

Local Property Risk Assessment

Introduction

Risk assessment is an integral part of all investment strategy. Investors use a wide range of techniques, from the most advanced rocket science to basic instincts, to evaluate their portfolio.

At an overall level, decisions must be made on the geographical split, between the UK, the US, Europe and so on. Equally, a broad view needs to be taken on the division between equities, bonds, cash and property.

The Volterra Local Property Risk Assessment service focuses on a specific aspect of risk, namely the location risk associated with a particular property portfolio. This is *complementary* to existing types of risk analysis, and *extends* this to a further dimension. Once decisions have been made about how much of a fund to allocate to property, and how it should be split across the various types, our service answers the question:

- How risky is the range of locations in which a property portfolio is allocated?

What the service does

- Local Property Risk Assessment quantifies the degree of risk associated with the geographical spread of any given property portfolio in the UK
- It enables comparisons to be made of the degree of risk of the individual types of property in any portfolio - offices, industrials, warehouses and retail
- It shows the effect of any acquisition or dispersal on the overall local risk of the portfolio



The Risks

There are two dimensions to the degree of risk of the locations in a property portfolio, which are both captured in the analysis. They are:

- The extent to which any particular location is exposed to events which are specific to individual industries.
- The *type* of economic area in which the property is located

Exposure to Industry Specific Events

An obvious example of the first of these was the experience of the coal mining areas in the 1980s. Once the mines began to be closed, economic prospects for *all* property in such areas took a sharp down-turn. A portfolio did not have to include specifically industrial sites for it to be adversely hit by this shock. Offices, retail and warehousing in these areas were also affected.

Of course, risks have their up-side as well as their down. Local areas such as Bracknell or South Cambridgeshire have proved popular and profitable locations. But these areas have a heavy concentration in a few industries such as computing. If, for any reason, these industries experienced a shock, such areas would be more exposed than others which have a wider spread of industries.

The Local Property Risk Assessment service does not attempt to predict whether industry-specific shocks might occur. It tells you which areas are inherently more exposed if such events do take place - because their industrial structure is more concentrated on a small number of industries.

Types of economic area

Areas which are far apart geographically can be very similar in terms of their economic structures. A property portfolio may appear to have taken account of geographical risk by being spread across the country. But if the investments are in places which are essentially similar, the risk is concentrated.

For some areas, there are few, if any, surprises. The old industrial area of Wigan, for example, is most similar to North West towns such as St. Helens, Rochdale and Oldham, along with South Wales areas like Llanelli. Others are harder to guess. For example, in terms of the overall economic mix, the areas most similar to Bristol are Northampton, Manchester, Derby, Southampton, Reading and Nottingham. Sunderland's closest matches are to be found in Burnley, Gloucester, Blackburn, Coventry, Preston and Leicester.

The Service does not rely on time-series forecasts – of which there is increasing scepticism – and which rely on the future being like the past. Nor does it rely on rental data, which is often either lacking or unreliable.

The Service

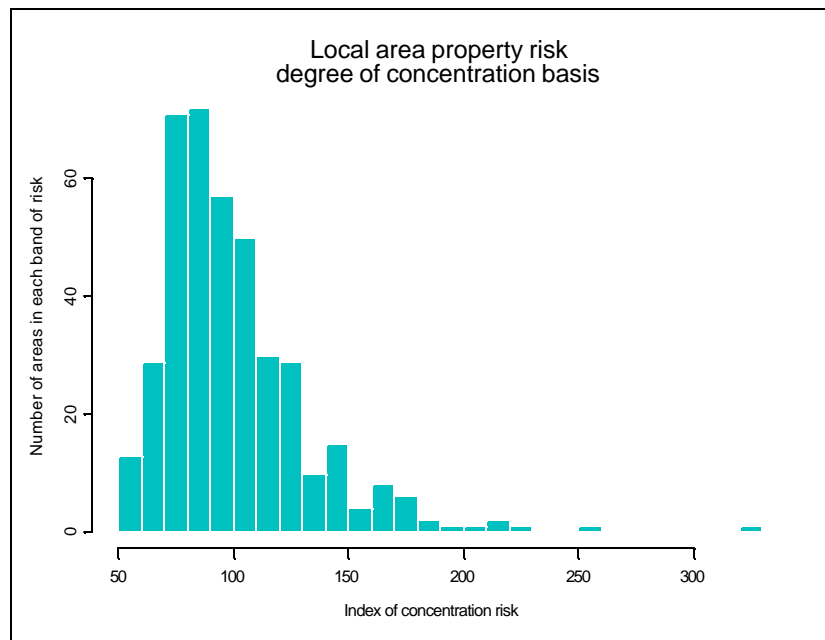
The service uses up to date information on all the Local Authority Districts in the UK to provide the risk assessment. This information is regularly updated as data is released.

The data is used to construct measures of the concentration of employment across industry sectors within Local Authority Districts. This data may then be analysed along with data from the property portfolio in order to assess the degree to which the two measures differ. This will enable us to quantify the risk to the portfolio associated with industry specific events. Portfolios with larger investments in more concentrated areas will generally be riskier.

The data is also clustered, using advanced fuzzy clustering techniques, into distinct geographical area types (for example, cities, market towns etc) and into employment types (for example, industrial sector employment). Each Local Authority District falls into these clusters with a varying degree of membership. Comparison of a given portfolio with this data will then

enable an assessment of the degree of geographical risk associated with the portfolio. Again the more similar the places into which the portfolio is concentrated, the riskier it will be.

The chart below shows, for example, the distribution of risk by industry concentration in local economic areas in Great Britain. The overall degree of this risk for any portfolio can be calculated according to the degrees of risk in the areas where the portfolio is located. The risk index of a portfolio is greater than 100 if it is riskier than the GB average, and less than 100 if it is more concentrated in areas with lower concentration. Similar charts can be produced for risk associated with area type.



The Service can be provided for any portfolio, for which the client can provide data on the postcodes and area of the sites within the portfolio. We provide an analysis and short report on each portfolio presented. Scenarios of potential adjustments to the portfolio can also be considered.

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