

Briefing Retail sector

December 2014



Image: Causeway Bay

SUMMARY

The prime street shop leasing market remained subdued due to the sluggish performance of the luxury sector.

- After six consecutive months of contraction, Hong Kong's retail sales resumed growth and rose by 3.5% and 4.8% year-on-year (YoY) in August and September respectively.

- Sales of luxury products, including popular tourist items such as watches, jewellery, electrical goods and photographic equipment, have continued to cool.

- We have noted a rising number of renewal and early surrender cases in the prime street shop segment.

- Rents in major shopping malls rose slightly by 1.0% quarter-on-quarter (QoQ).

- The impact of recent demonstrations on the retail sector is believed to be temporary and the situation should gradually normalise after the protests end.

"Slower growth in the Mainland and the on-going anti-corruption drive are having a chilling effect on the sector." Simon Smith, Savills Research

→ **Market commentary**

The prime street shop leasing market remained subdued over Q3/2014 amid sluggish retail sales, especially in the luxury segment. A number of international luxury retailers and retail groups have reported weaker sales growth over the third quarter of the year. The shift in the profile of Chinese visitors (from overnight to same-day), a fall-off in mainland spending on luxury items as a result of the anti-corruption drive and a slowing economy, as well as increasing competition from neighbouring cities such as Seoul and Taipei (as trendy destinations for wealthy Chinese travellers), have all compounded the slowdown in the luxury sector.

Total retail sales reverted to positive growth in August and September after six consecutive months of contraction, with the value up by 3.5% and 4.8% YoY respectively. However, the decline in the luxury sector, especially the super high-end watch and jewellery trade has dented the overall performance of Hong Kong's retail market and resulted in a modest growth of 1.6% over the third quarter. Excluding luxury items, electrical goods and photographic equipment, the sales value from other types of retail outlets actually posted a stronger growth of 5.0% over the same period.

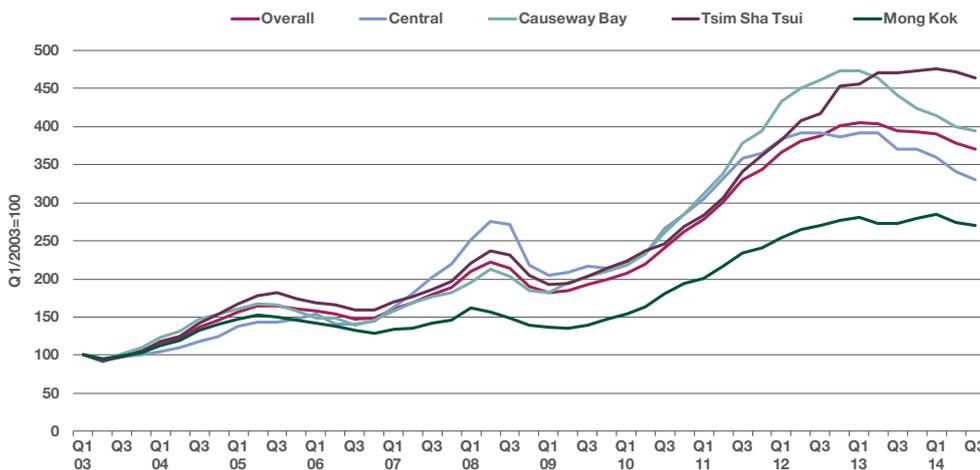
The Occupy Central movement, which began in late September, caused some disruption to normal operations in certain core shopping districts, but it has been reported by a number of retailers including Luk Fook Jewellery and Sa Sa that the adverse impact on their shops in affected areas was mitigated by positive growth in sales in other districts because of a shift in spending patterns. The actual impact of the event on the overall retail sector will be reflected in the official government data for October, due to be released in early December.

Suffering from weakening sales and dwindling profits, retailers are being pressed to rethink or restructure their network planning, halt expansion plans, relocate stores for rental savings or even downsize operations. Market activity in the prime street shop segment was subdued over the last quarter and we have noted a rising number of renewal and early surrender cases in recent months. Overall prime street shop rents in Hong Kong fell by approximately 2% QoQ in September. In contrast, major shopping centres in Hong Kong continue to see sustained demand from both local and international retailers and average base rents increased by 1.0% QoQ over Q3/2014.

Quality shopping centres are increasingly considered as a "valuable" option when compared to street shops in prime locations after years of more moderate rental growth in that sub-market. The trade and tenant mix and quality management offered by shopping centres is attracting strong demand from international brands, especially small to medium sized operators with limited experience of the local market. Newcomers launching in shopping centres in recent months include Phase Eight (a British fashion brand), Scotch & Soda, TOMS, Moleskine, Monica Vinader, Castañer (a Spanish shoe brand) and Helianthus (a Korean leather goods brand).

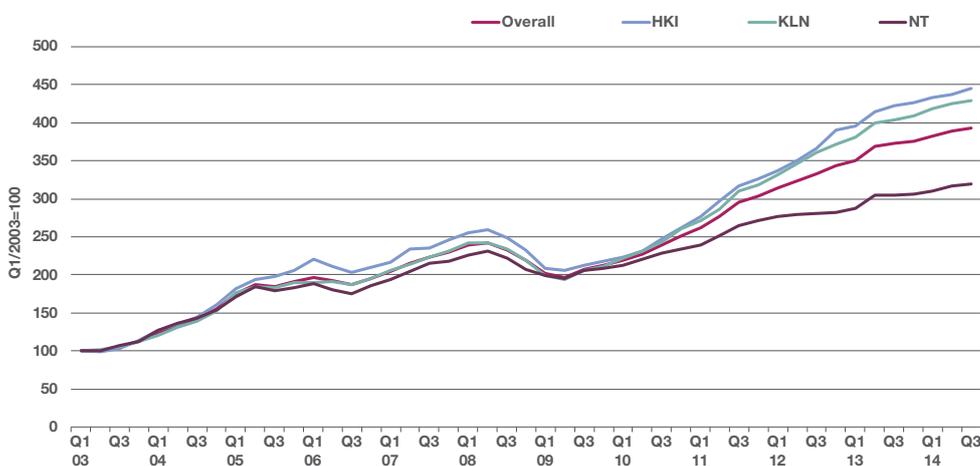
Year-to-date, prime street shop rents in the four core shopping districts of Hong Kong, namely Tsim Sha Tsui, Mong Kok, Causeway Bay and Central, declined by between 2%

GRAPH 1 **Savills prime street shop rental indices by district, Q1/2003–Q3/2014**



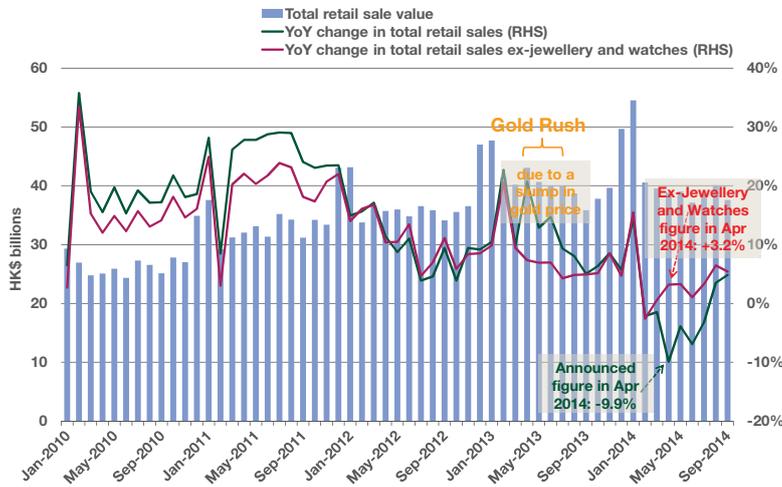
Source: Savills Research & Consultancy

GRAPH 2 **Savills major shopping centre rental indices, Q1/2003–Q3/2014**



Source: Savills Research & Consultancy

GRAPH 3
Retail sales value (YoY changes), Jan 2010 – Sep 2014



Source: Savills Research & Consultancy

to 11%, while average base rents in major shopping centres rose by 4.5% over the same period.

Looking ahead, we believe that the impact of the recent demonstrations on the retail sector should only be temporary, with the situation gradually normalising after the protests end. However, the weakening of the luxury sector due to the slowdown of mainland demand is expected to last into 2015. We expect to see a further rental correction in the prime street shop sub-market over the remainder of 2014 and the first half of 2015, especially in second- and third-tier locations. Overall, prime street shop rents are expected to decline by 5% to 10% over the next six to nine months. The shopping centre segment will be less affected and remain relatively strong – it is expected to see further rental growth in the range of 5% to 10% over 2015. ■

Please contact us for further information

Savills Retail

Savills Research



Nick Bradstreet
Deputy Managing Director
Head of Leasing
+852 2842 4255
nbradstreet@savills.com.hk



Susan MacLennan
Deputy Senior Director
Retail
+852 2840 4891
smaclennan@savills.com.hk



Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk



Kathy Lee
Director
Retail Consultancy
+852 2842 4591
kylee@savills.com.hk

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