Asian Cities - 2H 2022

SPOTLIGHT
Savills Research

Shanghai Retail

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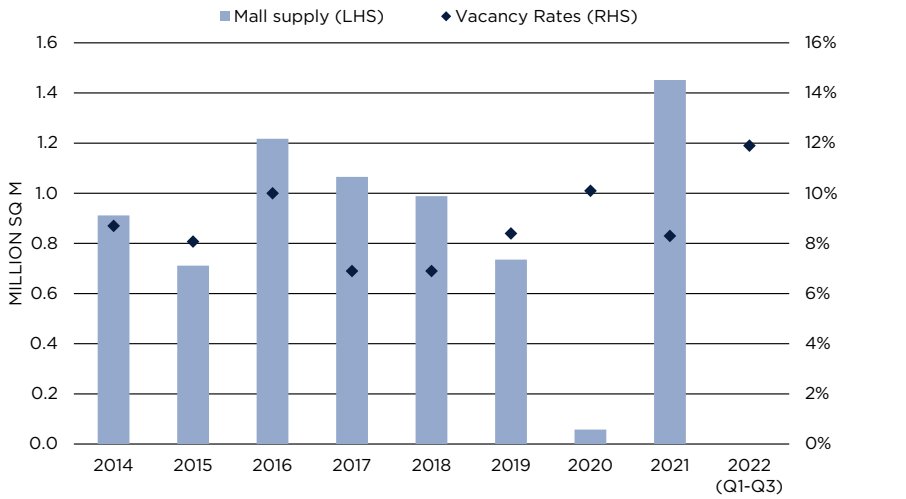
第一太平戴維斯

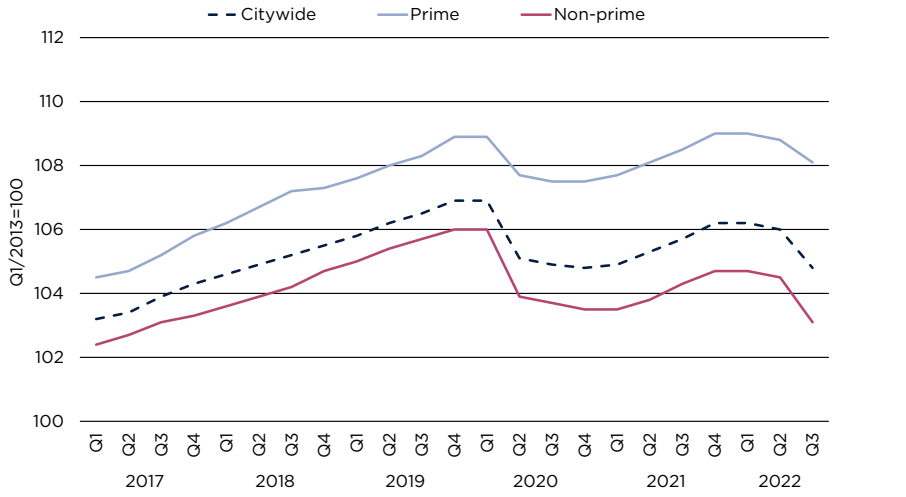
Down but not out

GRAPH 1: Shanghai Mall Supply & Vacancy, 2014 to Q3/2022



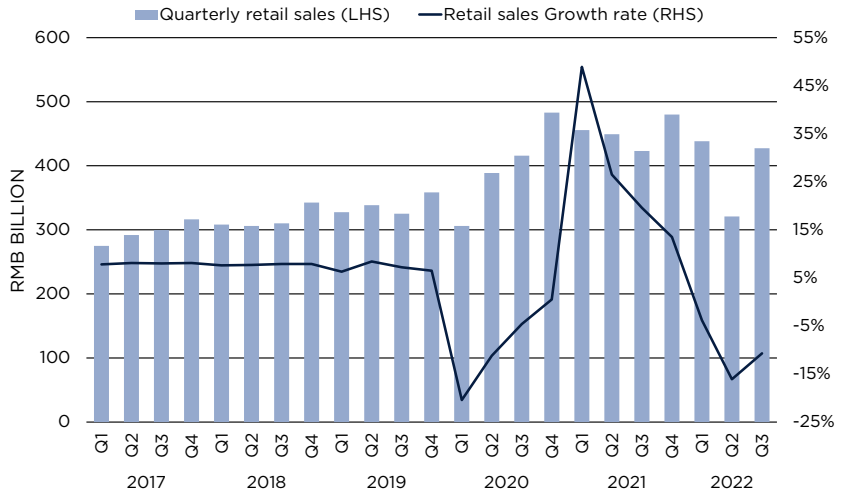
Source Savills Research

GRAPH 2: Shanghai Retail Rental Index, Q1/2017 to Q3/2022



Source Savills Research

GRAPH 3: Shanghai Quarterly Retail Sales, Q1/2017 to Q3/2022



Source Savills Research

MARKET OVERVIEW

A surge in COVID cases and subsequent lockdown in March had an outsized effect on the retail market, with Shanghai's retail sales falling 10.7% YoY in the first three quarters of 2022, with wholesale and retail sales down 9.4% YoY, and accommodation and F&B sales down 24.8% YoY.

After the lockdown was eased in June, consumption began to recover with consumer spending skewed towards food, though there was also a pickup in some discretionary expenditure in Q3/2022, such as NEVs (New Energy Vehicles), smartphones, jewellery and cosmetics growing by 39.8%, 6.6%, 4.9% and 1.3%, respectively. Demand for NEVs is driven by policy support, highly competitive offers in a fiercely contested space, as well as an increasingly environmentally conscious consumer base. International cosmetic brands have been snapping up a stable of niche brands and bringing them to the China market, while they are initially marketed online; pop-up stores and offline store networks will often follow, with Shanghai typically the first choice.

The forced closure of nearly all retail premises for two months or longer posed a huge challenge to tenants, especially those with perishable items, high labour costs, limited cash reserves, concentrated local exposure and an inability to transition to online platforms. It is no surprise therefore that the F&B sector accounted for 44% of space vacated in Q3/2022 with tenants facing significant cash flow strain while restrictions on in-store dining continued even after the lockdown ended. Other affected sectors include fashion and children-related venues, especially in-person education centres which were already reeling from the double reduction campaign which started last year. Community and one-stop shopping malls were particularly affected by some of these early terminations.

While retailers are in crisis management mode at the moment in response to the deteriorating economic situation, the changing consumer behaviour and spending patterns will need retailers to reassess and adjust long-term plans and strategies if they are to remain competitive once the market eventually recovers.

SUPPLY, VACANCY AND RENT

No new projects were launched within the Outer Ring Road in the first three quarters of 2022, with the total stock remaining

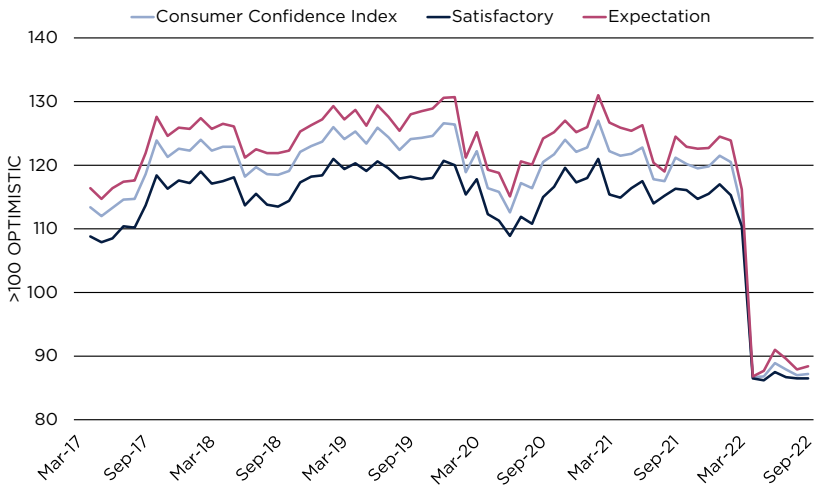
unchanged at 14.7 million sq m. Many handovers have been delayed given the suspension of construction activity and deteriorating market conditions. While 566,000 sq m was initially planned to launch in 2022, the figure is likely to be closer to 266,000 sq m (four projects) while additional delays could be possible. Indeed, back in 2020, the original COVID outbreak resulted in all but one project being postponed to 2021, resulting in a record supply that year of 1.4 million sq m.

The citywide shopping mall vacancy rate grew 2.0 ppts in Q3/2022 to 11.9%, the highest level in over a decade. Prime retail area rates increased 2.6 ppts QoQ to 11.3% while non-prime area rates grew 1.9 ppts QoQ to 12.0%. The withdrawal of larger restaurants and children's service stores was the main cause of the increase in most projects' vacancy rates. Tourist numbers have also fallen sharply and some business areas reliant upon their trade were greatly affected, such as Nanjing Road (E) with its vacancy rate hitting a record high.

Rents fell further in Q3/2022 with landlords' attempting to fill recently vacated units. First-floor rents fell 1.2% QoQ to an average of RMB26.2 per sq m per day, whilst prime and non-prime areas' rents fell 0.6% and 1.4% QoQ respectively. Most landlords are willing to make concessions to tenants and will continue to engage with tenants in the coming quarters to maintain tenant confidence. These figures likely understate the full impact as they primarily capture the first floors of leading malls often occupied by larger retailers utilising the space from more of a branding and client engagement perspective. Upper floors, older projects, and developments outside of the main retail districts are likely suffering a decidedly bigger impact.

Despite a two-month lockdown and continuing uncertainty, Shanghai remains a preferred option for both retailers and consumers. Adjustments to COVID controls point to an eventual end to restrictions, though the market will remain challenging in the short term.

GRAPH 4: Consumer Confidence Index, Q1/2017 to Q3/2022



Source Savills Research

TABLE 1: Selected Leasing Transactions, Q3/2022

TENANT	CATEGORY	PROJECT	AREA	GLA (SQ M)
Maybach	Automotive	BFC	Yu Garden	1,250
Uniqlo	Fashion	Hongyi Plaza	Nanjing Rd (E)	1,200
Royal Pilates	Leisure & Entertainment	The MixC	Qibao	500
gaga	F&B	Xintiandi	Huaihai Rd (M)	400

Source Savills Research

MOVING FORWARD

Open plan projects performed slightly better in terms of footfall over the last two quarters, despite being easily affected by weather, with natural ventilation and many other WELLness principles and sustainable ESG concepts pulling in more potential shoppers. Anchor stores, such as supermarkets, are incredibly important in community centres as they continue to bring in consumers given their relative proximity to consumers and their focus on daily necessities. Innovation and sustainability seem likely to be integrated into the future

retail market, with brands emphasising their ESG credentials outcompeting peers and resonating with young consumer preferences. Retailers are also using more environmentally friendly materials, injecting art, cultural and heritage elements into schemes, while also investing more in the development of the local community. As sustainability-conscious retailers continue to capture more market share, landlords will also have to incorporate sustainability principles into developments.

Consumers have become more health-conscious since the start of the pandemic, leading to growth in demand for outdoor activities and sports brands. A preference for functional and professional products has fuelled growth for brands like Lululemon and Asics while several sports and fitness centres, such as Pilates, stretch and indoor skating, are tentatively restarting their expansion plans. Increased demand for camping and outdoor experience also spurred expansion for brands like The North Face, Kolon Sport, Snow Peak, Descente and other outdoor brands.

Shopping mall rents and occupancy rates are expected to remain under pressure in the short term. The market is likely to see a more pronounced divergence in performance between high-quality projects with proactive and supportive management teams who are still able to attract new retailers and the other projects which might be more reactive as landlords focus on short-term cash flow.

Most brands for the time being remain focused on streamlining existing operations while they remain cautious about expansion plans. While some retailers may not survive the current travails, Shanghai remains one of China's leading consumption centres and as the market settles down and the country learns to live with COVID, new retailers will emerge to fill the void. While some of the demand will come from international brands looking to capitalise on a similar market rebound to what they saw in other countries, it is likely that the majority of demand will be driven by domestic brands. New start-ups and concepts, digital-first rollouts, and the ability to swiftly adapt to new trends give them a distinct advantage given the rapidly evolving consumer habits.

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