SUMMARY

There has been no respite for the retail sector in the third quarter and rents on the street have now returned to pre-GFC levels.

- Street shop rents are now down 50-70% from their peak in what has been a market collapse.
- We are seeing a tenant’s market for street shops emerge for the first time in almost 20 years, and there are some great deals out there for those looking to take advantage of the situation.
- On prime streets retailers are tending to renew at a 30-40% discount while in secondary areas we are seeing increased vacancy.
- Given the 'new norm' we expect shopping mall rents to come under pressure next year as luxury brands continue to be hit hard.
- New Territories malls remain relatively more resilient given that they are less luxury orientated.
- The outlet concept is maturing in Hong Kong but we feel there is plenty of room for it to develop further.

“Good news is hard to find right now but New Territories malls are holding up well while F&B and the young, affordable mass market segment remain active.” Simon Smith, Savills Research
Street shops – a tenant’s market

What has happened to street shop rents over recent quarters could be considered the real estate equivalent of a ‘flash crash’ in the stock market. We haven’t seen this rate of decline since the Asian Financial Crisis in 1998-2000 and rents in some cases are now down 50% to 70% from peak levels in Q1/2013. On the upside, this means that there are some great deals out there with some landlords offering substantial rental reductions in addition to 4-year fixed-rent leases and one to two months rent-free. Despite this, many retailers remain cautious as demand remains lackluster while at the same time legacy rents are eating into their margins.

There are some areas of activity here and there. On secondary streets, deals priced at around HK$200,000 per month (retailers will need a minimum of HK$800,000 in sales) for an 800 to 1,000 sq ft unit can succeed in attracting retailers if supported by strong footfall. It is worth noting that while new leases are being offered at 70% below peak values, renewal usually attracts a more modest, but still hefty, 30% to 40% discount. On prime streets retailers are tending to renew while on secondary streets, they are much more likely to surrender or fail to renew causing vacancies to rise. F&B is still quite active especially new concepts and casual dining.

Shopping malls – landlords still dominate

Shopping mall rents saw a small increase quarter-on-quarter in Q3 on average while prime ‘mega-malls’ continued to see brands, many of them international, keen to take space. Despite this, we think that rents in prime shopping centres will come under pressure in 2017, particularly as the leases of luxury brands expire and require renegotiation. The larger New Territories malls saw some growth in sales, particularly in the young, affordable, mass market segment whether cosmetics or casual fashion. The New Territories malls are more resilient to the change in the market because they are less orientated towards luxury.

To combat the current market challenges, however, we have seen more emphasis on service, training, knowing your customer and selling one-to-one. Suddenly, everyone is having to go the extra mile.
The retailer’s conundrum

■ Offline v online. Yes, it hasn’t gone away and retailers are still trying to strike the perfect balance. The popularity of ‘click & collect’ is growing, helping to drive traffic to physical stores. A joined-up offering is ideal but often hard to find.

Customers can order online and collect at store:
- Lane Crawford
- Burberry

■ Malls v street shops. While the prime malls can offer the (mainland) footfall, unit sizes are often tight and rents are still at world-beating levels. There are some great deals on the street and current rental levels may not change much over the coming 12 months. When they do, history suggests they will come back sharply.

Outlets

Now a well established format with a proven track record of success in China and also popular among mainland overseas tourists - think Bicester in the UK or Swire’s Citygate here in Hong Kong.

Compared to conventional outlet centres in Europe, America or even other Asian countries, the format of outlet centres in Hong Kong is categorized as “factory outlet centre” in an international context, which is not a purpose-built outlet development. In fact, almost all of the new additions (with the exception of the Citygate extension) are partial conversions of existing retail or industrial properties for outlet tenants. This phenomenon may indicate that some landlords are shifting their focus from high-end to mass market and they are looking for alternative options or solutions for under-performing projects. Moreover, it also indicates that retailers now hold excession inventory as a result of declining in-store sales performance.

We believe that the outlet sector still has lots of room for growth, as there is plenty of scope for new development formats and there is always the possibility of the involvement of international outlet operators who are yet to enter the market.

| MTR: Heng Fa Chuen Paradise Mall |
| Location | Atop Heng Fa Chuen MTR Station |
| Theme | Sports |
| Brands | Nike Factory Store (biggest in HK)  
  Ipanema (first store in HK)  
  Under Armour (only outlet store in HK)  
  Adidas, New Balance, SKECHERS, Kappa etc. |
| Size | 43,000 sq ft GFA |
| Opening date | September 2016 |

| Hopewell: E-max WearHouse |
| Location | Kowloon Bay International Trade and Exhibition Centre |
| Brands: | D-mop  
  Levis  
  The North Face  
  GAP  
  ISSI Outlet (including brands like Coach, Gucci, Burberry etc.) |
| Size | 50,000 sq ft GFA |
| Opening date | August 2016 |
| Expansion plan | will be expanding to B1 and B3 |

| Tribeca (RDM): Kwai Hing |
| Location | KCC100, close to Kwai Hing MTR station |

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