Valuation Advice on Yields and Market Rents

Citycon's properties in Finland and Sweden Q3 2020

Table of Contents

1. Instructions

In accordance with our instructions as the External Valuer of Citycon Oyj ("Company"), we have provided our view on yields and market rents of the properties held within the Company's investment property portfolio and located in Finland and Sweden as at 30 September 2020. The provided yields and market rents are used for Company's internal valuation required for financial reporting and performance measurement purposes. All the properties included in the property portfolio were valued internally by the Company except for Lippulaiva in Finland and Kista in Sweden, which were updated, and the opinion of Fair Value was given by JLL.

Concerning the valuation of Lippulaiva we state the following:

Fair value is defined by the International Accounting Standards Board (IASB) and IFRS 13 as:

"The price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants on the measurement date."

The International Valuation Standards Board (IVSB) considers that definitions of Fair Value are generally consistent with Market Value and we confirm that the Fair Value reported is effectively the same as our opinion of Market Value.

We confirm that our valuation is fully compliant with IFRS accounting standards and IVSC valuation standards and guidance. We also confirm that we have prepared our valuation as external valuers and that we have no involvement with the subscriber or the properties valued which is likely to cause a conflict of interest in our provision of this advice.

The Fair Value stated do not include transaction costs, in accordance with normal valuation practice in the market.

2. Scope of work

For this quarter we have provided our view on yields and market rents of the properties held within the Company's investment property portfolio and located in Finland and Sweden. In addition, we have valued Lippulaiva located in Finland and Kista located in Sweden. View of market rents and yields have been provided by local JLL offices in Finland and Sweden. Valuation of Lippulaiva was carried out by local JLL office in Finland. We have valued the property individually and no account has been taken of any discount or premium that may be negotiated in the market if all or part of the portfolio was to be marketed simultaneously, either in lots or as a whole.

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 not measured the properties leasable areas but have relied on the information supplied to us by the Company. We have not read copies of the leases or of other related documents but have relied on the tenancy information provided by the Company, which reflects the latest available tenancy position.

We were not instructed to carry out a site survey or environmental assessment nor have we investigated any historical records to establish whether any land or premises are or have been contaminated. Unless we have been provided with information to the contrary, we assume that the Properties neither are, nor are likely to be, affected by land contamination and that there are no ground conditions which would affect its present or future use

We were not instructed to carry out a structural survey, but we have reflected any apparent wants of repair in our opinion of the value as appropriate. The Property has been valued on the basis of the Property owner's advice save where we have been specifically advised to the contrary, that no deleterious materials have been used in its construction.

We have assumed that the Property has been erected and is being occupied and used in accordance with all applicable planning and zoning laws and regulations, consents and permits and that there are no outstanding statutory notices. We assume that the Property and the buildings comply with all statutory and authority requirements including, but not limited to building, fire and health and safety regulations

Finally, and in accordance with our normal practice we confirm that this report is confidential to the party to whom it is addressed for the specific purpose to which it refers. No responsibility whatsoever is accepted to any third party in relation to this report of the contents thereof. Neither the whole or part of the report, nor any references thereto, may be published or referred to in any document or statement or in any form of media or communicated to any third party without our prior written approval of the form and context in which it will appear.

3. Material valuation uncertainty due to Novel Coronavirus (COVID – 19)

The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organisation as a “Global Pandemic” on the 11th March 2020, has impacted global financial markets. Travel restrictions have been implemented by many countries.

Market activity is being impacted in many sectors. As at the valuation date, we consider that we can attach less weight to previous market evidence for comparison purposes, to inform opinions of value. Indeed, the current response to COVID-19 means that we are faced with an unprecedented set of circumstances on which to base a judgement.

Our valuations are therefore reported on the basis of “material valuation uncertainty”’ as per VPS 3 and VPGA 10 of the RICS Red Book Global. Consequently, less certainty – and a higher degree of caution – should be attached to our valuation than would normally be the case. Given the unknown future impact that COVID-19 might have on the real estate market, we recommend that you keep the valuation of these properties under frequent review.

4. Market overview

4.1. COVID-19 and retail as asset class

Global retailers must prepare to navigate a period of elevated risks to cash flow and increased operational costs arising from a slump in consumer demand and disruption to supply chains.

The drop in international travellers will most acutely impact global gateway cities, luxury markets and superprime retail destinations. Domestic retail spending may suffer a temporary decline from consumer reluctance or inability to visit destinations where infection risks are elevated. Non-essential goods items and leisure services will be hit harder than perishables and essential dry goods, which have seen elevated demand as consumers stockpile to avoid personal shortages. As the outbreak spreads, this behaviour can be expected to emerge in new geographies.

In the short term, supply chain disruption will lead to lower inventory levels for some retailers and may result in upward pressure on consumer prices, albeit much depends on the flexibility to source and manage stock. Fashion operators following a traditional two-season model are likely to see disruption spill over later into the year.

While the during the summer the foot fall and sales increased as the pandemic calmed down, currently the important Q4 seasonal sale period is at risk, as there are signs of second wave of the pandemic. Even if the situation calms down, Lunar New Year sales have already suffered a deep blow and months of inactivity are unlikely to be made up.

Protecting cash flow remains crucial for all retailers, and particularly for those operators with thin profit margins, including weaker retailers and non-food value operators. Due to uncertainty, new lease negotiations are difficult, and at the moment more temporary leases have been applied.

Retailers with the infrastructure to fulfil online orders through home delivery are currently being perceived as beneficiaries of consumers' reluctance to visit stores and we are seeing an increased conversion of people to online. Greater emphasis will be placed on the shift towards a flexible omni-channel retail model and sustainable fulfilment; strengthened partnerships between landlords and retailers will need to emerge to achieve this.

In the longer term many retailers are likely to rethink their supply chains to ensure continuity of their operations and to mitigate risks of future shocks. Coupled with initiatives to improve the sustainability performance and limit the environmental impact of wider operations, retailers may opt to produce and house more stock locally. This may boost additional demand for logistics space and/or drive the repurposing of existing store networks.

4.2. Finland

4.2.1. Economy

The world economy is at a state of great uncertainty due to the COVID 19 pandemic. The World Health Organisation (WHO) classified the Coronavirus as a pandemic on March 11th. The disease has spread around the world gradually and due to this, as well as the actions taken by countries, the phase of the pandemic varies around the world. The measures taken to prevent the spread of the disease cause the global economy to slow down. Especially the movement restrictions have hit the economies hard, as they have separated the consumers from service providers. Due to this the service and retail sector has been hit the worst. This is unusual, as previously the demand for services has survived economic downturns with minimal effect. OECD forecasts the world GDP to decrease by 6-8% in 2020. In Europe the decreases in GDP in different countries have varied between 5-23% compared to the levels of Q4 2019. Finland has been on the more positive end of the spectrum with a decrease of 6% while Spain and Great-Britain have suffered worst. The outlook for the balance of 2020 continues to be muddled. While economies around the world seem to have endured the worst of the crisis, numerous risks persist. With the recovery still fragile, monetary and fiscal policy will likely remain necessary over the coming quarters.

The Ministry of Finance and Nordea forecast the Finnish gross domestic product to decrease in 2020 by 6 percent (forecast 16.06.2020) and 5 percent (forecast 04.09.2020) respectively. The forecasted increase in unemployment has been more moderate than expected and the number of furloughed people has decreased from the peak witnessed in spring. Measures have been taken by the Bank of Finland, Finnvera, Business Finland and banks to secure financing for companies. By the beginning of September a large scale insolvency wave in Finland is yet to be witnessed.

The changes in the real economy can be felt in the letting market faster than in the capital market. The effects of the Corona virus pandemic can be seen primarily in accommodation sector, restaurants, services and non-essential retail. If the pandemic persists for an extended period, causing the economic growth to decrease notably, businesses will start to renew their views of the future. This will be reflected in their demand for space and eventually at the demand of office premises.

The effects on the capital market lag behind the letting market. In situations where the real economy experiences negative changes, the free capital searches more vigorously for safe havens and the importance of cash flow is further highlighted. In addition to this, the volatility of the stock market further increases the appeal of real estate in the eyes of investors. The possible significant slowdown of the economy affects the allocations within the real estate market. The capital gravitates towards secure core real estate, which in turn means a decrease in demand for the more opportunistic assets, assuming the possible influx of new capital does not replace the lost demand.

The largest risk for the real estate sector is a possible disturbance in the financial market, which could be caused by a wave of bankruptcies or the loss of trust between market players as in the financial crisis of 2008. The disruption would likely severely hamper the financing of real estate investments. The effect is further enhanced by the fact that real estate investing is commonly largely funded by debt and investment unit size is large. This could have severe and long-term effects on the functioning and the liquidity of the real estate market.

4.2.2. Retail market

Retail Occupancy Market

At the end of Q3 the shopping centres were open throughout the country. However, the shopping centres have widely agreed to more flexible opening hours and especially majority of the specialty stores have used the opportunity and have reduced the opening hours. Even in the summer, as the pandemic was calmed down, the opening hours remained limited, and it remains to be seen will the more flexible opening hours become the new normal.

At the beginning of the pandemic, the foot fall in the shopping centres decreased drastically, but increased during the summer as the number of infections dropped. Now there are signs of second wave of COVID-19 pandemic after the summer and restrictions have been inserted. Starting from October, restrictions in regions which are in acceleration phase (incl. Uusimaa) of COVID-19 include that half of the maximum number of clients may be inside the restaurant at a time and the restaurant must be closed at latest at 23:00. This will again challenge restaurant's financial situation. In general, the foot fall in shopping centres may again drop, especially if more restrictions will be inserted and the increasing infections will change the customer's behaviour.

At the beginning of the pandemic, number of landlords have granted or are willing to negotiate of rent frees, rebates or other arrangements especially when it comes to the restaurants. Afterwards there have been no signs of such reliefs.

Retail Investment Market

In the first quarter there were two shopping centre transactions. Grocery store driven Tikkuri mall in Tikkurila, Vantaa was sold to opportunistic investor Alma Property Partners and shopping centre Espen in Vaasa city centre was sold to Trevian as part of the sale of the entire block. Other transactions in retail sector included hypermarket Prisma in Itäkeskus, Helsinki, which was sold to VVT Property Fund I Ky. Approximately 70 % of the property's leasable area has been leased to hypermarket operator. Property in Jätkäsaari, Helsinki leased fully by Verkkokauppa.com, was sold to French fund Corum. All the assets were sold for undisclosed amount. All the transactions have been made or well-prepared prior the spread of COVID-19.

In the second and third quarter, after the spread of COVID-19, there has been one shopping centre transaction. Aberdeen Standard Investments sold their half of shopping centre Chydenia located in Kokkola. The gross lettable area of the building is around 8,000 sq. m. Other transactions in retail sector in Q2 and Q3 included portfolio of three properties with emphasis on department and grocery stores located in Helsinki, Lohja and Kokkola, which were purchased by Serena Properties. In addition, Trophi acquired two hypermarket properties located in Kemi and Pieksämäki.

The shopping centre prime yield has risen to 5.2 %. While there is yet no solid evidence on the market after the COVID-19 outbreak, the current uncertainty which targets specially to shopping centre properties, and the increased cost of financing has had its impact on prime yield. Even prior to COVID-19 the demand for retail properties has decreased as the sector is facing difficulties as the people's consumption habits continue to change and online shopping is increasing. In addition, retail stock in has increased significantly during few quarters before COVID-19 especially in HMA.

Comment on Citycon's properties

While there are strong signs that there is a need for rent decrease especially within fashion sector, there is also some evidence of decreased rent levels during renegotiations. Therefore, in shopping centres with high emphasis on fashion sector some movement downwards have been made in market rents. These centres include IsoKarhu, IsoKristiina, Koskikeskus and Trio. In addition, in IsoKristiina there have been few larger premises leased with rent clearly lower than before and in Trio there are several contracts about to end, and most likely there will be some decrease in rental income.

Cashflow yields were increased slightly for the properties which can be seen most vulnerable against COVID-19 to reflect the uncertainty tied to the cashflows in addition to decrease in market rents.

4.1. Sweden

4.1.1. Economy

The COVID-19 pandemic caused Sweden's GDP to fall by around 8.3 per cent in the second quarter. According to the National Institute of Economic Research (NIER) the decline was broad-based. Fears about infection and social restrictions to limit contagion led to a dramatic decrease in households' consumption of some services. Plunging demand abroad and supply problems brought a sharp fall in exports, which contributed to industrial production plummeting by no less than 23 per cent.

Statistics Sweden's activity indicator and other high-frequency statistics point to a strong rebound in GDP in the third quarter. Both household consumption and exports have made up much of the ground lost in the second quarter. Exports have been boosted by the easing of lockdown measures outside Sweden and by rising demand, and the previous supply issues have largely evaporated. Domestically, reduced infection rates and behavioural changes among both consumers and firms, together with the economic policy response, will help push up household consumption by around 5 per cent in the third quarter. A number of indicators, including the Economic Tendency Indicator and the PMI, are pointing to continued recovery in the fourth quarter.

The government's emergency support is helping both households and firms to ride out the deep economic downturn and is also helping to prop up expectations. Above all, the short-time work programme has limited the decline in employment and curbed the rise in unemployment, which will average 9.2 per cent in the third quarter. Employment has decreased particularly among those on fixed-term contracts (often young people and those born abroad), partly because the current system for short-time working means that firms must first cut fixed-term staff. The sharp fall in fixed-term employment has affected women more than men, partly because a majority of these workers are female, but also because industries with relatively high numbers of women on fixed-term contracts, such as hotels and restaurants, have been hit particularly hard by the crisis.

The emergency measures introduced to support households and firms in Sweden mean that government net lending will be deeply negative, and fiscal policy highly expansionary. Some of these measures, such as the higher rate of subsidy for short-time working, will expire at the end of the year, while others, such as the higher ceiling on unemployment benefit, will be extended.

The current economic downturn means that wages will continue to grow relatively slowly over the next couple of years. Inflation expectations are also generally low. CPIF inflation – the increase in the consumer price index with a fixed interest rate – will therefore remain well below the Riksbank's target level for the next couple of years, and so the central bank will stick to its low interest rate policy.

4.1.2. Retail market

<u>Retail Occupancy Market</u>

Retailer sentiment was unsurprisingly dampened in March as the outbreak of the virus drastically changed consumer behaviour. Many retailers reported an initial 70-80 percent decrease in footfall, leading to a significant drop in sales as consumers stayed home to stay safe. While this effect was clearly noted in the larger shopping centres as well as on the high street, convenience and grocery-anchored retail and the DIY segment faired significantly better, in some cases even seeing an increase in sales during this period. This was further made clear through retailer demand, which has remained strong in the convenience and grocery segments throughout. In addition, although F&B was initially impacted by the pandemic, it's one of the sectors to have seen the fastest recover in demand for new space. Equally, brands and concepts with a solid strategy for navigating the new retail landscape are the ones in position to expand in the current market climate.

Retailers that already have adopted a multi-channel offering are seeking physical exposure to complement their online offering, often limited to one or a few flagship locations. Most traditional retail chains are continuing to decrease store space across the country. All the above trends have been prominent within the retail landscape for quite some time and have been clearly solidified, and in some cases accelerated, by the Covid-19 pandemic. As most ongoing negotiations for retail locations were put on hold during these volatile times, landlords have reported substantial delays in many ongoing development projects. While very few deals came to a closing during the period, we did see momentum starting to pick up again slightly in June. The situation is putting downward pressure on terms. Rather than lower rents, landlords tend to offer rent-free periods, investment contributions or turnover-based rent only for a limited time in order to get the deal signed.

Retail Investment Market

Boosted by two major deals in Q1, retail transaction volumes in H1 amounted to almost SEK 10 billion, an increase of 40 percent compared to H1 2019. The largest transaction at approximately SEK 4 billion included the acquisition of the regional shopping centre Farsta Centrum, comprising 115,000 sq m of retail space in the southern suburbs of Stockholm, by the Alecta, Keva and HEA Property formed JV Stadsrum, sold by listed company Atrium Ljungberg. The second largest transaction was the Netto portfolio of 111 grocery stores throughout Sweden. The 118,000 sq m portfolio, was sold by Coop to Cibus, making their debut investment in Sweden.

The largest retail transaction during Q3 was a transaction of nine properties located in four cities in the southern part of the country during September. The properties lettable area is approx. 17,800 sq m. The transaction price is confidential but has been estimated in media to SEK 260 million which equals approx. SEK 14,600 per sq m. A grocery operator is the largest tenant in all properties. Other tenants are pharmacies and restaurants. The buyer was Svenska Handelsfastigheter and the seller is confidential.

In September the property Sicklaön 73:116 in Nacka was sold by Dominant Invest to Coeli. The property has a lettable area of approx. 3,800 sq m. The largest tenants are a grocery store, car service and a gym. The transaction price was SEK 135 million which equals approx. SEK 35,100 per sq m. The property is located closely to where the new subway station will be located in Nacka and the new owner will work to develop the property.

While Q1 was a relatively strong period for retail investments, transaction activity drastically slowed in Q2-Q3 due to the overall uncertainty in the market in general and the turmoil of the retail sector in particular. Most critically, banks have become more reluctant than ever to finance retail investments, regardless of quality, location and composition of tenants. While there is still demand from certain investors seeking exposure to the sector, primarily in grocery and convenience anchored units in good locations, the difficulty in funding investments at viable interest rates is having a severely dampening effect on transactions. While the sector is currently not favoured by many investors, there could be a boost for transaction volumes as funds and listed companies in need of equity might be forced to sell the kind of high-quality assets that are still in demand. We do expect to see more assets coming on the market and transaction volumes increase before the end of 2020, as several International Retail REITS are under pressure, both operationally and financially.

Comment on Citycon portfolio

During Q3 2020 the transaction market for retail properties have continued to slow down. There has however been a transaction of a portfolio of grocery stores which shows an interest in this segment.

We have recognised an increase in request for more flexible and low rental levels for retailers generally in Shopping centres, especially fashion and shoe tenants. We have reflected this with adjustments in market rent downwards for tenants in these categories. The yield has in general remained stable compared to the previous quarter with only slight adjustments.

In Helsinki 23rd October 2020

Yours faithfully

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