

Briefing Snapshot – Going vertical

November 2012

→ Going up? – Duplex retail becomes commonplace in Shanghai

As Shanghai's retail market continues to grow, so it continues to evolve. One notable development of the last two to five years is for retailers to open duplex, triplex and multiplex stores. This trend began in 2006 and 2007, with the opening of Zara's first Shanghai store in Times Square and Montblanc's duplex location in CITIC Square. While this trend was initially limited to a few select retailers, it has gained momentum over the last two years, with more fast-fashion and high-end retailers, including Louis Vuitton, Dior, Gap and H&M, all applying the format in order to offer their full range of products. A walk along Huaihai or Nanjing roads shows clear signs of this trend, as even some smaller retailers are now utilising a second floor, having been converted from apartments, storage space or offices, to retail space.

There are numerous benefits to utilising these upper floors.



Source: Montblanc China

Broader product range – larger stores

The majority of vertical stores are still established by international brands. As the importance of China's market increases, brands have tended to introduce a wider range of products to attract their desired consumers. Therefore, there has been a demand for larger store sizes.

There are obvious difficulties in attempting to open a 3,000-sq m store, all contained on the first floor. The larger a store, the harder it will be to find a suitable location. As such, many retailers have accepted that they will need to move up or move out. While the first floor typically hosts the most competition for space, upper floors are less highly sought-after. This configuration offers retailers the advantage of capitalising on the lower rents charged for higher floors, but still allows them to maintain a street-level presence in order to entice shoppers into their stores.

Higher visibility

Securing a location on the most highly sought-after and trafficked streets in the city is always foremost in the minds of retailers. In first-tier cities such as Beijing and Shanghai, flagship stores in core retail areas are employed as brand building or advertising locations, as opposed to purely relying on retail sales turnover to justify their high rental costs. Taking possession of multiple-storey retail locations allows retailers to develop a stronger and more striking retail environment, reinforcing their brand image, particularly when the retailer has several product lines. The larger the store's size, the more eye-catching the store, resulting in competitors



Source: Adidas China



Source: Soufun.com

feeling that they must follow suit just to keep up.

Rising rents – cost savings

Shanghai's retail market, while not necessarily mirroring the stellar growth seen over the last ten years in China, has still recorded relatively consistent and moderate growth.

→ Twelve years ago, in 2000, key shopping malls in Shanghai leased first-floor space for approximately RMB20 per sq m per day (US\$106.8 per sq ft per annum) on a net area basis, while today, these same shopping centres could be charging up to RMB75 per sq m per day (US\$402 per sq ft per annum), an increase of 275%. Although some portion of this rental growth may be negated by inflation, if you take the government's official figures at face value, the period's combined inflation for Shanghai was just 30%.

Rents have certainly become more expensive, yet retailers are generating ever greater revenues. As a result, they must constantly monitor their costs in an attempt to strike a balance between affordability, sales turnover, visibility, footfall and pedestrian accessibility.

One way to satisfy these disparate aspects is via multiplex retail stores, enabling them to maintain their prime downtown location, yet keep costs down, simultaneously operating a larger store with a wider range of products, and boldly advertising their brand.

Second-floor shopping centre rents typically operate at a 25% discount to the first floor, with the third floor again operating at a 25% discount to the second floor and so on. These savings are not insubstantial, and have even

greater variance in the case of street stores. As it is extremely challenging to rent out the second floor of a retail store to a retailer, landlords often look to small businesses or individuals who may use the space for office or residential purposes.

While first-floor retail rents on Huaihai Road might reach RMB40 to RMB60 per sq m per day (US\$214.8 to US\$321.6 per sq ft per annum), offices on the second floor are priced closer to RMB5 to RMB7 per sq m per day (US\$26.4 to US\$37.2 per sq ft per annum), with apartments priced at RMB3 to RMB4 per sq m per day (US\$15.6 to US\$21.6 per sq ft per annum). It therefore makes a great deal of sense, from both the landlords and the retailer's perspectives, to convert the upper floors into retail space, packaged with the first-floor lease space for RMB25 to RMB35 per sq m per day (US\$134.1 to US\$187.8 per sq ft per annum). This is undoubtedly a win-win situation for both landlord and tenant.

Outlook

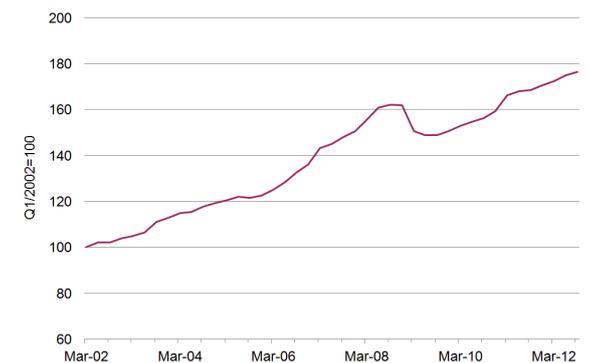
Despite being one of the most populous cities in the world, Shanghai remains a remarkably compact place. Most prime retail space is situated within a 4- to 5-km radius, and is focused along just two roads, with a total retail space of approximately 2.2 million sq m dedicated to shopping malls and department stores.

As the tenant profile along Huaihai and Nanjing roads continues to improve, more prominent retailers will require larger retail premises, and so the need and ability to lease duplex units will likely continue to gain momentum.

Although new shopping malls, including Jing An Kerry Center, SHK's APM and Swire's Dazhongli, are recorded in terms of generating new supply to the market, this expansion of retail space into vertical areas in prime locations is largely unrecorded and untracked.

This increase in supply should help suppress rental growth, which has squeezed retailers' profitability over the last few years, as retail sales growth falters. ■

GRAPH 1 Retail rental index, Q1/2002–Q3/2012



Source: Savills Research & Consultancy

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