

Briefing Retail leasing

March 2017



Image: Louis Vuitton pop-up, ifc mall

SUMMARY

We see light at the end of the tunnel but don't expect a smooth ride in 2017 which will see more consolidation from luxury retailers and further rental declines.

- There were early signs of a slowing rate of decline in the prime street shop segment in the second half of 2016, with rents down by 20% y-o-y in 2016 compared with the 30% decline recorded in 2015.

- After tumbling by over 50% from their peak in early 2013, rents on the street have now returned to pre-GFC levels.

- The sharp rental adjustment is out of sync with a local economy which is in better shape compared with eight years ago.

- Centre landlords are becoming slightly more flexible on leasing terms and rental rates, while more short-term leases are noted in core locations.

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"We believe that the recent rental adjustment cycle has overshot in the prime street shop segment, and rents are likely to bottom out in the second half of the year."

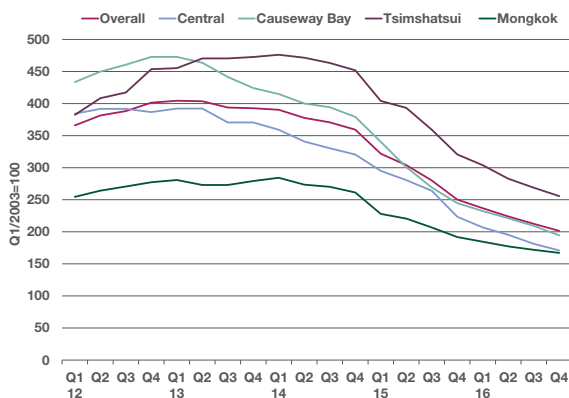
Simon Smith, Savills Research

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→ **Street shops – overshooting on the downside**

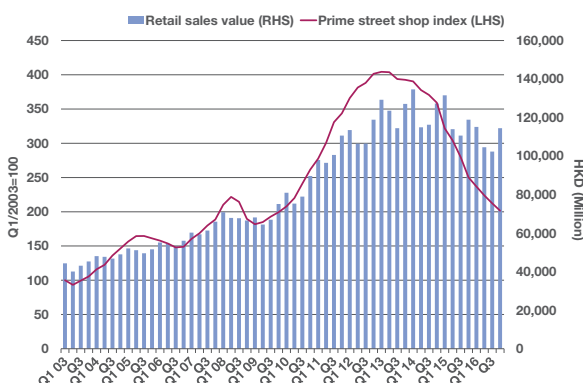
The rental adjustment cycle in the street shop segment was very evident in 2016 with increasing vacancies and falling rents. There were signs of a slowing in the rate of decline in the second half of 2016, however, while retail sales fell at a slower pace towards the end of the year. Prime street shop rents in the core shopping districts were down by 20% year-on-year in 2016 following the 30% decline recorded in 2015. Steeper declines have been noted on second- and third-tier streets where take-up has been particularly limited. Street landlords have had to become more flexible on leasing terms and rental rates,

GRAPH 1 **Savills prime street shop rental index by district, Q1/2012–Q4/2016**



Source: Savills Research & Consultancy

GRAPH 2 **Savills prime street shop rental index versus HK retail sales value, Q1/2003–Q4/2016**



Source: Savills Research & Consultancy

TABLE 1 **Key economic indicators, 2008 vs 2016**

	2008	2016
GDP per capita (In chained (2014) dollars)	HK\$276,164	HK\$321,045*
Total visitor arrivals	29,506,600	56,654,903
Overnight	17,319,500	26,552,681
Same-day	12,187,200	30,102,222
Overall per capita expenditure on shopping		
Overnight	HK\$3,116	HK\$3,553*
Same-day	HK\$1,316	HK\$1,954*
Mainland visitor per capita expenditure on shopping		
Overnight	HK\$4,056	HK\$4,676*
Same-day	HK\$1,926	HK\$2,256*
Unemployment rate	4.1%	3.3%
Median domestic monthly household income	HK\$18,400	HK\$25,600

*Data as of 1H/2016

^Preliminary figure

Source: HKTB, Census & Statistics Department, Savills Research & Consultancy

while some have decided to lease out premises on a short-term basis (sometimes for just a few months) to minimize rental losses, hoping for a turnaround later in the year.

Most of the luxury brands remain cautious when it comes to store expansion and the leasing market remained very sluggish at the beginning of 2017. Market activity did pick up slightly after Chinese New Year, however, with some retailers such as smaller chains and individual operators, snapping up affordable space in good locations with strong footfall which they could not afford three or four years ago.

We believe prime street shop rents will bottom out in the second half of this year as the current adjustment cycle looks to have overshot. After tumbling by over 50% from their peak in early 2013, rents on the street have now returned to pre-GFC levels. Such a sharp adjustment is out of sync with a local economy which is in a better position compared with eight years ago by many measures including economic productivity, tourism, the labour market, as well as domestic household income levels.

Shopping malls – more landlord flexibility noted

Shopping mall rents finally saw a small downward adjustment quarter-

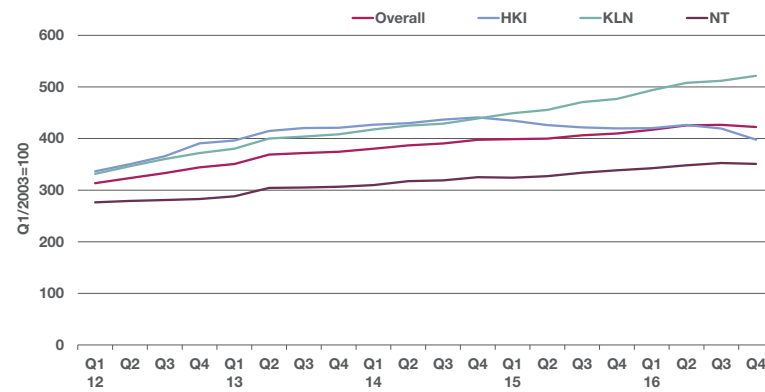
on-quarter in Q4/2016 after six years of consecutive growth, with overall major shopping centre base rents down by 1.0% over the quarter. Rental rates in most of the surveyed malls remained relatively stable towards year-end especially those largely supported by local demand. However, some shopping centres located in secondary areas of traditional shopping enclaves are feeling more pressure. Landlords generally are becoming more flexible for the brands they like and for tenants who are deemed most suitable for the trade-mix. More specialty F&B and pop-ups are being brought in to increase the variety of offerings and create excitement. On the other hand, brands are more willing to try new concepts to boost their brand image, such as Louis Vuitton's men's pop-up store in ifc Mall.

More supply is expected to come on stream in 2017 both in core locations and suburban markets, including the one million-sq ft New World Centre redevelopment and the Grand YOHO, which will increase competition in the shopping mall segment. Rents in some centres will continue to feel downward pressure in 2017, but to a much lesser extent than the prime streets.

More luxury consolidation expected

The year of 2016 ended with a lethargic leasing market and tenant consolidation, especially in the luxury segment. While Prada closed its store at the Peninsula Hotel Shopping Centre, which had been open since 1986, Louis Vuitton cut back their flagship store in Harbour City from three storeys to two storeys. Despite the better-than-expected sales performance over recent months, more consolidation cases are expected throughout 2017, as retailers implement last year's plans or wait until the expiry of existing leases to rationalise. ■

GRAPH 3 Shopping centre rental index by region, Q1/2012–Q4/2016



Source: Savills Research & Consultancy

TABLE 2 Prime street shop and shopping mall rental indices, Q4/2016

	Q4/2016 QoQ	2016 YoY	2015 YoY
Prime street shop rents			
Overall	-5.1	-19.5	-30.4
Central	-5.7	-23.5	-30.0
Causeway Bay	-7.1	-20.6	-35.5
Tsim Sha Tsui	-4.9	-20.3	-29.0
Mong Kok	-2.8	-12.9	-26.6
Major shopping centre rents			
Overall	-1.0	+3.1	+3.0
Hong Kong Island	-5.1	-5.2	-4.8
Kowloon	+1.9	+9.4	+8.6
New Territories	-0.5	+3.7	+4.1

Source: Savills Research & Consultancy

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