Valuation Advice on Yields and Market Rents

CITYCON OYJ
31 MARCH 2020

CONTENTS

INSTRUCTIONS

Our instruction from Citycon Oyj was to provide Citycon with our opinion on yields and market rents for their investment portfolio as at 31 March 2020, to be used in their internal valuations. The purpose of the internal valuations is financial reporting and performance measurement. The internal valuations include all investment properties excluding any redevelopment projects and any new acquisitions which are valued externally.

SCOPE OF WORK AND ASSUMPTIONS

This report is for the use only of the party to whom it is addressed for the specific purpose set out herein and no responsibility is accepted to any third party for the whole or any part of its contents. Neither the whole nor any part of our report nor any references thereto may be included in any published document, circular or statement nor published in any way without our prior written approval of the form and context in which it will appear.

This valuation advice is a professional opinion and is expressly not intended to serve as a warranty, assurance or guarantee of any particular value of the subject properties. Other valuers may reach different conclusions regarding yields and market rents of the subject properties. This valuation advice is for the sole purpose of providing the instructing party our independent and professional opinion on the portfolio's properties' yields and market rents on the valuation date, to assist Citycon with their internal valuations of the properties.

We confirm that we have had no previous material involvement with any of the properties prior to the 30 June 2017 valuation for Citycon and there is no conflict of interest.

We have carried out our work based upon information supplied to us by Citycon, which we have assumed to be correct and comprehensive.

We have inspected all the properties internally in between May 2017 and March 2020.

CBRE

MARKET OVERVIEW

NORWAY

Retail Occupancy Market

The Norwegian economy has shown solid performance over the past years, allowing Norges Bank to be among few the hawkish central banks in a global environment dominated by the US/EU/China trade war and Brexit fears. Over the past few weeks this has been completely turned on its head by the global COVID-19 pandemic.

This extraordinary situation has led to the government implementing the strictest peace time restrictions on the Norwegian society ever, closing schools and kindergartens and many non-essential shops and F&B outlets. Despite prime minister Erna Solberg recently announcing a NOK 100 bn fiscal crisis package and a pledge to "do whatever it takes", registered unemployment with the Labour and Welfare Administration (NAV) has skyrocketed to levels not seen since World War II due to massive temporary layoffs across the entire country.

Due to the extremely volatile nature of the situation, forecasts are changing almost every week. That said, our latest forecast is that Norway will dive into a recession, yielding a GDP contraction of -1.7 percent in 2020, and a drop in CPI inflation to 0.9 percent. The NOK is also expected to remain weak against the major currencies, resulting in tougher trading conditions for importers, i.e. a majority of retailers.

The situation is disastrous for all retailers except supermarkets, as many normal retailers are closed indefinitely and the ones that are still open are experiencing strong sales declines. The current measures will last until April 13th but are expected to be continued after this as well. Because of the crisis, there have been widespread rental cuts and stops from many landlords, but despite this, it seems inevitable that there will be bankruptcies, particularly among smaller, independent businesses, meaning that most shopping centres currently have a high risk of suddenly increased vacancy. Given the generally weak sentiment around brick-and-mortar retail, we believe there is risk that the damage done by COVID-19 shutdowns can become a longer-lasting problem for the physical retail sector, including shopping centres.

Data collected by Kvarud Analyse show that the sales income at Norwegian shopping centres fell 27 percent the first full trading week with under the current society lockdown regime from the authorities, while footfall fell 35 percent week on week. Generally, it is the biggest shopping centres that feel the most pain, while more local, convenience-type shopping centres are slightly less affected. This was also reflected in a data collection exercise that CBRE performed among a selection of larger and smaller shopping centres in the Oslo region on March 26th: At the bigger shopping centres, at least 40 percent of retail unites were closed, while at least 18 percent of units at the smaller shopping centres were closed.

On the other hand, average basket size stood at NOK 399 in the first week of full closures, up 33 percent YoY, driven by that people are buying more groceries (as more meals are made and consumed at home) and that many are purchasing supplies and equipment to optimize productivity while working from home.

Retail Investment Market

Retail transactions amounted to around NOK 2.9 billion in Q1 2020, which is 18 percent of the preliminary transactions volume for the quarter. The share is in line with the normal volumes, but nonetheless, the actual volume was down 38 percent YoY. The prime shopping centre yield in Q1 2020 is estimated to have increased 10 bps to 4.60 percent, after increasing 25 bps in Q2 2019, primarily as a result of the weak investor sentiment in the shopping centre segment. There also continues to be moderate upwards pressure on secondary yields. Furthermore, the COVID-19 situation also has the potential to force retail yields upwards, but this will entirely depend how severe and lasting the effects on occupiers will be.

There has been registered only a few shopping centre transactions in Q1 2020, all of which involving Citycon: Markedet in Haugesund, Torvbyen in Fredrikstad and Stovner Senter in Oslo.

Comment on Citycon portfolio

Market rents have predominantly remained stable across the portfolio with minor adjustments for some assets in line with quarterly sales performance and leasing activity. The interest from investors for secondary provincial retail and shopping centres continues to be limited. In light of this, and general market sentiment, the yield requirement for four assets in the portfolio has been moderately increased since last quarter. Additionally, CBRE Norway has advised on a rental discount to be included for non-essential tenancies, and a gentle increase in cash flow yield to factor in the current market uncertainty.

DENMARK

COVID-19 outbreak is yet another challenge for the retail market and market fundamentals are further weakening. There is no doubt that retail is the hardest hit asset class. Due to Copenhagen high street retail being heavily reliant upon tourism, significant contractions in footfall have been seen even prior to current measures, which have put a stop on retailer activity. This situation could result in more online shopping, but transportation restrictions pose a significant challenge to the supply chain and logistics industries. Renegotiation requests for rent reduction and a decline in renewal requests could be expected. Further on, occupiers will look into possibilities for deferral of monthly payments, at least for the next three months.

Retail Occupancy Market

According to Statistics Denmark, retail sales increased 0.4% from Q3 2019 to Q4 2019 when corrected for price trends, normal seasonal fluctuations and the effect of trading days. The product group Food and Everyday Commodities as well as Clothing decreased in sales, while Other consumer goods increased by 1.4%.

When comparing Q4 2019 versus Q4 2018 after seasonal adjustments, the retail sales of clothes and furniture has decreased by 9% and 1% respectively. The best performing retail sector was retail sale of watches and jewellery in specialized stores with an 11% increase.

Food & Beverage has an increasing role in the retail landscape, especially in high-street areas and in shopping centres. According to estimates from Statistics Denmark concerning the Danish consumption, the average household spent approximately DKK 14,500 on restaurants, cafés, fast food and takeaway in 2018. This is an increase of DKK 1-2,000 in the last 5 years. Comparatively households in the Capital Region of Denmark spent slightly above DKK 19,700 on average in 2018 on restaurants, cafés, fast food and takeaway. The consumption is increasing and clearly most prominent in this region compared to the country average.

Prime net shopping centre rents have been quite stable since Q3 2015 and currently stand at DKK 5,500 per sq m pa. Thus, no changes to the rental level is seen in Q4 2019. Due to Covid-19 increased vacancy could be expected and pressure on rent levels.

Retail Investment Market

The end of the fourth quarter 2018 showed a change in investor sentiment. The shopping centres are experiencing challenges regarding e-commerce and in addition, as a result of weaker investment demand and confidence, market players have been withdrawing their sales from the market due to difficulties in achieving expected pricing. This change in sentiment is also evident in large investors such as Danske Shopping Centre currently increasing investment in renovation and strengthening of the assets to meet the challenges with increased competition from e-commerce and changes in customer behaviours. In September 2019, Danske

Shopping Centre further announced they will adjust the rental levels due to the expected increase in vacancy in Danish shopping centres.

This change in sentiment is also evidenced by the sale of two shopping centres in the fourth quarter of 2019 and first quarter of 2020. Oding Group A/S has acquired Viborg Storcenter A/S through 100% share transfer. The shopping center is 9,924 sq m and located in Viborg. Aviva Investors was the purchaser of Galleri K shopping arcade in Copenhagen for DKK 1.75bn. Initial yield nor rental level has been disclosed for both sales.

The retail property transaction volume in 2019 was DKK 2.9bn, which is a decrease of 56% compared to 2018. In 2019 Q4, DKK 861m was transacted, a decrease of 43% Q4 on Q4. As of Q1 2020, the general shopping centre yields is at 5% for prime shopping centres and at 7% for good secondary shopping centres following 25 and 50 bps adjustment over the last quarter. The increasing yields are a consequence of the continuing growth in e-commerce, further pressuring retailers particularly in secondary locations. The forecast trend for both yields is softening.

Comment on Citycon portfolio

Albertslund is an established shopping centre with a stable track record, while Straedet is a newly developed centre with more uncertainties, characteristic of new centres. Expected rental levels are stable, while economic incentives are expected to increase. Alignment with current investor sentiment in regard to yields is expected. Due to current COVID-19 outbreak, all shopping centres in Denmark are forced to close (except supermarkets and Pharmacists located within a shopping center). It is uncertain when shopping centres can open again and what negative effects this lockdown will bring. Increased vacancy due to retailer going bankrupt is expected, however the government have issued economic help packages to ease the negative effects of the COVID-19 outbreak, it is however uncertain who and how these help packages will help.

ESTONIA

The impact of the coronavirus pandemic on the economy is generally expected to be temporary, and it is hoped that the economy will recover soon, given that the crisis will be managed in a reasonable time. The government has launched an initial €2 billion economic packages to support the economy. The Estonian economy increased by 4.3% in the Q4 2019. Pre COVID-19, according to the Eesti Pank, countries economy was expected to grow by 2.3% in 2020. Now Eesti Pank is assuming that the economy will shrink by 6%.

Retail Occupancy Market

Pre COVID-19 pandemic the retail sales in Estonia were steadily growing. In 2 months of 2020, the turnover of retail trade enterprises (except motor vehicles) increased by 9.2% year on year compared to the same period a year ago. The turnover of stores selling manufactured goods increased by 13% and the turnover of grocery stores by 7% compared to the same period of the last year.

In Tallinn, shopping centre rents in Q4 2019 remained stable. The market experiences somewhat increased vacancy due to recent expansions and openings. However, it has not affected rent rates. Pre COVID-19 pandemic the downward pressure on rents in the largest shopping centres in Tallinn was unlikely to be observed in Q2 2020. After the COVID-19 pandemic due to government restrictions, most of the tenants had to shut their shops and timetable for reopening is unknown. At the moment only grocery shops, pet shops, telecommunications companies and pharmacies are allowed to work inside the malls. All the rest of retail enterprises have to face an absence of revenues from physical stores. Some landlords are working on finding ways to reduce the burden for tenants, for example, one of the real estate funds announced that it plans to reduce financial obligations to many small and medium-size tenants from April.

Despite ongoing disturbances, Tallinn is observing a further increase in retail space at existing locations. Major shopping centre Porto Franco - a multi-functional development will be delivered in Tallinn in 2021 and will add 32.000 sqm of retail space. New Shopping centre called Väike-Järve Ärikeskus opened in Q1 of this year, producing 9000 sqm of new retail space. Tallinna Kaubamaja prolonged their lease with Viru Keskus for the next seven years and with that postponing their expansion plans. Pre COVID-19 pandemic total new retail space to be opened in 2020 in Tallinn was to be increased by 25,000 sqm.

Retail Investment Market

Yields of Estonian retail assets remain the lowest among the three Baltic countries. Prime shopping centre yield in Estonia have been softened by 25 bps, comparing to previous quarter. The yields were revised based on worsen sentiments in the market, taking into account the outbreak of the pandemic. However, it is not clear yet, what will be the full impact of the quarantine and when it will end. Thus, the upward pressure on yields remains.

Comment on Citycon portfolio

Despite preliminary figures of an increased performance during the two first months of the year, both assets are facing a massive drop in footfall and sales due to COVID-19 lockdown. On the other hand, difficulties of weaker competitive shopping centres could cause a faster recovery of Citycon properties in long term. Nevertheless, the position of shopping centres in the real estate market will be more apparent after quarantine restrictions.

In Copenhagen, Denmark, Oslo, Norway and Riga, Latvia – 8th April 2020

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