Hong Kong - July 2020

MARKET IN MINUTES

Savills Research

Retail Leasing

savills

Retail market showing signs of stabilisation

Having seen dramatic declines since 2013, prime street shop and shopping mall rents seem to have found a floor but this may only be temporary.

- Retail sales have for the first time recorded 11 consecutive months of double-digit decline amid the prolonged social unrest and the global coronavirus pandemic.
- Many luxury and mid-range retailers are struggling to maintain their P&Ls and offloading unprofitable stores.
- Rental declines stabilised in both the prime street shop and shopping centre segments, falling by only -1.7% and -0.8% respectively over Q2/2020.
- Foot traffic in shopping malls showed some signs of improvement in May and June fuelled by pent-up demand from local consumers.
- A slower-than-expected recovery in the tourism market means that a more balanced approach to local consumers and mainland tourists is warranted moving forwards.
- Retail categories such as lifestyle brands, health-related products and affordable family-friendly retailers which appeal to domestic shoppers are beginning to have a stronger presence in the market.

> "Rising vacancy levels continue to plague the market with mid-range fashions joining luxury retailers in rationalising store numbers, but rents appear to have stabilised for now."
>
> 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

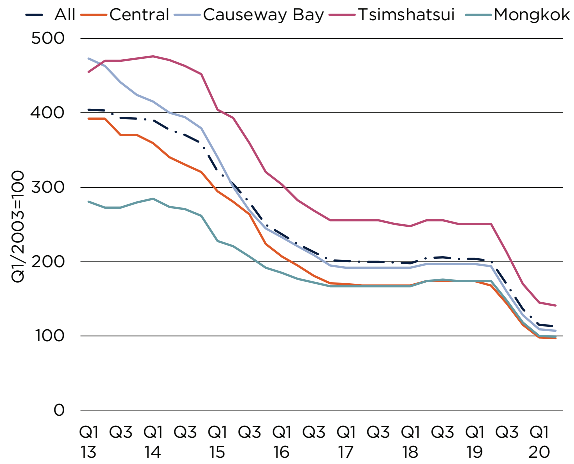
Barrie Chan
Deputy Senior Director
+852 2842 4527
bchan@savills.com.hk

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 Q2/2020



Source Savills Research & Consultancy

TABLE 1: Prime Street Shop Rental Changes

	YOY CHANGE			QOQ CHANGE	FROM PEAK (Q1/2013)
	2018	2019	Q2/ 2020	Q2/ 2020	Q2/ 2020
Overall	+2.4%	-33.2%	-43.5%	-1.7%	-71.9%
Central	+3.8%	-34.0%	-42.2%	-1.2%	-75.3%
Causeway Bay	+2.4%	-34.9%	-45.0%	-1.9%	-77.4%
Tsim Sha Tsui	+0.0%	-32.0%	-43.7%	-2.6%	-69.1%
Mong Kok	+3.9%	-32.0%	-43.0%	-1.2%	-64.7%

Source Savills Research & Consultancy

TABLE 2: Shopping Centre Rental Changes

	YOY CHANGE			QOQ CHANGE	FROM PEAK (Q1/2019)
	2018	2019	Q2/ 2020	Q2/ 2020	Q2/ 2020
Overall	+1.6%	-30.5%	-39.0%	-0.8%	-39.0%
Hong Kong Island	+3.0%	-30.6%	-38.8%	-1.7%	-38.8%
Kowloon	-0.4%	-29.2%	-38.3%	-0.6%	-38.3%
New Territories	+2.6%	-32.0%	-39.9%	-0.2%	-39.9%

Source Savills Research & Consultancy

MARKET COMMENTARY

The local retail industry has experienced the longest business disruption in its history amid the prolonged social unrest and the global coronavirus pandemic. Retail sales have for the first time recorded 11 consecutive months of double-digit decline since July last year. Tourist-focused sectors such as jewellery and watches, cosmetics and luxury fashion took the biggest hit due to sinking tourist traffic, with the value of sales of jewellery and watches plummeting by over 69% over the first five months of 2020.

Sales of clothing and related products also tumbled by 50% over the same period. Declining sales volumes and an uncertain market outlook have prompted retailers to rationalize their footprint, and a number of luxury brands including Valentino, Tiffany & Co., Coach and Prada have already given up their retail outposts on Canton Road in Tsim Sha Tsui and Russell Street in Causeway Bay, two of the most expensive commercial addresses in the city.

Whereas retailers are struggling to maintain their P&Ls, many landlords still believe that the current market turmoil is mostly temporary and are reluctant to offer substantial rent reductions upon renewal. Perhaps more concerning is that more mid-range retailers are joining the luxury brands and have been offloading unprofitable stores in recent months. Swatch has already quit its store on Queen's Road Central, while Topshop, GAP and Adidas may not renew their leases in Central. Vacancy on prime streets in traditional tourist districts is set to rise.

In the meanwhile, vacancy in some of the prime shopping centres has increased to 5 to 10% in recent months. Despite the rise in vacancy, many shopping centre landlords remain reluctant to adjust rents significantly and are cutting back the temporary rental concessions which were offered to tenants early this year. It is expected that we will see more store closures in the coming months and that vacancy rates will continue to rise if the discrepancy in rental expectations between landlords and tenants persists. Our rental indices show that major shopping centre rents remained largely stable in Q2/2020 following a 16.5%-decline in the first quarter. Rental declines in the prime street shop segment have also taken a pause following a steep correction of over 71% from their peak in 2013 and down by only -1.7% over the past three months.

At the time of writing, the pandemic appears to be under control and the government has eased most social-distancing measures in recent months. The city is gradually resuming normal activities with public services/facilities, businesses and schools reopening. After months of social isolation and lockdown in the rest of the world, the virus has changed the way we live, shop and travel and may have a lingering impact on the global tourism and consumer economy. The question for Hong Kong's retail industry now is will the market revert to "normal" after COVID-19 and if not, how will the city's retail landscape evolve?

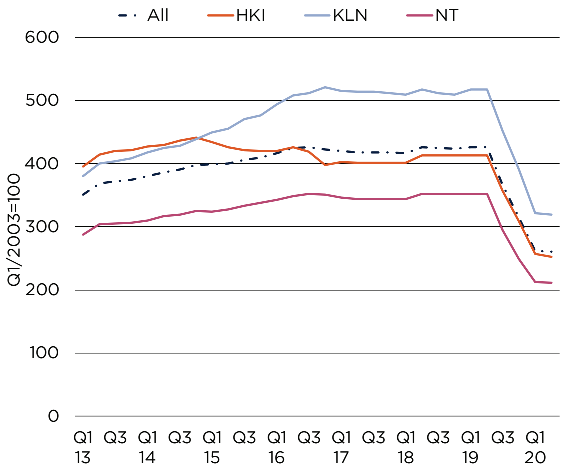
While foot traffic in shopping malls showed some signs of improvement in May and June fuelled by pent-up demand from local consumers, retailers and shopping centre owners are waiting anxiously for a stronger recovery when the city reopens its borders to international visitors, possibly in late September. However, we do not expect mainlanders, the main source of tourist arrivals in Hong Kong, to return in great numbers immediately due to a shift in their travel preferences and behaviour.

We believe that mainlanders will remain wary of travel overseas for some time, preferring initially to become domestic tourists. We already hear that places such as Hainan Island, China's tropical island, are proving to be exceptionally popular among local tourists, and are reporting high hotel occupancy rates and strong luxury retail sales. In addition to the shift in travel behaviour, Hong Kong will also face tougher competition for Mainland tourists from other local, regional and global tourist destinations and the idea that the city will see a return to its heyday in 2013 seems unlikely. Local social unrest has also dented the city's image in Mainland China.

The post-COVID outlook for Hong Kong's retail industry remains very challenging. Some structural changes in demand profile and market fundamentals are underway and both retailers and landlords need to adapt and constantly reinvent to stay relevant. A slower-than-expected recovery in the tourism market means that a more balanced approach to local consumers and mainland tourists is warranted moving forwards but the shopping preferences of locals and tourists are of course quite different.

Local consumers are more focused on their "whole of life" needs, prioritizing health and well-being, caring about their family and community, and valuing the local culture and sustainability. Retail categories such as lifestyle brands, health-related products and affordable family-friendly retailers which appeal to domestic

GRAPH 2: Savills Shopping Centre Rental Index, Q1/2013 to Q2/2020



Source Savills Research & Consultancy

shoppers are beginning to have a stronger presence in the market. As an example, Muji and lululemon have opened their largest stores in Telford Plaza and Harbour City respectively, while Sweaty Betty, a UK women's activewear brand, is opening its second store in Causeway Bay this month. Following its success in Tsim Sha Tsui and Tsuen Wan, Don Don Donki is opening two more stores in Causeway Bay and Central in the second half of the year.

However, we still expect to see a rise in vacancy on both prime streets and in shopping centres during the third quarter, as retailers continue to face challenges both locally and globally forcing them to rationalise networks which will mean fewer branches and smaller stores. Shopping centre landlords meanwhile will need to be more creative in terms of the way they use vacant space. More pop-ups are expected, while other cultural and educational uses will help to create a positive and unique shopping experience for consumers. Additional recreational areas could also become more common, such as outdoor open spaces, children's playgrounds and pet-friendly areas, helping to draw traffic and enhance customer engagement.

TABLE 3: Recent Store Closures And New Openings

BRAND	LOCATION	TIME OF CLOSURE / NEW OPENING
Store closure		
Tiffany &Co.	1881 Heritage, Tsim Sha Tsui	Q1/2020
Valentino	Harbour City, Tsim Sha Tsui	April 2020
Prada	Plaza 2000, Causeway Bay	June 2020
Swatch	China Building, Central	June 2020
New openings		
Blue Bottle	Lyndhurst Terrace, Central	April 2020
lululemon	Harbour City, Tsim Sha Tsui	May 2020
Charles & Keith	Harbour City, Tsim Sha Tsui	May 2020
Muji	Telford Plaza 2, Kowloon Bay	June 2020
Don Don Donki	Pearl City Mansion, Causeway Bay	July 2020
Sweaty Betty	Fashion Walk, Causeway Bay	Q3/2020
Don Don Donki	100 QRC, Central	2H/2020

Source Savills Research & Consultancy