Total		10
ICAAP Capital		53
Current total capital (31 December 2019)		548
Surplus		**495**

In respect of the FOR, a general £10k has been estimated as the firm's minimum capital adequacy. This has been determined as follows:

- Under the FCA guidance GENPRU 2.1.57, there is a requirement to incorporate running costs that are not directly incurred by PFSL simply because its associated entity, PATRIZIA UK Limited, has not charged these across to PFSL. This covers principally staff cost that are employed by PATRIZIA UK but they manage PFSL as well.
  - Operating 4 partnerships
  - Monitoring of the activities of the LPs, including asset management, accounting and financial information
  - Monitoring of any reporting to investors
  - Monitoring of and calculating any distributions and drawdowns (not many)
  - FCA compliance reporting
  - Dealing with investor queries
  - Review annual accounts
  - File notices with Companies House

None of these are time consuming due to the limited activity of PFSL and the entities is acts on behalf of. These are estimated at £5k.

- The historical running costs of PFSL are circa £20k of which one quarter is £5k.
- If PFSL were to be wound up, the additional staff cost and consultancy would be covered by the £10k because PFSL would not spend money on the FCA renewal and the annual audit.

Therefore, the FOR of £10k can be split into £5k of recharges and running costs of PFSL (legal, consultancy and audit). Taking one quarter of these, £10k appears reasonable.

7. Financials

Year	Base Fee £'000	Performance Fee £'000	Operator Fee £'000
2018 Actual	n/a	n/a	58 Note that the disposal of most operating assets delayed invoicing of the fund operator fee until 2019.
2019 Actual	n/a	n/a	73 Note, this includes a portion of 2018 catch up fees.
2020 Forecast	n/a	n/a	45

The annual cost base is marginal with only audit fees, tax advisory, regulatory consultancy costs being incurred. The 2019 annual cost base was £20k (2018: £19k). The profit for the year was £58k (2018: £44k) based on income of £73k, an unrealised FX gain of £5k less costs of £20k. Therefore, after allowing for unrealised fx translations, both years have generated a healthy profit of £58k (2018: £44k).

8. Wind up of PFSL and Liquidity Risk

PFSL holds the £45,000 capital requirement in cash at the bank. The firm has considered and calculated the cost of an orderly wind down of the firm and has discussed this with its accountants in the past. It has also taken into account general guidance under the FCA's Wind-down Planning Guide ('WDPG') introduced in December 2016 although given the nature and size of the firm's organisation, has considered this only as guidance according to proportionality. If the firm was to lose all of the operator contracts, the firm could be wound down within 6 months at a nominal cost of say £10,000 maximum. The accountants believe this could be done easily and cheaply, as there are no staff, office premises or other contracts which would need to be terminated. Therefore there is no liquidity issue if the funds on account were needed to be used to wind down the business, there would be surplus at the end.

As at 31 December 2019 PFSL held capital of £490k. Senior management monitor cash balances on a monthly basis by way of the month end review process thereby assessing the liquidity position regularly. Management accounts are prepared on a monthly basis and these are a further tool for the PATRIZIA group to implement robust strategies and policies for cash management. The directors are fully aware of PFSL's position within a group and its liquidity is always considered at two levels the second of which is considering the group as a whole.

PFSL has no pledges or encumbered assets and therefore having to hold further liquidity to support these positions is not relevant.

9. Governance

The Directors of PFSL all hold Senior Management Functions in line with the FCA's Senior Management and Certification Regime ('SM&CR') introduced for all solo regulated firms from 9 December 2020. Under this regime, PFSL is deemed to be a 'Core' Firm. Therefore all senior managers are within the scope of the FCA Conduct Rules ('COCON') including COCON 2.1 (for all staff) and COCON 2.2 (senior managers). The senior managers have received training in Conduct Rules as part of SM&CR and this will be repeated annually.

All of the directors are involved with the full business of PFSL and are authorised to investigate any activity as to the risks which are deemed appropriate to accept and those which are unacceptable and should be eliminated or mitigated. The Board of PFSL meets annually but the 3 directors speak weekly and therefore can easily discuss any significant internal control failures that have occurred. More regular board meetings are held as and when necessary. The directors also discuss the quality of internal policies, disciplines, controls, processes and monitoring procedures in place to deal with risk and also make recommendations for improvements where applicable on a weekly basis as necessary.

10. Remuneration Policy

The Financial Conduct Authority ('FCA') has systems and controls rules (SYSC 19C for BIPRU 50k firms and where relevant SYSC 19F) regarding remuneration of key staff of certain FCA authorised firms. This includes investment management firms such as PFSL, regardless of the type of remuneration involved. This reflects the spirit and rules of the EU Capital Requirements Directives on capital adequacy. It also reflects Article 27 of the MiFID Org Regulation.

PFSL must report annually on its remuneration governance process and certain details on its remuneration policies and practices these are all covered by applying “proportionate” arrangements. As well as there not being any employees of PFSL there are also no individual bonus payments. There is a separate remuneration policy for PFSL notwithstanding it holds no employees.

11. Code Staff identification and quantitative disclosure

The FCA classifies Code Staff as those staff whose activities could have a material impact on the firm’s risk profile. The Code Staff for PFSL have been identified as those staff who are responsible for the operator mandates and/or are PFSL approved persons. They are easily identifiable and the risks and responsibilities for all staff are consistent throughout the platform hence one approach can be applied to all.

For the calendar year 2019, there were a total of 3 Code Staff who were employees of other PATRIZIA entities for all of the year. These three Code Staff are also directors of PFSL and hold senior management functions (as defined by FCA rules) including governance, control, or risk functions for the firm. There is no remuneration for Code Staff for the 2019 year since the staff are all paid by other PATRIZIA group entities. However there is an internal remuneration policy in line with SYSC 19C for a BIPRU firm. There are no bonus payments, pension payments or any other incentives paid to the Code Staff by PFSL.