CBRE

Market commentary & Opinion of yield movement

CITYCON OYJ
31 MARCH 2023

CONTENTS

INSTRUCTIONS

Our instruction from Citycon Oyj was to provide Citycon with support for their investment portfolio as at 31 March 2023, 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 March 2023.

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MARKET OVERVIEW

DENMARK

Retail Occupancy Market

Life has returned to normality and the retail sector has fully reopened following the pandemic. In a normal environment, one would expect this to impact the consumer expectations positively, but the war in Ukraine has had larger economic consequences all over Europe. The war has caused inflation levels to reach historical highs as well as exacerbating post-pandemic supply chain disruptions. As of March 2023 the consumer confidence indicator was -23.1, which is a slight increase from February where the consumer confidence indicator was -25.1. This slight increase follows a positive trend since October, where the consumer confidence indicator was at the lowest level ever since Denmark Statistics started recording in 1974 at -37. 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 7% in January 2022 from the end of September 2022 when corrected for price trends, seasonal fluctuations, and the effect of trading days. Over the same period retail turnover in supermarkets has decreased by 11%. In October, an increase in turnover for books and home office supplies was one of the few sectors that increased. This sector has continued its positive momentum, experiencing an increased turnover of 25% in January from October. Another sector that has experienced momentum in the last recorded period is retail sales of electronic goods via internet, which grew by 25%.

The majority of the retail sectors have experiencing decreases in turnover over the last period, however, the decline is more prominent in some sectors. Retail sales of fames, toys and music and video recordings in specialized stores, decreased by 28%.

Prime net shopping centre rents remained unchanged in Q1 2023 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

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 DKK 13.23bn in 2022, an increase equal to 323% compared to 2021. One of the largest transactions this year included both shopping centres and supermarkets. The general shopping centre yield has been revised slightly upwards in Q1 2023 at 5.35% for prime shopping centres and at 8.00% for good secondary shopping centres.

Comment on Citycon portfolio

Albertslund is an established shopping centre with a stable track record, while Straedet is a newly developed centre which comes with more uncertainties. Expected rental levels are stable, while economic incentives are expected to increase. Although the transaction activity and comparables remain at a relatively modest level and the evidence is limited, given the effect of change in the general market circumstance since 31 December 2022, it is likely that yields have continued to move out (predominantly due to the higher costs of debt).

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ESTONIA

Retail Occupancy Market

The sharp rise in energy and commodity prices, as well as Russia's war in Ukraine, led to a decline in the Estonian economy in the second half of 2022. Employment growth stopped in the second half of 2022 compared to the first half of the year, and employment decreased in those branches of activity that were most directly affected by the crises, especially in the manufacturing industry. At the end of the first quarter of 2023, the number of registered unemployed people was approximately 10,000 more than a year earlier. The increase in the consumer price index in Estonia has decreased, and in March it was 15.3% higher than a year ago, according to Statistics Estonia. Compared to last March, goods were 14.4% more expensive and services 17.2% more expensive.

According to Statistics Estonia, in February 2023, the turnover of retail trade enterprises was EUR 740 million. Compared to last year's period, turnover decreased by 6% at constant prices. Turnover decreased in most areas of activity, but sales in textile, clothing and footwear stores increased by 5% compared to February of last year. The most significant decrease was recorded in enterprises engaged in stores selling manufactured goods, where the turnover fell by 8% year-on-year. The most considerable decrease, by 13%, was recorded in stores selling predominantly computers and their accessories, books, sports equipment, games, toys, etc. Turnover decreased also 11% in stores selling household goods and appliances, hardware and building materials, by 5% in stores selling via mail order or the internet, by 3% in stores selling second-hand goods and in the non-store retail sales (stalls, markets, direct sales), by 3% in pharmacies and stores selling cosmetics. The turnover of grocery stores decreased by 5% compared to the same month last year, and the turnover of motor fuel retail companies decreased by 4%.

Although the sales and footfall of shopping centers in Estonia have improved, and utility costs have decreased compared to the last six months, the high inflation, declining purchasing power, and significantly reduced consumer confidence are affecting retailers' profitability. Therefore, there could be cases where landlords have trouble collecting rent, and with retailers being careful opening new businesses, we could see a rise in vacancies.

According to the monitoring group of the E-commerce Union of Estonia, e-commerce and the package volume of parcel machines showed impressive growth despite the general stagnation of retail sales and trade. In the first quarter of 2023, the volume of e-commerce parcel machines was 3.3 million packages, which is more than 400,000 packages or 14.4% more than the same time last year. E-commerce already exceeds 20% of the total turnover of retail trade here. The European e-commerce market report 2022 highlights that an estimated 77% of the population makes e-shopping in Estonia.

In Tallinn, no new shopping centres were opened in Q1 2023, but at the end of the summer, a new 18,600 sqm retail park next to IKEA will be opened. As for other pipeline projects, Astri Grupp have announced that the renovation of Keskturg will be finished by 2025; US Real Estate announced about TALSINKI, a residential and commercial quarter with a gross area of 86,000 sqm next to the Port, which is similar in concept to the Rotermann quarter, where the center of the quarter is a cozy central square surrounded by commercial and commercial premises.

Retail Investment Market

The investment climate in the Baltics remains calm, with no transactions involving larger, higher-volume assets taking place in Q4 2022 or Q1 2023. This is largely due to the increase in interest costs, which has caused buyers and sellers to have differing expectations of yield and property value. In Tallinn, rental prices for shopping centers have increased somewhat due to high inflation and rising interest rates. When indexing the rental price, many landlords have chosen to index the rent at a lower rate than stipulated in the contract, except in cases of fixed indexation, because a ~20% rent increase according to the local CPI would be unaffordable for many tenants, and it is more important to keep vacancy rates under control.

Compared to the previous quarter, prime shopping center yields in Estonia for sizable regional multi-tenancy traditional formats have not changed significantly. However, increasing borrowing costs have weakened general market sentiment, leading to more flexible pricing expectations and other conditions. As a result, prime shopping center yields have risen by 25 bps and are currently estimated at around 7.50%, compared to 7.75% in Latvia and 7.50% in Lithuania.

Undeveloped residential land market

The residential market has been constantly active in Tallinn over the last ten years, with the construction of dwellings being on the rise since 2012. According to the Register of Construction Works, 6,521 dwellings were completed in 2022, which is 214 less than in 2021. The majority (65%) of new dwellings were apartment buildings, with the most popular type being 3–5-storeyed buildings. According to the Land Board of Estonia, 9,652 apartments were sold in Tallinn in 2022, which is 11% less than the previous year, 9% more than in 2020, and 1% less than in 2019. However, the sale of new apartments slowed down sharply in November 2022, with almost 90% fewer transactions made in Tallinn and Harju County compared to a year ago. From March 2023, there has been a minimal revival in the market for new developments, but apartment prices remain at the same level as six months ago.

In contrast to the sluggish market for larger investments and the decline in the number of apartment transactions, the number of sales of residential land has remained surprisingly stable compared to the second half of 2022. At the beginning of 2023, one larger apartment building land transaction has been completed. As long as the prices per square meter of apartments and the construction costs change proportionally, no major changes in the prices of undeveloped residential land are foreseen.

Overall, with the recessing economy and uncertain geopolitical situation, the real estate market has started to cool down, including the residential land market.

Comment on Citycon portfolio

Kristiine SC is an established shopping center with a stable history. Rocca al Mare Shopping Center has seen a significant increase in vacancy over the past five years, but the plan to transform the tenant mix has now been clarified. The center will be complemented by a second grocery store - a new premium grocery called Delice, which should open in Q3 2024, and a dental center, which is scheduled to open its doors in Q3 2023. Also, in Q2 2023, one of the anchor tenants on the first floor with 2,000 sqm leasable area, Half Price, will open. Expected rental levels are stable.

Although the transaction activity and comparables remain at a relatively modest level and the evidence is limited, given the effect of change in the general market circumstance since 31 December 2022, it is likely that yields have continued to move out (predominantly due to the higher costs of debt).

NORWAY

Retail Occupancy Market

The Norwegian central bank raised the Key Policy Rate (KPR) in March 2023 again, bringing the KPR to the current level of 3.00 percent. The central bank's latest forecast indicated KPR reaching a top of between 3.50-3.75 percent in the fall. The 5-year NOK swap rate has been volatile in Q1, fluctuating between 2.8%-3.8%. At the end of the period, the swap rate is 3.3%, but we expect more volatility from uncertain KPR and economic outlooks.

Private consumption surprised positively in Q4 2022, with new car sales as a key driver. In total, private consumption in 2022 grew by 6.8% YoY. However, private consumption in January 2023 decreased by 10.8% from December. Continued elevated inflation and increasing interest rates will put pressure on private consumption in the coming quarters as private consumption growth is expected to fall to 2.3 percent in 2023. CBRE are currently forecasting a 2023 GDP growth of 1.2 percent, while mainland GDP is expected to expand by 1.3 percent. CPI inflation reached a peak of 7.5 in October, before trending downwards. In March CPI was estimated at 6.5 percent in December but would have been at 7.4 percent without the household electricity bill scheme from the Norwegian government. CPI inflation is expected to decrease throughout 2023, averaging 4.6 percent. However, average inflation in Q4 is expected to fall to 3.6 percent.

The last year, NOK has depreciated significantly against both GDP, EUR and USD. The NOK is forecasted by Nordea Markets to appreciate against GBP and EUR, both in the short (0-3 months) and medium term (6-12 months). In the short term, NOK is expected to depreciate slightly against USD, but appreciate in the medium term.

No sector was left in negative territory as Norwegian shopping centres sales grew by 5.8 percent in Q1 2023, according to Kvarud Analyse. As Easter was one week earlier than last year helped the Grocery sales volume, which grew by 9.0 percent YoY in March. F&B had the highest growth in Q1 with 15.6 percent YoY.

Average basket size was NOK 357 in Q1 2023, compared to NOK 358 in 2022. So far in 2023, visiting numbers are up by 10.1 percent. In general, the largest shopping centres (Annual sales> NOK 1 bn) have had the largest increase. Visiting numbers are also up compared to 2019, by 1.3 percent.

Retail Investment Market

The Norwegian CRE investment market had a slow start to the year, with Q1 volume falling by 67 percent YoY. Retail investment volume decreased by 87% YoY, to NOK 1.15 bn. Retail transactions amounted to 9.1 percent of the total transaction volume in Q1, down from 19.6 percent of the total transaction volume in 2022.

The estimated prime shopping centre yield and prime high street retail yield have been trending upwards in 2022 and is still volatile due to fluctuations in financing costs. Prime shopping centre yield is currently estimated to be 5.4 percent. The prime high street retail yield is estimated to be 4.50 percent. Going forward, upside risk dominates as increasingly fierce competition from e-commerce, increased interest rates and economic uncertainty could put upward pressure on yield levels.

We have registered two shopping centre transactions in Q1 2023. Ulsteinvik Amfi was sold by Brattøra Eiendom to Olav Thon Eiendomdsselskap an estimated fee around NOK 175 million. 50 percent of Amfi Eikunda in Egersund was sold by Coop to LL Sørco for an undisclosed fee.

Comment on Citycon portfolio

Market rents have predominantly remained relatively stable across the portfolio with minor adjustments in line with recent sales performance and leasing activity.

Although the transaction activity and comparables remain at a relatively modest level and the evidence is limited, given the effect of change in the general market circumstance since 31 December 2022, it is likely that yields have continued to move out (predominantly due to the higher costs of debt).

General outlook

Capital markets are very sensitive to the overall economy and usually the first one to reflect the market conditions. Tightened financial conditions are visible in the increased cost of capital, impact on LTV's and lenders' assessment of risk related to different property types. As a result, decreasing investment volumes and a general softening in pricing across all sectors has been observed.

Against the economic backdrop, retail is not immune. With bond rates moving up and other alternative asset classes becoming cheaper, increased borrowing costs and further potential rate rises from the ECB, it is expected that property yields including retail will continue to move out.

In Copenhagen, Denmark and Riga, Latvia – 20th April 2023

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