

Briefing Retail sector

July 2015



Image: Shanghai New World Daimaru

SUMMARY

Flat rents disguise the true extent of the turmoil in the retail market and the mixed performances of individual projects.

- Retail sales recorded a mild recovery in the second quarter, with May recording year-on-year (YoY) growth of 8.7%, bringing year-to-date (YTD) YoY growth to 8.0%.
- Three new shopping malls held soft openings in the second quarter, adding 174,000 sq m of retail space to the market.
- Average first-floor shopping mall rents in prime retail areas remained unchanged at RMB46.0 per sq m per day, while non-prime areas decreased 0.1% quarter-on-quarter (QoQ) to RMB16.8 per sq m per day.
- Shopping mall vacancy rates in prime retail locations increased 0.9 of a percentage point (ppt) in Q2/2015 to 5.3%.
- At least 450,000 sq m of shopping mall space is expected to be launched in 2H/2015, with an additional 260,000 sq m having been delayed to 2016.

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 “More lifestyle and niche brands are testing the mainstream market, bringing a breath of fresh air to consumers.”

James Macdonald, Savills Research

➔ **Market commentary**

The overall retail market showed signs of stabilising in the second quarter, with retail sales growth rates accelerating to 8.7% in May from 7.3% in March. This improvement in sales growth brought the year-to-May sales figures to RMB400 billion, up 8.0% YoY.

A significant increase in recent years of Chinese buyers travelling overseas and purchasing goods on these trips seems to have convinced the central government to roll out policies to boost domestic sales. As consumers become more savvy and demanding, tax reforms by the government and reasonable pricing strategies by retailers are believed to be important to attract consumers back to stores.

Taking effect from 1 June 2015, import tariffs for western-style clothing will be reduced to between 7-10% from 14-23%, and taxes on ankle-high boots and sports shoes cut in half to 12%. At the same time, tariffs on diapers and skincare products will drop to 2%, from 7.5% and 5%, respectively.

Supply

Three new shopping malls, totalling 174,000 sq m, were launched onto the market in the second quarter of 2015. Star Live is a 60,000 sq m retail development located in Changning district; MTR City Plaza South is a 41,000 sq m project located just to the south of the Zhenbei metro station in Putuo district; and Crystal Galleria is a 73,000 sq m retail scheme located just to the north of the SOGO department store in Jing'an district.

The addition of Crystal Galleria makes Nanjing Road (W) the second largest retail submarket in Shanghai with total stock at 543,000 sq m, 6% of the city's total stock, or 21% of prime stock.

Rents

Average first-floor shopping mall rents in prime retail areas remained unchanged in Q2/2014 at RMB46.0

per sq m per day, while non-prime areas recorded a decrease of 0.1% QoQ to RMB16.8 per sq m per day.

The market is expected to remain tough for the foreseeable future while rents are forecasted to remain flat overall. Fashion retailers, based on a survey of 30 key players, slowed their expansion rate over the past 12 months to 7.4% from 12% for the preceding 12 month period; at the same time, retail stock is still growing at around 10% per annum.

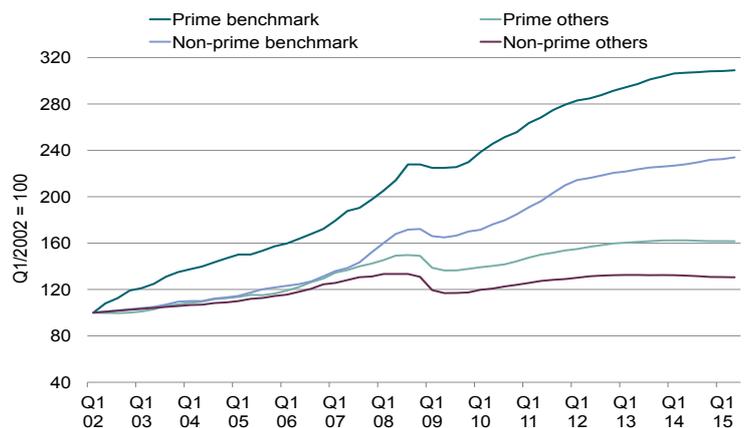
Retailers' expansion strategies are different. In the first half of 2015, Forever 21, New Look and Coach each opened two new stores, with additional ones scheduled to open

in the second half. Club Monaco and Giada upgraded their stores in Lujiazui with more space and product lines. However, some other brands are shrinking size, relocating or closing stores. This will further widen the rental gap between benchmark and under-performing projects.

Vacancy

Overall vacancy rates in prime areas increased 0.9 of a ppt to 5.3%. The main reason for this is the soft opening of Crystal Galleria, which resulted in vacancy rates along Nanjing Road (W) increasing 4.2 pts to 8.3%. The three other prime areas also recorded increases of up to 0.5 of a ppt.

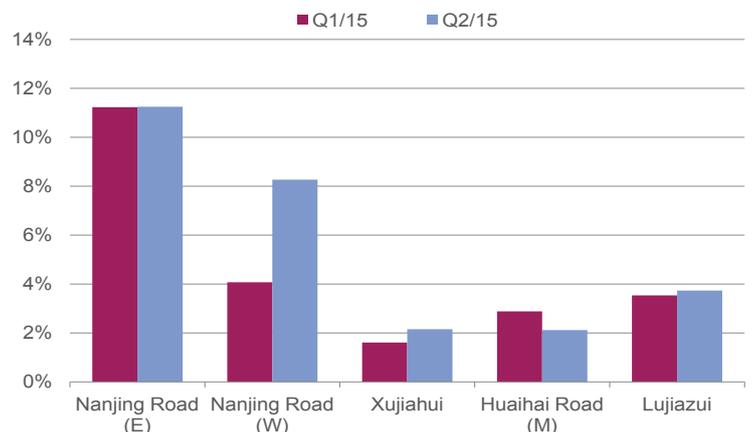
GRAPH 1 **Retail rental indices, Q1/2002–Q2/2015**



Source: Savills Research

Note: Benchmark means five to six market-leading projects based on a comprehensive assessment of reputation, management, design, business and developer experience.

GRAPH 2 **Vacancy rates in prime areas, Q1/2015 vs. Q2/2015**



Source: Savills Research

Huaihai Road (M) was the only area to see a decrease in vacancy rates in the second quarter. The area enjoys the lowest vacancy rates of any submarket since 2010 at 2.1% and is also the only one that has witnessed a decrease in vacancy over the last 12 months.

Huaihai Road (M) is leading the market in terms of both renovation and innovation. K11 and Xintiandi are now among the first choices for domestic niche brands to test the mainstream market, such as boutique multi-brand buyer D2C and lifestyle brand Blank. The first restaurant under the Shanghai Min and Oreno JV, as well as the first restaurant by Shanghai Expression, also opened in Xintiandi in 2015.

Lifestyle retail

Lifestyle retail is increasingly a catchall phrase for lifestyle brands, lifestyle retailers and lifestyle stores. Lifestyle retail can be small independents or international chains, come from any positioning or retail category, and be located anywhere in a city. The thread that ties lifestyle retail together is the emphasis on the consumer rather than the product.

Lifestyle retail identifies a specific and sometimes narrow catchment group and creates a store format, layout, location and design that best suits this grouping. The store is then stocked with the correct products, irrespective of the product category. The stores also provide services to enhance and augment the whole experience. A lifestyle retailer can be a multi-brand or individual brand as long as they have a broad enough product or service offering to provide the consumer with the desired experience. The most important thing is that there is a strong sense of personality with a clearly-defined target customer group.

Considered a niche market in China, the development of lifestyle stores is still in its infancy. Existing lifestyle stores are mostly managed by individuals, located in inconspicuous street corners with low footfall and cosy environments. However, as the retail market (especially physical stores) slows down and shopping malls seek greater differentiation, more investors and landlords are eyeing this retail category, hoping to offer more unique shopping experiences to customers.

As the market matures and becomes more accepted by consumers, and as lifestyle retailers grow their business, they are increasingly moving off the streets and into large-scale power centres and those malls with distinctive positioning.

Retailer

■ Modern House



The Korean brand opened its first store in China in Sky Mall in Xinzhuang, the southwest hub of Shanghai. The store offers furniture and home-related accessories. Sister brand Butter, which offers a wide range of gadgets for younger customers, also opened in an adjacent unit. Total lease space is around 2,000 sq m.

■ Blank



Blank is a lifestyle brand by J Gallery, a designer clothing brand from Shanghai. The store is updating from the original J Gallery store in Xintiandi Style, adopting a new conceptual design and integrating food, clothing, furniture and floriculture

■ Shanghai Expression



Shanghai Expression is a lifestyle brand under the Xinhua Media Group, which operates over 2,000 bookstores in Shanghai. The latest store opened in the Himalayas Center in Q2/2015, with total space of around 1,300 sq m, the group's largest store to date. The store not only includes a bookstore, but also offers different activities such as a kid's play area, photo studio and handicraft classes. Products from Oshadai, Moss Vita and L&C are also available for sale in the store.

■ Hi Oryx



Hi Oryx is a running-related lifestyle retailer under Really Sports. The first store opened in Daning Life Hub in Zhabei district in May, with two floors (750 sq m) of space, providing mainstream sports brands' running equipment as well as a themed restaurant, a foot test system and running classes. ■

Project focus

U Fun

U Fun is being jointly developed by KWG Property and R&F, two leading developers based in Guangzhou. The consortium acquired the mixed-use development site from Hines and Shanghai Municipal Investment in two stages in 2010 and 2011, for a total transaction value of RMB3.4 billion.

Scheduled to open in Q4/2015, the project will be the first shopping mall in New Jiangwan Town, one of Shanghai's emerging upscale residential communities. Located in Yangpu district, it is supported

by high-end residential buildings, a growing middle class community, strong educational resources and rich greenery and landscaped areas.

With direct access to the New Jiangwan Town station (metro line 10), which will be further extended to the Waigaoqiao Free Trade Zone by 2018, the project is expected to attract residents in the northeast of Shanghai from both Puxi and Pudong.

U Fun has a retail GFA of 70,000 sq m, with a riverfront view. Anchor tenants include City Shop and OSGH Cinemas.



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