MARKET IN MINUTES
Savills Research

Retail Leasing

Q2 rents find a floor

Quarter on quarter rises in rents reflect a gradual improvement in sentiment but any clear turnaround will be dependent on the lifting of border restrictions.

- Sentiment in Hong Kong's retail market continued to improve in the second quarter supported by rising retail sales.
- The leasing market has shown signs of revival with an increase in activity levels in core areas and stabilised rents.
- Rents in both the prime street shop and major shopping centre segments have stabilised after 18 months of decline, registering a QoQ growth rate of 0.3% and 1.2% respectively.
- Local consumption will remain the main demand driver over the second half with border restrictions increasingly likely to remain in place and with the rollout of government's consumption voucher scheme.
- We see increasing opportunity for landlords and retailers in some New Territories districts where population growth is expected to run ahead of retail provision over the next three years according to Planning Department projections.

> "Improving retail sales numbers and lower unemployment have helped to stabilise rents while landlords are deploying pop-up concepts and short-term leases to fill vacant space until tourist demand returns."
>
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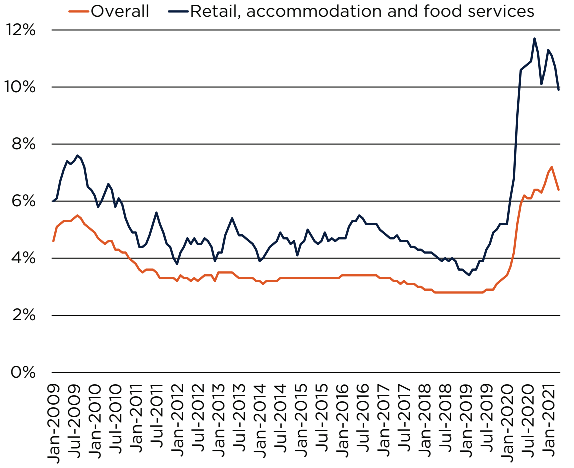
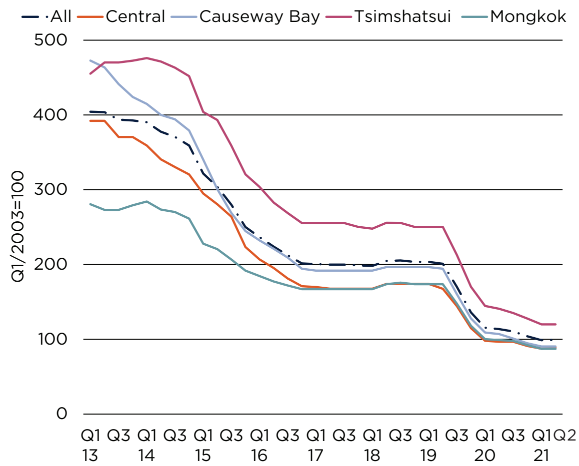
GRAPH 1: Unemployment Rate, January 2009 to April 2021



Source Census and Statistical Department

GRAPH 2: Savills Prime Street Shop Rental Indices, Q1/2013 to Q2/2021



Source Savills Research & Consultancy

MARKET COMMENTARY

Sentiment in Hong Kong's retail market continued to improve over the second quarter supported by better retail sales figures. According to the latest government statistics, retail sales value in May 2021 rose by 10.5% YoY after a 12.1% increase in April. In further positive news, the unemployment rate in the city dropped back to 6.0% in May from 6.4% in April, which helped to boost consumer confidence.

The leasing market also showed signs of revival with a slight increase in activity. High profile vacant and available (upon lease expiry) space in core locations continued to be filled and American Eagle Outfitters took up the G/F, 1/F and 2/F of LHT Tower in Central (part of the previous GAP premises) while Hang Seng Bank will occupy the G/F and 1/F of Hing Wai Building at 36 Queen's Road Central (part of the old Adidas triplex store).

Domestic demand dependent sectors including F&B, grocery-related stores and athleisure brands have remained the key market drivers over the first half. Other retailers are sitting on the side lines, waiting for heavily discounted opportunities or clearer signs of an end to border restrictions. However, many multinational brands, especially fashion brands, have frozen their budgets for expansion this year which has inevitably contributed to slower take-up. In response, pop-up stores and short-term leases are now being widely adopted by both retailers and landlords as a short-term strategy in view of an uncertain recovery timeline.

Pop-ups can be used to test new markets, store formats and/or concepts without substantial investment and/or any long-term commitment, while short term leases can help fill vacant units and increase the variety of offerings (sometimes exclusive). Pop-up concepts have now expanded from fashion brands to homeware retailers and licences can range from a couple of weeks to six-months; interesting examples including Ikea's pop-up store at Po Wing Building on Lee Garden Road in Causeway Bay and Mother of Pearl's pop-up (a bubble tea house) at The Upper House.

Rents in both the prime street shop and major shopping centre segments have finally stabilised after 18 months of decline, registering QoQ growth of 0.3% and 1.2% respectively. Supported by strong local demand, the suburban shopping centres have outstripped their counterparts in core areas registering an increase of 3.7% in rents over the second quarter compared with unchanged levels at core.

We have also noticed that there is still a discrepancy in rental expectations between retailers and landlords, and we believe that leasing activity will gain momentum once supply and demand find an equilibrium. The occupancy ratio (the rent-to-sales ratio) is expected to improve in the near term given the current low rent environment (in what was once the world's most expensive high street commercial property market) and the recovery in retail sales.

A "zero-COVID" strategy has successfully kept infection rates in Hong Kong much lower than in other global financial hubs, however the threat of variants which currently hangs over major economies has cast uncertainty over the reopening of the city's borders and the return of international travel. It seems that Hong Kong's retail market will have to continue to rely on domestic demand for the time being.

Looking ahead, further residential population growth will be focused on the New Territories and North Lantau. According to Planning Department projections, the Tuen Mun, Tai Po and North Districts will see the fastest population growth rates of

TABLE 1: Prime Street Shop Rental Changes

	Q2/2021		
	QOQ CHANGE	YOY CHANGE	FROM PEAK (Q1/2013)
Overall	+0.3%	-12.7%	-75.5%
Central	+1.2%	-8.5%	-77.4%
Causeway Bay	0%	-15.4%	-80.9%
Tsim Sha Tsui	0%	-14.8%	-73.6%
Mong Kok	0%	-11.8%	-68.9%

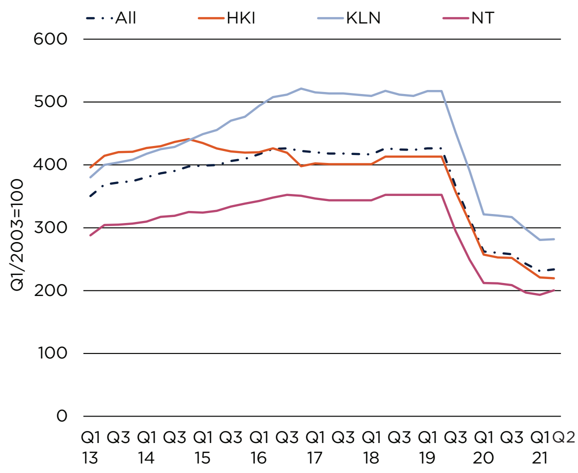
Source Savills Research & Consultancy

TABLE 2: Shopping Centre Rental Changes

	Q2/2021		
	QOQ CHANGE	YOY CHANGE	FROM PEAK (Q2/2018)
Overall	+1.2%	-10.2%	-45.2%
Hong Kong Island	-0.6%	-13.4%	-46.8%
Kowloon	+0.4%	-11.8%	-45.6%
New Territories	+3.7%	-5.3%	-43.1%

Source Savills Research & Consultancy

GRAPH 3: Savills Shopping Centre Rental Index (Base Rent), Q1/2013 to Q2/2021



Source Savills Research & Consultancy

10.6% to 13.5% over the next three years to 2024 compared to territorial growth of 3.4%. Tuen Mun District is expected to overtake the Eastern and Kwai Tsing Districts to become the fourth most populated district by 2024 with a population of over 556,600 (the top three most populated districts are Shatin, Kwun Tong and Yuen Long). Furthermore, Yuen Long, Tuen Mun and Kai Tak will see significant growth in middle-class households given the large quantum of new private residential supply in the pipeline, and overall spending power in these areas is expected to rise sharply as a result.

Local retail supply in some of these fast-growing districts is struggling to keep up with flourishing demand. As an example, shopping centre space per capita in Yuen Long and Tuen Mun will total 5.2 sq ft and 6.0 sq ft GFA per resident in 2024, much lower than other highly populated districts such as Sha Tin (8.5 sq ft) and Tsuen Wan (14.7 sq ft). We therefore believe that these areas will provide extensive opportunities for both retailers and shopping centre developers. Similarly, looking at the future growth in office populations, Cheung Sha Wan is a rising star with over 2 million sq ft of new Grade A office space scheduled to come on stream over the next two to three years, an increase of 30% in total stock.

In the short run, the rollout of the government's consumption voucher scheme will boost the local retail market as well as the F&B and hospitality sectors. According to government information, about 7.2 million of the city's permanent residents are eligible for the HK$5,000 e-voucher. It is expected that a total of HK$30 billion (the total financial cost of the scheme is HK$36 billion of which $600 million will be spent on administration) will be injected into the domestic market over the next five to eight months and will stimulate the local economy and add 0.7 of a percentage point to GDP growth.

TABLE 3: Population Projections and Per Capita (Major) Shopping Centre Stock by District Council District, 2024

DISTRICT COUNCIL DISTRICT	POPULATION PROJECTS, 2024	POPULATION GROWTH 2024 VERSUS 2020 (%)	TOTAL EXISTING AND PLANNED MAJOR SHOPPING CENTRE STOCK, 2024 (MILLION SQ FT)	PER CAPITA MAJOR SHOPPING CENTRE STOCK (SQ FT / RESIDENTIAL POPULATION)
Central and Western	231,600	+3.1%	2.42	10.4
Wan Chai	166,300	-5.0%	3.79	22.9
Eastern	531,600	-2.1%	3.59	6.7
Southern	268,300	+0.1%	1.35	5.0
Sham Shui Po	468,000	+6.2%	2.57	5.5
Kowloon City	443,800	+4.3%	6.49	14.6
Wong Tai Sin	427,700	+2.3%	3.86	9.0
Kwun Tong	706,800	+2.1%	6.96	9.8
Yau Tsim Mong	316,500	-3.1%	11.83	37.4
Kwai Tsing	517,200	+1.6%	4.87	9.4
Tsuen Wan	305,000	-2.7%	4.47	14.7
Tuen Mun	556,600	+10.6%	3.36	6.0
Yuen Long	666,500	+3.2%	3.45	5.2
North	361,600	+13.5%	2.45	6.8
Tai Po	350,800	+12.7%	2.36	6.7
Sha Tin	717,500	+4.1%	6.13	8.5
Sai Kung	504,200	+6.0%	5.83	11.6
Islands	197,300	+5.7%	3.02	15.3

Source Planning Department, Savills Research & Consultancy