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Savills World Research
Shanghai

Briefing
Retail sector

April 2016

Image: Parkside Plaza, Putuo district

SUMMARY

Super-regional malls continue to outperform the wider market, with vacancy rates falling to historical lows.

- Retail sales grew by 7.0% year-on-year (YoY) in the first two months of 2016, 1.1 of a percentage point (ppt) lower than the same period in 2015.
- Wujiaochang received the first new, quality retail supply in over nine years with the completion and opening of the 140,000-sq m Hopson One.
- First-floor shopping mall rents in prime retail areas increased by 0.3% quarter-on-quarter (QoQ) to an average of RMB48.6 per sq m per day, while non-prime areas increased by 0.1% QoQ at RMB17.0 per sq m per day.
- Vacancy rates in prime areas increased by 0.9 ppt in Q1/2016 to 5.7%, while non-prime areas (including downtown and decentralised areas) fell by 0.5 of a ppt QoQ to 9.0%.
- New taxation policies bring new challenges, especially to the landlords and online cross-border traders.

"New VAT regulations will require landlords to review their existing contracts to avoid loss in rental revenue."
James Macdonald, Savills Research

Market commentary

Shanghai's retail market got off to a slow start in 2016, with retail sales growing by only 7.0% in the first two months, 1.0 ppt lower than the same period in 2015.

In the first quarter, first-floor shopping mall rents in prime retail areas increased by 0.3% QoQ to an average of RMB48.6 per sq m per day, while non-prime areas increased by 0.1% QoQ at RMB17.0 per sq m per day.

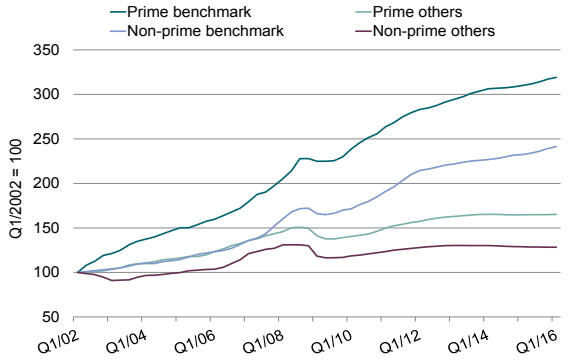
Supply

One new project – Hopson One – opened in the first quarter, in the Wujiaochang area. Boasting 140,000 sq m of retail GFA, the project is comparable in size to its neighbouring peers, Wujiaochang Wanda Plaza and Bailian You Yi Cheng. Michael Kors, Massimo Dutti and Old Navy opened stores in the project, their only retail premises within 5km of the mall.

Hopson One is the first quality retail project launched in the Wujiaochang area for over nine years. The area achieved the second highest average rents of all the non-prime retail areas at RMB25.3 per sq m per day. Wujiaochang Wanda Plaza is one of the best performing projects. Owned and operated by the Wanda Group, its cinema (Wanda Cinema Wujiaochang store) is reported to have recorded Shanghai's highest box office takings for the past two years.

GRAPH 1

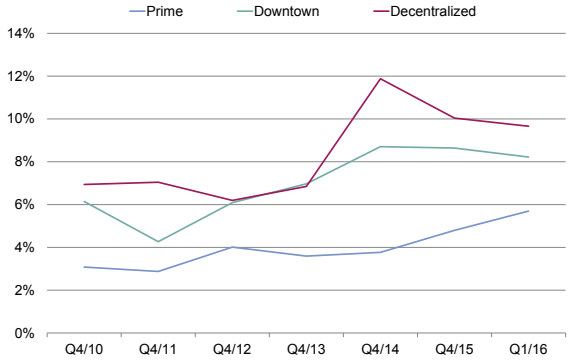
Retail rental indices, Q1/2002–Q1/2016



Source: Savills Research
Note: 1)Benchmark refers to five to six market-leading projects based on a comprehensive assessment of reputation, management, business and design. 2) Rent is based on affordable rents of fashion and accessories tenants on the first floor.

GRAPH 2

Vacancy rates, 2010-Q1/2016



Source: Savills Research

Vacancy

Vacancy rates in prime areas increased by 0.9 ppt in Q1/2016 to 5.7%, while non-prime areas (including downtown and decentralised areas) fell by 0.5 of a ppt QoQ to 9.0%.

Super-regional malls continued to outperform in the market, with vacancy rates falling 1.1 ppts QoQ to 2.6%, comparable to even to that of prime benchmark projects (2.0%).

Leisure and entertainment related tenants have been particularly active of late, with landlords increasing their space allocation to these tenants in all prime, downtown and decentralised areas. The introduction of the Lego Discovery Center in Parkside Plaza and Sega Joypolis in Global Harbour helped to push down vacancy rates and also increased the leisure and entertainment tenants' share in the Puxi market to 10%, 3 ppts higher than at the end of 2014.

F&B now accounts for 31% of occupied retail space in the Pudong market, 5 ppts higher than that of Puxi. Unlike Pudong, Puxi has a thriving street retail market that provides a significant number of options for F&B retailers, offering lower costs and greater accessibility to residential populations. F&B tenants' share of retail space in the Pudong market is expected to continue to increase towards the end of the year.

While prime retail areas are still the locations most in demand from tenants, projects in prime areas are not immune. Consumers tend to prefer large-scale shopping malls with modern design and an up-to-date tenant mix; there are only six projects in the prime retail areas that can offer over 80,000 sq m of GFA retail space. Some smaller projects are struggling to find the best tenant mixes and positioning as retailers become more selective when choosing a mall, tending to prioritise more modern malls that have been designed more in line with the tastes of the modern consumer.

Policy

Transition from business tax (BT) to value added tax (VAT)

According to State Administration of Taxation, the transition from BT to VAT will apply for the real estate industry starting May 1, 2016.

Landlords of existing developments will be allowed to use a simplified calculation method at a lower tax rate, though the taxpayer will not be allowed to claim tax credits or issue special VAT invoices. However, new projects after May 1, 2016 will be requested to adopt the new policy.

Landlords will need to review their terms and rental collection in the coming years to avoid a reduction of net rental revenue after tax. The coming two to three years will likely see more varied rental terms to adapt to the new set of policies, but in the long term, the VAT system is seen as beneficial to both landlords and tenants to alleviate tax burdens. As always, strong landlords and tenants will have the upper hand on negotiations on how to incorporate the changes into leasing contracts, and how any increase in taxes is offset or any tax savings are distributed.

The transition from BT to VAT will also be applied to the construction industry, financial services and lifestyle services. Lifestyle services include hospitality, food and beverage, healthcare and entertainment, and were generally taxed at 5% under the previous regime, though certain entertainment services are subject to rates from 3% to 20%. Under the new VAT regime, the tax rate will increase to 6%, but as with the real estate and construction industries, tax credits for the costs of goods sold and services consumed (including rentals) can help to lower the tax rates. As rental costs are tax deductible, as long as the landlord is a general taxpayer, rents will, from the retailers' perspective, be less onerous than under the previous regime.

Cross-border e-commerce stricter taxation

The State Administration of Taxation, jointly with the Ministry of Finance and the General Administration of Customs, issued "Notice on Import Tax Policies for Retail of Cross-border e-Commerce" in an attempt to better regulate the booming cross-border e-commerce market.

The new regulation states that transactions can enjoy a temporary zero per cent tariff rate for individual transactions of less than RMB2,000 per time, and less than RMB20,000 per year. Consumer tax and VAT are not eligible for exemption and are charged at 70% of the taxable value.

In addition to the increase in quotas, the postal article tax (行邮税) will be lifted from 10-50% to 15-60%.

Smaller online operators who import goods into the country in small packages through the postal system and then resell the product online are likely to be the most impacted by the increase in taxes as they rely heavily upon the postal article tax, which has a lower tax rate than the import tax, and bonded warehouses to deliver imported products at rock bottom prices.

The new taxation rules are likely to result in the marginalisation of these smaller online operators, resulting in an increase in the cost of imported goods to those flowing through more legitimate channels, giving back some pricing power to bricks-and-mortar retailers and omni-channel players. The hope is that price uniformity continues such that consumers will focus more on service, convenience and environment.

Project focus

Daning Central Square

Daning Central Square is located in the Daning area of the Jing'an District (formerly the Zhabei District). The project is located to the north of Daning Lingshi Park, less than 1km from Shanghai Circus World Station (Metro line 1) and the North-South Highway.

The main façade of the project runs along Wanrong Road, which is planned to extend to the south (under Lingshi Park) and to the north connecting with Sanquan Road in order to facilitate some of the traffic build up on Gonghexin Road. The improvement of the road network will foster greater footfall and visibility of the project

With 60,000 sq m of retail GFA, the Daning Central Square is the largest retail project to be launched in the area since the completion of Daning Life Hub ten years ago. The past decade has witnessed the evolution of Daning from a mere residential neighbourhood to a thriving and multi-functional commerce centre in Zhabei. Approximately 2.2 million residents are now living within 5km of the project.

The project has eight low-rise buildings and a comprehensive tenant mix. Daning Central Square is expected to open in the second half of 2016.

Please contact us for further information

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