Market commentary & Opinion of yield movement

CITYCON OYJ
31 MARCH 2022

CONTENTS

INSTRUCTIONS

Our instruction from Citycon Oyj was to provide Citycon with support for their investment portfolio as at 31 March 2022, 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 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 of the subject properties. This valuation advice is for the sole purpose of providing the instructing party our independent and professional opinion on the movement of market yields 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 January 2022.

MARKET OVERVIEW

DENMARK

Retail Occupancy Market

The Danish government reacted swiftly to encounter the economic impact caused by the outbreak of Covid-19 in the Spring last year, and there is no doubt that the retail sector has faced an unprecedent disruption of commerce. As of February 1st, 2022, Covid-19 is no longer viewed as a critical threat to society, which allows the people to resume their lives as before the pandemic. This has allowed the retail sector to fully reopen. In a normal environment, one would expect this to impact the consumer expectations positively, but the ongoing situation in Ukraine has had larger economic consequences all over Europe. The war has caused inflation levels to reach historical highs as well as extubating post-pandemic supply chain disruptions. As of March 2022, the consumer confidence indicator was -14,4, which is even lower than the height of the pandemic. With the increase in energy prices, and a lot of Danish households dependent on gas to fuel their car, the general Dane has less money to spend on luxury goods in the foreseeable future.

According to Statistics Denmark, retail sales decreased by 14% from the last quarter of 2021 to end of January 2022 when corrected for price trends, seasonal fluctuations, and the effect of trading days. The effects of the re-opening of the society globally has effected the supermarkets, where the turnover has decreased by 13%. Another indicator that the population now is more prudent is the decrease in the shoe and leather goods, where there has been a sharp decrease from the previous period, with a drop of 47%. The overall drop in retail sales can serve as an indicator that the population are now either slowing down their consumption, or that they are spending money outside of their home country.

One sector that has not followed the overall trend of decreased spending is the turnover of groceries and other home goods over the internet. While not on the same levels as the height of the pandemic, the sector has remained strong going out of the stay-at-home period. The main issue with online retail is the ongoing supply-chain issues going occurring globally.

Another sector which emphasizes the change from a period where the public stayed at home to now having more freedom is the flower retail sector. From the last quarter to the end of January, the sector has seen a sharp decline of 49% from last quarter to January, which can be attributed to people now being less at home, which decreases the need of decorations which demand daily care.

Prime net shopping centre rents remained unchanged in Q1 2022 at DKK 5,250 per sq m p.a. Looking forward, the pent-up demand caused by the long lockdown of the retail sector, and a higher level of job security could serve as a positive indicator for the expected increase in the retail sector. However, the current situation in Ukraine will pose a threat to the inflation level and the consumer confidence will affect retail sales in an uncertain amount of time going forward why higher vacancy on the medium/longer term is expected.

Retail Investment Market

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. Additionally, the disruption caused by regional periodic lockdowns and prolonged social distancing measures in most of 2020, has further accentuated the already existing pressure on brick-and-mortar retail caused by the rapid growth of e-commerce.

Total retail investments were reported at DKK4.1bn in 2021, an decrease equal to 31% compared to 2020. In 2022, retail investments are DKK 2,5B, which is a bit above 2021 levels. One of the largest transactions this year included both shopping centres and supermarkets.

The general shopping centre yield has been revised slightly upwards in September 2021 at 5.10% for prime shopping centres and at 7.10% for good secondary shopping centres. The trend for both yields is softening, as vacancy is increasing.

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.

ESTONIA

The volume of the Estonian economy is expected to grow strongly this year by over 9%. Nevertheless, deduction of the price increase, the economic growth is likely to be around zero or slightly negative. The halt or slight decrease of the economic growth is caused by decreasing trade, the reducing purchasing power due to rapid increase in prices, progressing of uncertainty, and the withdrawal of extensive one-off transactions. The vigorous growth in prices will increase the volume of the economy, therefore increase in salaries and incomes is expected to remain fast. However, it is remaining slower than the price growth. According to the latest Bank of Estonia forecast, in the following year the inflation is expected to increase by 10%, of which the biggest share is energy.

The unemployment rate has fallen from 6.9% in 2020 to 6.2% in 2021. Unemployment is expected to increase to 8.0% in 2022, and the trend is believed to continue in the following year. However, the percentage of registered unemployment in 2021 exceeds the percentage before the pandemic in 2019. According to Statistics Estonia, the CPI increased 2.7% in March 2022 compared to February and 15.2% compared to March of the previous year. In 2021, consumer goods were 13.7% and services 18.1% more expensive.

Retail Occupancy Market

According to Statistics Estonia, in February 2022, the turnover of retail trade enterprises was 683 million euros. Compared to February 2021, turnover increased by 4% at constant prices. Split by the segment this is an increasement by 4% in stores selling manufactured goods, 10% in enterprises engaged in the retail sale of automotive fuel and by 2% in grocery stores. Year-on-year turnover growth in turnover was 8% in January but slowed down in February. Turnover increased the most, by 15%, in stores selling second-hand goods and non-store retail sales (stalls, markets, direct sale). Turnover increased by 13% in pharmacies and stores selling cosmetics, by 5% in stores selling household goods and appliances, hardware and building materials, and by 5% in other non-specialized stores selling predominantly manufactured goods (department stores). Compared to January, the turnover of retail trade enterprises decreased by 9%. According to the seasonally and working-day adjusted data, the decrease in turnover was 2% compared to January.

Although after lifting the COVID-19 implied restrictions people are getting used to normality again, we are witnessing that people's needs have altered, and to be successful, the landlords of enterprises ought to be adaptable. The role and nature of shopping centers are changing. The pandemic did not move a massive number of consumers to e-commerce channels, but at the same time it raised a question of whether people should make purchases in-store or in e-commerce channels – these questions show that we are in the middle of significant changes. The shopping centers see themselves as having a bigger role in the evolution of communities and shopping centers are changing more dynamically than ever.

During the last decade, shopping centers have shifted from just retailer destinations to multifunctional experience hubs with increased lunch and dining options, wellness and entertainment offerings, as well as an access to public services, which all together help generate a footfall for the retail tenants. The aim is to create centers that evolve along the generation shift and are able to provide amenities, experiences, and entertainment to enhance the shopping experience. For example, in the second half of 2022, the MyFitness sports club is opening its doors in Kristiine Center, increasing its range in service providing.

Retail Investment Market

Compared to the previous quarter, shopping center prime yield in Estonia for the sizeable regional multi-tenancy traditional formats has not moved by evidence. Demand for commercial and retail real estate continues, although there were no remarkable transactions in Tallinn in 2022 Q1. In Tallinn, shopping center rents have stayed stable throughout the year. The prime rents are at the level of 45 EUR/sqm per month. The prime shopping centre yield is estimated at c.a. 7.0%, compared to 7.25% in Latvia and 7.0% in Lithuania.

The share of the variable price component in real estate contracts will become predominant, and customers will be forced to bear more market risk than before. The main question will be which indicators link the price formation to in general.

The increasing operating costs are receiving attention, a large part of which is energy prices and labor costs. Therefore, it is essential to increase energy efficiency to save on costs and, in addition, achieve green goals. The main focus is on sustainability and, consequently, on investments in buildings with BREEAM and LEED certificates. However, no less important are a well-thought-through concept, the flexibility of the spaces, synergy with other businesses, a strong location, and attractiveness in terms of customers' business. As a result, competition between sites is increasing.

Due to the world’s changed situation, the real estate market in Estonia is experiencing some turbulence and has slowed, but it has not to be seen as market downturn in general. The Estonian economy and real estate market will face significant geopolitical and economic challenges. There is no clarity on how the current geopolitical situation will affect the further investors’ appetite into the region. The economy is gradually affected by the pandemic pressure on the medical system, widespread price increases, supply chain disruptions, and rising transport costs. As a result, the margins of the tenants and the ability to pay rent are undoubtedly under pressure.

Comment on Citycon portfolio

During the pandemic, shopping centers were affected by Covid-19 restrictions and got into difficult situation. After lifting the restrictions – no vaccination certificates nor negative COVID tests are required; also, restrictions on the number of visitors and limited opening hours have been removed – as a result, the market has recovered vigorously and finally operate at full capacity. As a new addition, the Kristiine Center opened Caffeine at the end of March. The expansion of Kristiine Center follows Citycon’s strategy in the Nordic countries. The company aims to develop from a single-purpose shopping center to a contemporary multifunctional urban center that includes office spaces and residential real estate. Although, there are currently no new additions to Rocca al Mare, we are aware of the potential interest from some of the leading fashion retailers to enter the shopping center.

We are of the opinion that there has been no significant movement in (market) yields this quarter.

NORWAY

Retail Occupancy Market

The Norwegian central bank followed the guided path and hiked the key policy rate (KPR) to 0.75 percent in March. This is the third hike since the zero-percent interest rate regime ended last year. The central bank has guided seven additional hikes before the end of 2023, bringing the KPR to 2.50 percent. This indicates one hike per quarter until the end of next year.

Norway’s mainland GDP expanded by 3.9 percent in 2021, already surpassing pre-pandemic levels during the summer. CBRE predicts that mainland GDP will continue the expansion by 3.4 percent in 2022, although the situation in Ukraine has contributed to lower estimates.

As oil & gas prices started to rise towards the end of 2021, NOK strengthened against EUR and USD. The trend has partly continued into 2022 as oil & gas prices has continued to rise, NOK has strengthened against EUR, but remained fairly stable against USD. NOK is forecasted by Nordea Markets to continue to strengthen some against USD and EUR over the next 12 months. The expected NOK appreciation could contribute to better trading conditions for importers in the coming months, i.e., a majority of retailers.

We entered the new year with strict corona-related restrictions on the back of the Omicron mutation, witch brough uncertainty to the financial markets. However, by February, most of restrictions were lifted and society essentially returned to normal.

No sectors were left in negative territory in terms of 2021 sales growth at Norwegian shopping centres. Overall shopping centre sales were up 3.1 percent, according to Kvarud Analyse. The trend has continued into 2022 as all sectors have double digit YoY sales growth except for F&B, which is down 9.9 percent. According to Kvarud Analyse, overall shopping centre sales is up 10.3% in Q1.

Average basket size is NOK 364 per March 2022, while the YTD average basket size is NOK 375, down 6.3 percent compared to the same period last year. The reduction in basket size is more than offset by increased visiting numbers.

Retail Investment Market

Retail transactions registered the highest number since 2015, amounting to NOK 23.2 billion in 2021, up 87 percent from 2020, making up 14.5 percent of the total transaction volume for the year.

Retail assets has continued to be in favour by investors in 2022, with Q1 transactions of NOK 9.3 billion, more than doubling YoY. Q1 has been characterised by few large transactions – with only three transactions being close to or above NOK 1 bn.

The prime shopping centre yield per end of Q1 is estimated at 4.80 percent, down 10 bps YoY, but up 30 bps vs pre-COVID. Due to the increasingly fierce competition from ecommerce and with interest rates on the rise again, we do not expect prime yield to revert to pre-COVID levels despite the ongoing economic recovery.

We have registered four shopping centre transactions in Q4 2021. The 28,600 sqm Buskerud Storsenter in Nedre Eiker was sold by Citycon to Aurora Eiendom for around NOK 1.175 billion. The 22,000 sqm Magasinet in Drammen was sold by Citycon to Vedal Investor for around NOK 900 million. The 11,000 sqm Hunstadsenteret in bodø was sold by Gunvald Johansen AS to Stadssalg for around NOK 240 million. The 3,564 sqm Torggården kjøpesenter in Horten was sold by a private investor to Bjerch & Krefting AS for around NOK 60 million.

Comment on Citycon portfolio

All Covid-19 restrictions have been lifted for some time now. Despite the Covid situation most of the centres have performed well. Expected rental values are expected to remain relatively stable. Investment activity is back again and alignment with current investor sentiment in regard to yields is to be expected. We are of the opinion that there has been no significant movement in (market) yields this quarter.

In Copenhagen, Denmark, Oslo, Norway and Riga, Latvia – 21st April 2022

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