JLL

# Valuation *Advisory*

## Citycon Oyj

Market Valuation of the Investment Properties

30 September 2016

# Executive summary

At the end of September 2016, Citycon owned 55 investment properties, 5 properties owned through joint ventures and associated companies (including Kista Galleria and 4 properties located in Norway), two rented properties (located in Norway) and one property held for sale. This valuation statement includes 55 investment properties.

The valued portfolio is divided into four geographical areas; Finland, Norway, Sweden, and Estonia and Denmark. Below we present the key figures of the evaluated portfolio:

| 30 September, 2016 | Number of properties | Fair Market Value, EUR million | Wght. Average Net Yield Requirement | Wght. Average Initial Yield | Wght. Average Reversionary Yield | Wght. Average Market Rent, EUR/sq.m./ month | Wght. Average Operating Costs EUR/sq.m./ month |
|---|---|---|---|---|---|---|---|
| Total Property Portfolio | | | | | | | |
| Finland | 24 | 1,795 | 5.7 % | 5.2 % | 6.1 % | 30.1 | 6.6 |
| Norway | 19 | 1,456 | 5.2 % | 5.2 % | 5.7 % | 23.2 | 5.7 |
| Sweden | 9 | 748 | 5.2 % | 5.2 % | 5.6 % | 25.5 | 6.9 |
| Estonia and Denmark | 3 | 339 | 6.7 % | 7.3 % | 7.0 % | 20.1 | 3.3 |
| Total | 55 | 4,338 | 5.5 % | 5.4 % | 5.9 % | 26.2 | 6.1 |

Citycon's property portfolio includes a few relatively valuable properties compared to the rest of the portfolio. This means that the weighted averages are highly influenced by the changes in these properties. Shopping Centre Iso Omena (located in Finland) is the most valuable property in the portfolio under valuation.

The total fair value of the portfolio in Q3 2016 was approximately €4,338 million. Compared to Q2 2016 the fair value increased by ca. €242 million i.e. 5.9% when the property moved outside the valuation in Norway (Lade) is excluded from the comparison. This value increase also includes the Iso Omena extension which is now included to the valuations 100% after joint venture partner NCC's buy-out in August 2016. In addition committed investments, decreased yields, increased contract and market rental levels and strengthened Norwegian krone increased the value.

# Contents

# Scope of Instructions

In accordance with our instructions as the External Valuer of Citycon Oyj ("Company"), we have carried out a fair valuation of the properties held within the Company's investment property portfolio as at 30 September 2016, to arrive at our opinion of Fair Value.

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. The Fair Value does not include possible transaction costs.

We understand that this valuation is required for financial reporting and performance measurement purposes.

We confirm that our valuations are 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.

We carried out inspections of each of the properties during September–December 2011 when the property portfolio was evaluated by us for the first time. Properties added to the portfolio after the initial valuation have been inspected when added to the portfolio. In addition, we have re-inspected the other properties after the initial valuation. During Q3 2016 we have re-inspected Heikintori, Sampotori, Iso Omena, Myllypuron Ostari and Duo located in Finland and Kilden located in Norway.

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.

The valuations were carried out by local JLL offices in Finland and Sweden. In Norway, Estonia and Denmark we were supported in the delivery of our advice by local affiliates.

This report is addressed to and may be relied upon by the Company. It has no other purpose and should not be relied on by any other person or entity. No responsibility whatsoever is accepted on the part of any third party, other than those specified above and neither the whole of the Report, nor any part, nor references thereto, may be published in any document, statement or circular, nor in any communication with such third parties, without our prior written approval of the form and context in which it will appear.

# Market overview

## Finland

According to Statistics Finland's data, Finland's GDP increased by 0.0% in Q2 2016 compared to the previous quarter and 0.4% compared to Q2 2015. Forecasts for GDP growth in 2016 range from +0.8% to +1.2%, while in 2017 economists predict growth varying between +0.8% and +1.4%. GDP growth during 2016 will be mainly supported by domestic demand. In addition the unemployment rate has decreased and investments on the construction sector in particular have been growing strongly.

According to Statistics Finland's flash, in August 2016 retail sales increased by 2.9% year–on–year. Over the same period, the volume of retail sales, from which the impact of prices has been eliminated, increased by 3.6%. For the full year 2016 forecasts expect a 1.7% increase, and the growth is forecasted to remain moderate also in 2016–2018 being 2.0% p.a. (Oxford Economics, October 2016).

Prime shopping centre rents decreased ca. 3% both quarter–on–quarter and year–on–year. The weak outlook for retail sales limits rental growth potential and has kept occupiers cautious. Only few new occupiers have entered the market and this has been seen almost exclusively in Helsinki city centre or shopping centres in Helsinki metropolitan area. Most recent challenge will be large units left vacant after Anttila as the number of potential occupiers is limited. On the positive side the restaurant occupiers are active but overall polarisation on the market between good and poor locations and centres is increasingly evident. Prime shopping centre rents are forecasted to remain stable or increase slightly in 2017.

In Q3 2016 the retail transaction volume decreased significantly compared to previous quarter and year-on-year but the total cumulative volume in Q3 2016 is higher than in Q3 2015. The most notable deal of the quarter in retail segment was acquisition of Ideapark (ca. 30,000 sq. m) located in Oulu by Alma Property Partners and Avant Capital Partners. Overall the demand for core assets remains strong, as equity rich investors keep looking for safe havens. However, an increase in investment demand outside prime properties has also been evident, brought on mainly by new funds and returning international investors. After moving in during the first quarter the prime shopping centre yield has been stable standing now at 4.75%.

## Norway

According to Statistics Norway, GDP for Mainland Norway rose 0.4% in the second quarter of 2016. This is a slight increase from the 0.3% growth in the first quarter and the zero growth in the second half of last year. The GDP is expected to see a growth of 0.9% for 2016 and 2.1% for 2017. Main drivers are lower interest rate and a more expansionary fiscal policy although Norway's trading partners growth has slowed down in 2016.

According to Statistics Norway, in July 2016 retail sales decreased by 1.9% year–on–year. Total household consumption of goods in July 2016 decreased by 1.2% year-on-year. The estimate for 2016 is an increase of 1.9% compared to 2.1% in 2015.

The prime rent for shopping centres is still at NOK 13,500/sq. m, and is expected to remain so going forward. Despite the decrease in the index of retail sales, the top 50 shopping centres have increased their turnover by approximately 5%. The attractiveness and demand for prime areas in prime shopping centres are still good.

The 2016 transaction volume was NOK 41 billion as of September. The solid performance is driven by interest rates remaining low (10Y SWAP 1.5% as of September 15), which continues to attract investors seeking returns in a global low return. In addition, the Norwegian krone has remained weak, ensuring Norway is still attractive to foreign investors. Furthermore, both Norwegian and foreign investors continue to observe Norwegian economy showing relatively solid fundaments despite low oil price and slower labor market. Still, the demand for property is exceeding the supply so the investment market is expected to stay strong throughout 2016. The prime yield for shopping centres is expected to remain at 4%.

## Sweden

Sweden's GDP increased by 4.2% in 2015. In Q2 2016, GDP increased by 0.5% compared to Q1 2016. Forecast for GDP growth in 2016 is 3% and in 2017 2%. Swedish export's contribution to GDP last year was very positive, but is now a little weaker, particularly in service export. Like last quarter, the main growth drivers to the Swedish economy are household consumption and fixed gross investments. Next year however, household consumption and exports are forecast to be the main growth drivers. To date, the economic effect to Sweden of the Brexit vote has been nominal.

According to HUI Research, retail sales growth in 2015 was 5.8%. In the period January - July 2016 retail sales grew by 3.8% in current prices, compared to the same period in 2015. Furniture and DIY sales are continuing to perform strongly whereas sales of clothes and electronics goods is weak. For the full year of 2016, 4% retail turnover growth is forecast and then 3.5% in 2017.

In general terms, retail rents for strong shopping centres have increased in the region of 2% to 4% over the past year, assisted by the strong retail turnover growth in Sweden. A similar or slightly lower rate of rental growth is expected over the rest of the year as retail turnover growth rate eases somewhat and so the retailers ability to pay higher rents decreases a little. Generally, restaurant turnover growth is currently increasing at a higher rate than retail turnover, hence there is generally higher rental growth potential for the restaurant sub-sector.

In Q3 2016 the retail transaction volume was approximately SEK 12.7 billion. The total volume Q1-Q3 2016 was around SEK 19.3 billion, which is higher than the Q1-Q3 2015 volume of SEK 18.3 billion (higher than average). A notable transaction in Q3 was Heron City at Kungens Kurva retail area in south Stockholm which was sold to Capman by Niam. The lettable area is 49,415 sq. m and the price SEK 930 million (SEK 18,820 /sq. m) reflected a yield of between 6.25% - 6.5%. The centre is 95% let. The yield for prime external shopping centres in Sweden (Stockholm area) is currently in the region of 4.25%. Prime shopping centre yields have moved in and stabilised during the last year, given strong demand and low supply assisted by continued low interest rates. The market remains attractive with very high transaction volumes expected for 2016, even though bank financing for more secondary retail assets has become a little more difficult over recent months.

## Estonia

According to Statistics Estonia's data, Estonia's GDP increased 0.5% in Q2 2016 compared to the previous quarter and 0.8% compared to Q2 2015. Forecasts for GDP growth in 2016 range from +1.5% to +2.0%, while in 2017 economists predict growth varying between +2.4% and +2.6%. Forecasts have been revised downwards due to weaker economic outlook among Estonian main trading partners. The main growth engine of the Estonian economy remains to be domestic demand, especially private consumption. Export and investment growth is expected to recover in the years to come.

According to Statistics Estonia’s data, in July 2016 the turnover of retail trade enterprises increased 4% year–on–year. The growth at constant prices over the same period was 6%. The forecasts expect that growth in retail sales will slow in 2017 with the effect of slower growth in disposable income and return of inflation.

Prime shopping centre rents decreased ca. 0.2% quarter–on–quarter and 1–2% year–on–year. Despite strong retail sales growth, downward pressure on rents prevails due to increased new supply and increasing competition. Prime shopping centre rents are forecasted to continue a slight decline in 2016.

Estonian transaction market did not record any significant retail transactions in Q3 2016. At the same time there were remarkable transactions in other segments. A brand new Hilton Tallinn Park hotel with Olympic Park Casino property was sold for 48 million euros to East Capital fund in July 2016. A Baltic retail market transaction example is divestment of Domina Shopping Center in Riga for 74.5 million euros to EfTEN Fund III also in July 2016. Demand for prime assets remains strong, as the real estate market remains attractive in the low interest rate environment. Overall the investment market is expected to remain active for the next quarters with prime yields facing a further decline. The current prime shopping centre yield is estimated to be around 6.0–7.0%.

Denmark

Following a somewhat disappointing trend in the last six months of 2015, Danish GDP growth was surprisingly strong in the first two quarters of 2016, up by 0.5% on the previous quarter in Q2. The Danish economic upturn is expected to continue, albeit with GDP growth losing momentum due to Brexit triggering widespread economic uncertainty in the international marketplace. After United Kingdom's EU referendum and based on revised national accounts, Danske Bank, Denmark's largest bank has lowered its growth forecasts for 2016 and 2017. Danish GDP is therefore now forecast at 0.7% and 1.0% in 2016 and 2017, respectively.

According to Statistics Denmark's data, in August 2016 retail sales decreased by 0.5% year-on-year when seasonality and holidays were accounted for. Retail sales saw a drop in the first months of 2016 before bouncing back in April a mere 1.3%. Likewise, numbers saw an increase of 0.1% in both May and June before decreasing by 0.6% and 0.2% in July and August, respectively.

Both prime and secondary shopping centre rents stayed unchanged quarter-on-quarter. Throughout 2014, 2015 and 2016 prime shopping centre rents have increased, whereas secondary shopping centre rents have slightly decreased or stayed unchanged. This is a result of consumers, and thereby retailers, preferring attractive and well-assorted prime shopping centres. In Denmark, the increase in employment rate and consumer spending points towards mounting investment needs. Danske Bank forecasts continued growth in consumer spending the coming years which indicate that prime and secondary shopping centre rents are expected to remain stable or positive.

The most notable deal in Q3 2016 was private investor’s acquisition of Amagerbrogade retail and office property located in Copenhagen S for DKK 106 millions corresponding to a yield of 6.10%. Overall, the quarter was characterised by few transactions in retail. A strong demand for prime retail assets in Copenhagen CBD together with a relatively limited supply have put an increase to prices which is expected to result in more investments outside the prime area. The current low interest rate is contributing in several ways making property investments attractive relative to other investment opportunities. Due to current demand, the prime shopping centre yield is now 4.25%.

# Valuation Rationale

We have adopted a 10-year cash flow as the main valuation method. The model was provided by the Company. Cash flows are calculated based on information from existing lease agreements. For the period after the expiry of these agreements, our market evaluation of the estimated rental value (ERV) replaces the contract rent.

Potential Gross Rental Income equals leased space with respect to contract rents and vacant space with respect to ERV. Deducting both the ERV for the void period between the expired contract and assumed new contract, and the assumed general vacancy level after the start of the assumed new lease, results in the Effective Gross Rental Income. Effective Gross Rental Income less operating expenses (including repairs) equals the Net Operating Income (NOI). NOI less any capital expenditure and tenant improvements equals the bottom-level cash flow that has been discounted to reach the income stream's present value.

The residual value at the end of the 10-year cash flow period is calculated by using the exit yield to capitalise the 11$^{th}$ year bottom-level cash flow. The value of the property is calculated as the sum of the annually discounted net income stream, the discounted residual value at the end of the calculation period and any other assets increasing the value (e.g. unused usable building right) less the investments.

Development projects are included in the valuation of the portfolio in line with information received from the Company. Adopting the applied valuation model, future rental income is based on finalised rental agreements and rental projections for the valued development project. Correspondingly, the development period is considered as a period when premises generate no income or limited income and when uncommitted investments are included in the cost side as a value reducing factor. Thus, the value of a development project increases automatically when investments are committed and the opening day of the centre approaches.

Below is definition (according to IVSC glossary) and formula used to calculate some of the key figures reported in this valuation:

Weighted average yield requirement

"Yield – the return on an investment. Usually expressed annually as a percentage based on an investment's cost, its current market value or its face (par) value. Often used with a qualifying word or phrase."

In case of this valuation the weighted average yield requirement is weighted with the value of the property and the formula used is presented below.

$$= \frac{\text{(Value of property 1 x Yield requirement of property 1 + Value of property 2 x Yield requirement of property 2 ...)}}{\text{(Value of property 1 + Value of property 2 ...)}}$$

## Initial yield

"The initial income from an investment divided by the price paid for the investment expressed as a percentage."

The formula used is presented below.

$$= \frac{\text{(Annualised current rents – operating expenses)}}{\text{(Market value – estimated value of building right)}}$$

## Reversionary yield

"The anticipated yield from an Investment Property once a the Reversionary Value is attained."

"Reversionary Value – The estimated value of an investment property at the end of a period during which the rental income is either above or below the market rent."

The formula used is presented below.

$$= \frac{\text{(Annualised market rents – operating expenses)}}{\text{(Market value – estimated value of building right)}}$$

# Valuation

## Property Portfolio

At the end of September 2016, Citycon owned 55 investment properties, 5 properties owned through joint ventures and associated companies (including Kista Galleria and 4 properties located in Norway), two rented properties (located in Norway) and one property held for sale. This valuation statement includes 55 investment properties.

The property portfolio under valuation consists mainly of retail properties, of which 24 are located in Finland, 19 in Norway, nine in Sweden, two in Estonia and one in Denmark. The core of the portfolio consists of 50 shopping centre properties, which comprise 95.6% of the portfolio's leasable area and represent most of its value. The rest of the property portfolio consists of other retail properties such as supermarkets.

The total fair value of the portfolio in Q3 2016 was approximately €4,338 million. Compared to Q2 2016 the fair value increased by ca. €242 million i.e. 5.9% when the property moved outside the valuation in Norway (Lade) is excluded from the comparison. This figure also includes the Iso Omena extension which is now included to the valuations 100% after joint venture partner NCC's buy-out in August 2016. In addition committed investments, decreased yields and increased contract and market rental levels and strengthened Norwegian krone increase the value.

In the table on the next page, weighted average yields (weighted by the value of the properties) are presented. Citycon's portfolio includes a few relatively valuable properties compared to the rest of the portfolio. This means that weighted averages are highly influenced by the changes in these properties. Iso Omena (located in Finland) is the most valuable property in the portfolio under valuation.

| 30 September, 2016 | Number of properties | Fair Market Value, EUR million | Wght. Average Net Yield Requirement | Wght. Average Initial Yield | Wght. Average Reversionary Yield | Wght. Average Market Rent, EUR/sq.m./ month | Wght. Average Operating Costs EUR/sq.m./ month |
|---|---|---|---|---|---|---|---|
| Total Property Portfolio | | | | | | | |
| Finland | 24 | 1,795 | 5.7 % | 5.2 % | 6.1 % | 30.1 | 6.6 |
| Norway | 19 | 1,456 | 5.2 % | 5.2 % | 5.7 % | 23.2 | 5.7 |
| Sweden | 9 | 748 | 5.2 % | 5.2 % | 5.6 % | 25.5 | 6.9 |
| Estonia and Denmark | 3 | 339 | 6.7 % | 7.3 % | 7.0 % | 20.1 | 3.3 |
| Total | 55 | 4,338 | 5.5 % | 5.4 % | 5.9 % | 26.2 | 6.1 |
| | | | | | | | |
| Finland | | | | | | | |
| Helsinki Metropolitan Area | | | | | | | |
| Shopping Centres | 11 | 1,146 | 5.3 % | 5.1 % | 5.9 % | 31.5 | 6.9 |
| Other retail properties | 1 | 0 | 10.0 % | 31.5 % | 10.3 % | 18.0 | 0.0 |
| HMA total | 12 | 1,146 | 5.3 % | 5.1 % | 5.9 % | 31.5 | 6.9 |
| | | | | | | | |
| Other parts of Finland | | | | | | | |
| Shopping Centres | 9 | 578 | 6.3 % | 5.8 % | 6.6 % | 27.9 | 6.5 |
| Other retail properties | 3 | 71 | 6.5 % | 3.1 % | 2.8 % | 18.5 | 2.4 |
| Other total | 12 | 649 | 6.3 % | 5.5 % | 6.1 % | 27.5 | 6.0 |
| | | | | | | | |
| Norway | | | | | | | |
| Greater Oslo Area | | | | | | | |
| Shopping Centres | 7 | 598 | 4.9 % | 5.1 % | 5.4 % | 25.5 | 6.3 |
| Total | 7 | 598 | 4.9 % | 5.1 % | 5.4 % | 25.5 | 6.3 |
| | | | | | | | |
| Other Areas in Norway | | | | | | | |
| Shopping Centres | 12 | 859 | 5.4 % | 5.4 % | 5.9 % | 21.6 | 5.3 |
| Total | 12 | 859 | 5.4 % | 5.4 % | 5.9 % | 21.6 | 5.3 |
| | | | | | | | |
| Sweden | | | | | | | |
| Greater Stockholm Area and Umeå | | | | | | | |
| Shopping Centres | 7 | 644 | 5.1 % | 5.1 % | 5.4 % | 26.9 | 7.4 |
| Other retail properties | 1 | 22 | 6.7 % | 6.9 % | 7.1 % | 14.8 | 3.3 |
| Total | 8 | 667 | 5.1 % | 5.1 % | 5.5 % | 26.5 | 7.2 |
| | | | | | | | |
| Greater Gothenburg area | | | | | | | |
| Shopping Centres | 1 | 82 | 6.0 % | 6.0 % | 6.7 % | 17.3 | 4.7 |
| Total | 1 | 82 | 6.0 % | 6.0 % | 6.7 % | 17.3 | 4.7 |
| | | | | | | | |
| Estonia and Denmark | | | | | | | |
| Total | 3 | 339 | 6.7 % | 7.3 % | 7.0 % | 20.1 | 3.3 |

## Properties in Finland

The fair value of the Finnish portfolio is €1,795 million and it increased by 6.5% from Q2 2016. Compared to the previous quarter, the weighted average yield requirement has decreased by 10bps being 5.7%, the weighted initial yield has decreased by 20bps being now 5.2%, while the weighted average reversionary yield has decreased by 10bps (6.1%). The change in the value of the Finnish portfolio is due to Citycon acquiring part of Iso Omena shopping centre but in addition to that the change is driven by committed investments, decreasing of the yield in three properties and new building right in Lippulaiva shopping centre. In almost all of the properties market rents have been adjusted to reflect the changes in the local market and in three properties yield has been revised down and in three properties up due to market situation or changes in the property.

## Properties in Norway

The fair value of the Norwegian portfolio is €1,456 million, meaning that the portfolio's value has increased by 4.4% since Q2 2016. The strengthening of the Norwegian krone also affects the value, and excluding this the value of the properties has increased by 0.8%. The weighted average yield requirement has stayed unchanged being 5.2% as has the weighted average initial yield being 5.2% and the weighted average reversionary yield being 5.7%. The change in the value of the Norwegian portfolio is mostly driven by committed investments and increased rents. In six properties the yields have been adjusted and in almost all of the properties market rents have been adjusted to reflect the current local market situation or changes in property.

## Properties in Sweden

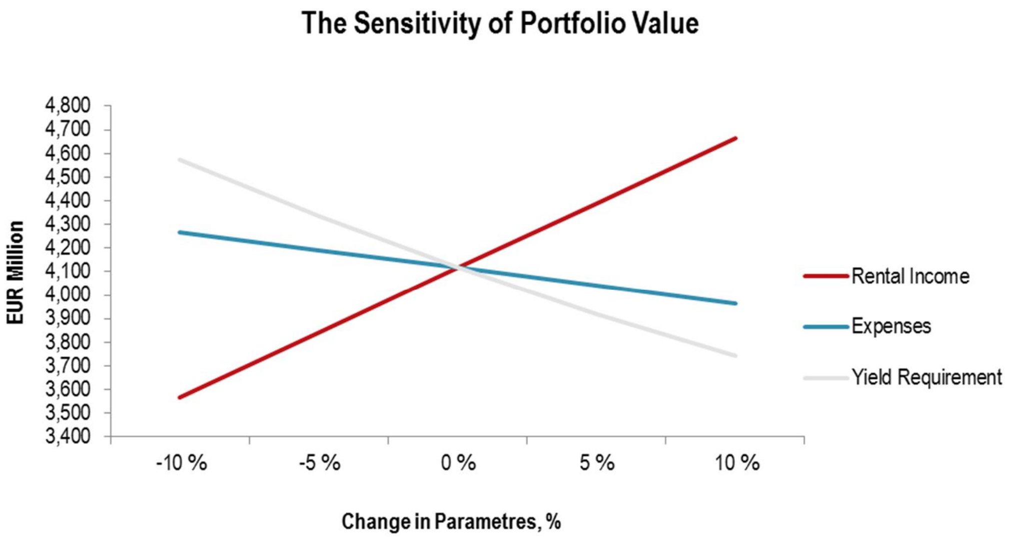
The fair value of the Swedish portfolio is €748 million, meaning that the portfolio's value has decreased by 0.2% since Q2 2016. The weakening of the Swedish krona also affects the value, and excluding this the value of the properties has increased by 1.9%. The weighted average yield requirement (5.2%), the weighted average initial yield (5.2%) and the weighted average reversionary yield (5.6%) have decreased by 10 bps. In two properties the yields have been moved in due to enhancement in the market situation or changes in the property. In addition, in almost all of the properties the market rents have been adjusted to reflect the changes in the local market or property.

## Properties in Estonia and Denmark

The fair value of the Estonia and Denmark property portfolio is €339 million, meaning that the portfolio's value has stayed practically unchanged compared to Q2 2016 value. The weighted average yield requirement of the portfolio (6.7%) has stayed unchanged, the weighted average initial yield (7.3%) has increased by 20bps and the weighted average reversionary yield standing at 7.0% has stayed unchanged when comparing to previous quarter. Market rents have been revised to reflect current market situation.

Sensitivity Analysis

A sensitivity analysis of the portfolio's fair value was carried out by creating a summary cash flow based on individual cash flow calculations. Changes in fair value were tested by modifying the key input parameters of the calculations. The parameters tested were yield requirement, estimated rental value and operating expenses. The current fair value of the properties was used as a starting point for the analysis, which was performed by changing one parameter at a time and then calculating the corresponding fair value of the total portfolio. The sensitivity analysis is a simplified model intended to support the understanding of the value effect of different parameters on the valuation. The figure below represents the results of the analysis.




As seen in the figure above, the value of the portfolio is most sensitive to the changes in estimated rental value and yield requirement. A 10% increase in estimated rental value leads to change of around 13% in value, while a 10% fall in the yield requirement causes an increase of around 11% in value. Changes in expenses have a more modest effect on the value than the other parameters.

Fair Value as at 30 September 2016

We are of the opinion that the aggregate of the Fair Values, free of liabilities and debt, of the properties in the subject portfolio as at 30 September 2016, is ca.

€4,338,000,000

(Four Thousand Three Hundred and Thirty-Eight Million Euros)

In Helsinki and Stockholm 13th October 2016

Yours faithfully

Tero Lehtonen
Director
For and on behalf of
Jones Lang LaSalle Finland Oy

Benjamin Rush
Associate Director
For and on behalf of
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Maria Sirén
Senior Analyst
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