MARKET IN MINUTES

Savills Research

Retail Leasing

savills

Retail market left reeling from latest challenge

Prime street shop and shopping mall rents fell heavily in the first quarter, down by 44% and 31% YoY.

- Many retailers are reporting a fall in sales of 50% to 80% over the first quarter with tourist-focused trades worst affected.
- Some retailers have closed all or part of their operations permanently or temporarily and staff are being laid off.
- Prime street shop landlords are proving more flexible and rents fell by 14% QoQ in the first quarter, down by 43% YoY.
- Some mall landlords are offering temporary rent relief of 30% to 50% discounts on a rolling monthly basis.
- As government introduces new measures to tackle a second wave of infections, retailers and F&B face a tough time at least over the next month or so.
- When will demand (mainland shoppers) return? Which sector will rebound fastest? How will retail be reshaped longer term? These are the questions which have yet to find clear answers.

> "A hardening local situation combined with a lack of visibility is giving rise to a wide range of reactions to the current crisis from landlords and tenants."
>
> SIMON SMITH, SAVILLS RESEARCH

Savills team

Please contact us for further information

RETAIL

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

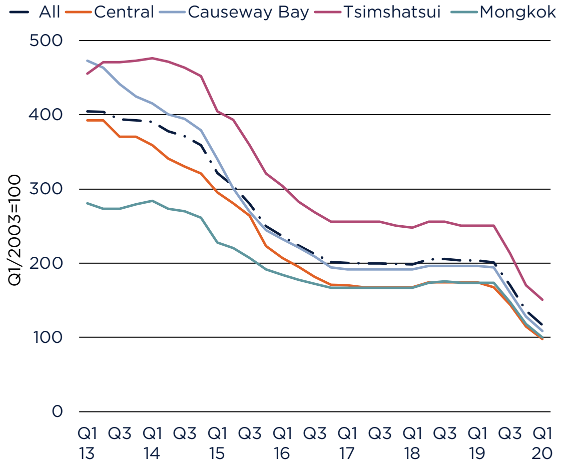
Barrie Chan
Deputy Senior Director
+852 2842 4527
bchan@savills.com.hk

RESEARCH

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

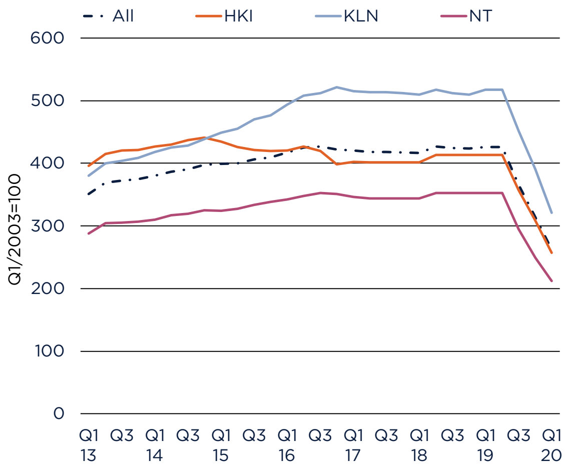
Kathy Lee
Director
Retail Consultancy
+852 2842 4591
kyylee@savills.com.hk

GRAPH 1: Savills Prime Street Shop Rental Index, Q1/2013 to Q1/2020



Source Savills Research & Consultancy

GRAPH 2: Savills Shopping Centre Rental Index, Q1/2013 to Q1/2020



Source Savills Research & Consultancy

TABLE 1: Comparing the Peaks and Troughs

	PERIOD	CHANGE
Mainland Visitor Arrivals	Jan 2019 vs Jan 2020	-54.2%
Retail Sales Value	Jan 2014 vs Jan 2020	-30.7%
Prime Street Shop Rents	Q1/2013 vs Q1/2020	-71.1%
Shopping Centre Rents	Q2/2018 vs Q1/2020	-38.5%

Source Savills Research & Consultancy

MARKET COMMENTARY

2019 was a year retailers and landlords would rather forget after the sector faced multiple challenges including a luxury tax cut in Mainland China, US-China trade tensions and local protest movements among other things. Just when we thought the worst was behind us, 2020 started badly with the COVID-19 outbreak which has already infected over 780,000 people globally and over 700 (31 Mar 2020) in Hong Kong. Local retail and F&B have borne the brunt of both the sharp decline in tourist arrivals and weak local consumption. Many retailers have reported a plunge in sales of between 50% and 80% over the first quarter of the year, while tourist-focused sectors such as jewellery and watches and cosmetics have seen a 90% drop off in sales or worse. The value of retail sales in February 2020 collapsed by 44.0% YoY, while the first two months of the year recorded a 31.8% decline compared to the same period in 2019.

Some retailers have closed all or part of their operations completely or temporarily for virus prevention and to reduce overheads and staff have been laid off. Singapore-based bookstore-chain Popular Bookstore shuttered all of its 16 outlets in March after 40 years in Hong Kong due to the poor business environment and fierce competition from online bookstores. Other recent brand closures include ALAND, a Korean fashion chain, Koi Kei Bakery and Jamie's Italian, an Italian restaurant run by celebrity chef Jamie Oliver. Were these due entirely to the outbreak? Probably not, but it was almost certainly a catalyst.

Prime street shop landlords have become increasingly flexible in rental negotiations over the past few months, while many shopping centre landlords are reluctant to adjust rents significantly regardless of the rise in vacancy. Amid a sharp decline in footfall and sales, some mall landlords have offered tenants temporary rent relief with some giving as much as 50% discounts on a rolling monthly basis. However, retailers remain reluctant to take up any new space and leasing market volumes were very sluggish in the first quarter. Prime street shop rents and shopping centre rents have fallen by 14.0% and 16.5% over Q1/2020, resulting a rental reversion on a three-year lease of -40% on average.

TABLE 2: Prime Street Shop Rental Changes

	YOY CHANGE				QOQ CHANGE
	2017	2018	2019	Q1/2020	Q1/2020
Overall	-1.3%	+2.4%	-33.2%	-42.6%	-14.0%
Central	-1.9%	+3.8%	-34.0%	-43.7%	-14.8%
Causeway Bay	-1.3%	+2.4%	-34.9%	-44.5%	-14.8%
Tsim Sha Tsui	-2.0%	+0.0%	-32.0%	-39.8%	-11.5%
Mong Kok	+0.0%	+3.9%	-32.0%	-42.3%	-15.0%

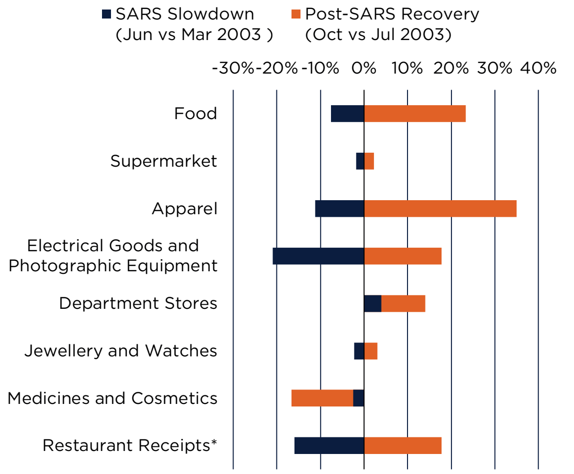
Source Savills Research & Consultancy

TABLE 3: Shopping Centre Rental Changes

	YOY CHANGE				QOQ CHANGE
	2017	2018	2019	Q1/2020	Q1/2020
Overall	-1.2%	+1.6%	-30.5%	-38.5%	-16.5%
Hong Kong Island	+0.8%	+3.0%	-30.6%	-37.7%	-16.7%
Kowloon	-1.9%	-0.4%	-29.2%	-37.9%	-17.7%
New Territories	-2.1%	+2.6%	-32.0%	-39.8%	-14.9%

Source Savills Research & Consultancy

GRAPH 3: Retail Sales SARS Change, October vs July 2003 and June vs March 2003



Source HKTB, Savills Research & Consultancy
* The comparison for Restaurant Receipts is Q2/2003 vs Q1/2003 for SARS Slowdown and Q3/2003 vs Q2/2003 for Post-SARS Recovery.

A LOOK AHEAD

Hong Kong is now facing a 'second wave' as numbers infected have begun to pick up and the government is introducing tougher measures including travel restrictions and lockdowns of community facilities while still deciding how to deal with 'high risk' social places such as gyms, bars, restaurants and cinemas. The retail sector, especially the F&B segment, will be further damaged by these temporary measures if they are introduced without some form of relief.

Many commentators have compared this epidemic with SARS in 2003 to look for how COVID-19 will impact the local economy and how the retail market might recover when the virus is contained. However, history may not provide a direct comparison as post-SARS Mainland visitor numbers jumped following the introduction of the Individual Visit Scheme on 28 July 2003. The face of retailing in Hong Kong since then has undergone a structural transformation which drove retail sales by value up by over 174% from 2002 to 2018 and caused more than double. At the same time, the industry's reliance on Mainlanders has increased nearly three-fold; shopping spending by Mainland Chinese tourists accounted for 29% of total retail sales locally in 2019, compared with 10% in 2002.

The questions now concern when Mainlanders will return to the city and in what numbers and if the social unrest which gripped the city in 2019 will resume once the COVID-19 outbreak is contained. In fact, many retailers have been 'toughing it out' since the market peaked in 2014 and many will be ready to reconsider their business strategies, especially those reliant on the Mainland market. Store consolidation is now on the agenda of retailers with networks of outlets, and more store closures are expected in the coming months. Vacancies are expected to rise over the next 6 to 12 months, which will put more pressure on rents over the rest of the year. The higher vacancies will force landlords to be more innovative in their leasing and marketing strategies to attract traffic and we are already seeing more pop-up concepts and shorter leases.

On a more positive note, the lower rental costs will attract newcomers to the Hong Kong market, which for too long has charged the world's highest occupational costs. Existing retailers will have to innovate with both their offline and online strategies to stay relevant. We expect 'social' sectors most affected by the outbreak such as F&B, gyms and cinemas to recover quicker than others when the virus dies down and local consumers quickly embrace their normal lives after months of lockdown and social isolation. Sectors with a stronger online presence such as fashion may see a slower return considering the shift in consumer behaviour from bricks-and-mortar to online during the outbreak.