MARKET IN MINUTES
Savills Research

Retail

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Retail vacancies hit two-year high

The booming F&B sector is set to support overall retail rental levels.

- On the back of a slowing economy and weakening consumer sentiments, annual retail sales (excluding motor vehicles) for 2018 nevertheless posted a second year of increases, albeit at a softened pace of 0.5% year-on-year (YoY), down from 1.2% YoY in 2017.

- Boosted by an injection of over 0.9 million sq ft of retail stock, the island-wide vacancy level hit a record high of 8.5% in Q4/2018.

- Nonetheless, Savills prime monthly rents in the Suburban Area held stable at S$28.80 per sq ft as suburban malls continued to enjoy proximity to high catchment areas, such as major residential estates and transport nodes.

- Despite the continued tightening of vacancy in the Orchard Area, Savills prime monthly rents for Orchard remained at S$29.90 per sq ft for three years as tenants remained cost-conscious.

- The further scaling back of foreign worker numbers in the services sector is expected to put further pressure on retailers' margins. Although new tenants have hitherto been willing to pay their pound of flesh to position themselves in popular malls, landlords must take note of the former's breaking point.

- While tenants are feeling the vicissitudes of their trade, the industry as a whole is not dysfunctional. With landlords' strong holding power, 2019 could still see room for modest rental growth, particular for prime suburban malls.

> "Although the retail industry is not firing on all cylinders, it is still able to keep rents aloft."
>
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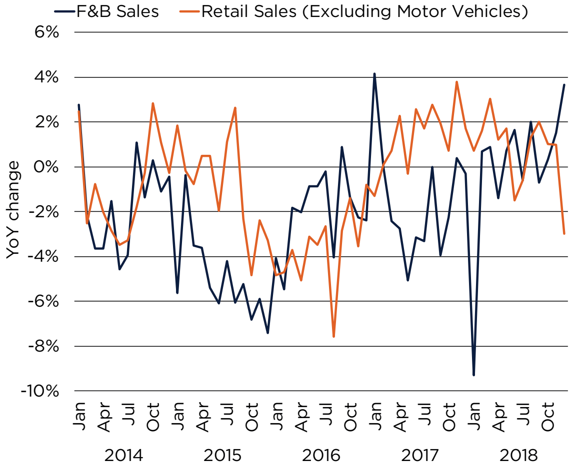
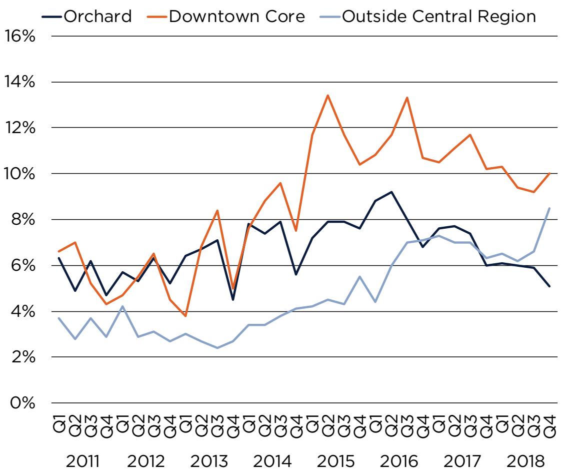
GRAPH 1: Growth In Retail Sales And F&B Sales, January 2014 to December 2018



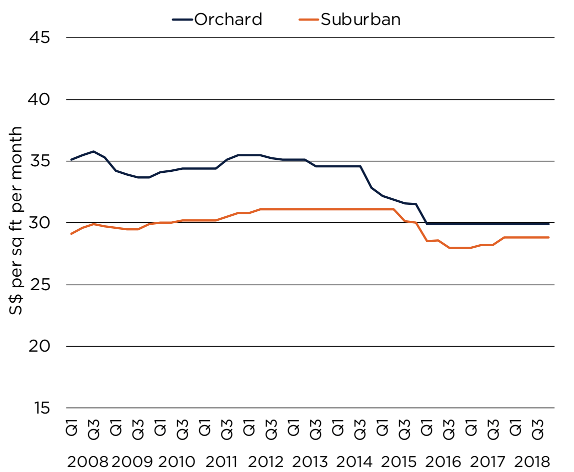
Source Singapore Department of Statistics, Savills Research & Consultancy

GRAPH 2: Vacancy Rates, 2011 to Q4/2018



Source URA, Savills Research & Consultancy

GRAPH 3: Prime Retail Rents, 2008 to Q4/2018



Source Savills Research & Consultancy

MACROECONOMIC OVERVIEW

According to the Ministry of Trade and Industry (MTI), Singapore's economy expanded 1.9% YoY in the last quarter of 2018, down from the 2.4% YoY recorded in the third quarter. For the full-year, GDP growth came to 3.2%, moderating from the 3.9% recorded in 2017. Despite the economic slowdown, the overall job market for 2018 improved, with higher employment, fewer retrenchments and a lower unemployment rate than the previous year. Nonetheless, the latest median household income data showed that the pace of annual growth eased from 3.9% in 2017 to 3.0% in 2018, the slowest since 2012.

On the back of a slowing economy and sluggish wage growth, as well as escalating US-China trade tensions, consumer sentiment weakened further. This reigned in spending by both locals and Chinese tourists – the top spenders for Singapore's tourism receipts. Although tourist arrivals continued climbing in Q4/2018, hitting a record in 2018, tourism spending on the shopping and dining fronts was down. In December, retail sales (excluding motor vehicles)[1] registered the largest dip of 3.0% YoY for the past two years. Although annual retail sales posted a second year of increases, the pace softened from 1.2% YoY in 2017 to 0.5% YoY in 2018. The weaker sales performance was mainly due to the sales drop for computer & telecommunications equipment (-3.8% YoY) from last year's sales hike during the major mobile launches as well as lower non-discretionary expenditure on supermarket receipts (-2.6% YoY).

Meanwhile, food and beverage (F&B) sales[2] concluded 2018 with an accelerated sales growth in the last quarter, hence moderating the full-year F&B sales decline to a four-year low at -0.2% YoY. Growth was led by the strong sales posted by fast-food chains (+6.8% YoY) while revenue from restaurants and cafes continued to slide.

RENTAL MARKET SHOWS SIGNS OF STABILISING

Several major completions in the last quarter of 2018 added over 0.9 million sq ft of retail space to the market, far greater than the average quarterly net supply of 144,000 sq ft for the last three years. As a result, the island-wide vacancy level hit a new record high of 8.5% in Q4/2018, surpassing the previous record of 8.4% in Q3/2016.

The completion of Jewel Changi Airport led to a vacancy spike in the Suburban Area, where the rate went up 1.9 percentage points (ppts) quarter-on-quarter (QoQ) to 8.5%, the highest level since the data was constituted in 2011. Despite the surge in vacant stock, rents in the suburban market held steady as most suburban malls are located at the centres of gravity in residential areas and are also close to major public transport nodes. For prime-facing retail units where rents demonstrated greater resilience, Savills prime monthly rents in the Suburban Area held stable at S$28.80 per sq ft.

Likewise, the vacancy level in the Fringe Area also went up to 9.5% due to the new addition of retail stock. In the same vein as with the suburban market, the rental index saw the largest growth of 3.5% QoQ in Q4/2018. The rental uptick in turn supported the rental index in the Central Region, which ended a two-quarter QoQ decline with a recovery of 1.2% from the previous quarter.

The retail supply in the Orchard Area remained tight, subsequently easing the vacancy level for the third quarter by 0.8 of a ppt QoQ. The decline in the vacancy level could also be due to the slew of luxury flagship stores opening in Orchard. Hugo Boss, one of many high-end retailers to come to the area, unveiled its first flagship store at ION Orchard. However, despite the drop in vacancy, rents did not grow in tandem, as tenants were still sensitive to any changes to fixed costs. Consequently, Savills prime monthly rents in the Orchard Area have remained at S$29.90 per sq ft for the last three years.

FAST CASUAL DINING CONTINUES TO LEAD

As fast-food chains continue to drive F&B revenue, some restaurant groups have diversified and expanded into the fast-food market. The local restaurant chain No Signboard Holdings launched its first fast-food concept at The Esplanade, appealing to a different target market with hawker-themed options such as Hainanese chicken rice and nasi lemak burgers. A second branch opened at One@KentRidge mall in November while a third site is set to open at PLQ Mall this year.

CREATING COMPELLING RETAIL EXPERIENCES

To attract footfall and induce spending in malls, landlords are enhancing their sites' overall appeal with more F&B choices. After the first phase of a facelift was completed in December 2018, Great World City increased its F&B component from 20% to 30% with new options such as Hototogisu Ramen, Mavrx Coffee Bar and Tim Ho Wan. Despite the lower rents for anchor tenants, some malls include more than one supermarket as these shops provide convenience and necessity, which e-commerce often lacks, hence creating a compelling reason to visit the mall. In addition to Cold Storage, Great World City will open another supermarket, Meidi-Ya, in

1 Retail Sales Index at Constant Prices (Seasonally Adjusted), Monthly. Updated as at 13 February 2019.
2 Sales Index of Food & Beverage Services at Constant Prices (Seasonally Adjusted), Monthly. Updated as at 13 February 2019.

TABLE 1: Major Projects In The Pipeline, 2019 to 2023

DEVELOPMENT	LOCATION	ESTIMATED NLA (SQ FT)	ESTIMATED COMPLETION
Funan	North Bridge Road	324,000	2019
Paya Lebar Quarter Mall	Paya Lebar Road/Sims Avenue	340,000	2019
TripleOne Somerset Podium AEI	Somerset Road	74,000	2019
Tekka Place	Serangoon Road	70,000	2019
Northshore Plaza I	Northshore Drive	62,200*	2020
Le Quest	Bukit Batok Street 41	60,000	2021
The Woodleigh Mall	Bidadari Park Drive	96,800*	2022
Punggol Digital District	Punggol Way	146,600*	2023

Source Company announcements, The Straits Times, URA, Savills Research & Consultancy
*Savills estimation, based on an efficiency rate of between 70% and 75%

June 2019. Don Don Donki opened its third store at City Square Mall, a 26,000-sq ft branch which comes with a food court.

Besides dining and grocery shopping, shoppers also visit malls for the irreplaceable experience of leisure and entertainment. Following the introduction of SuperPark at Suntec City, Nerf Experience Singapore is set to open its first family entertainment centre at Marina Square in 2H/2019, taking up 18,000 sq ft on the ground floor.

SUPPLY IN THE PIPELINE

The retail market will see a major supply injection in 2019 when over 1.9 million sq ft of new retail space is expected to come onstream. This is 90.4% more than the annual net supply of 1.0 million sq ft launched in 2018. In 2019, mega projects like Jewel Changi Airport are expected to be completed. Other major completions expected in 2019 include Funan and Paya Lebar Quarter (PLQ) Mall which have pre-commitment levels[3] of 70% and over 60%, respectively.

From 2020 to 2022, retail pipeline supply is expected to taper off. The main supply will come from auxiliary retail components in residential developments such as Northshore Plaza I, Le Quest and The Woodleigh Mall.

OUTLOOK

Going forward, the outlook for 2019 is expected to stay muted. The MTI is forecasting economic expansion to be slightly below the midpoint of its forecasted range of 1.5% to 3.5% YoY. In the face of external uncertainties and moderate economic growth, job security could potentially remain as one of the market's top concerns if recruiting momentum slows, which may in turn lead to a fall in domestic consumption. The tourism sector is projected to continue its upward trend in 2019 with higher visitor arrivals and tourism receipts, but the latter could register only a modest rise amidst headwinds such as China's slowdown, capital controls and regional competition. Weaker consumer spending overall may potentially cause retail sales to shrink further.

This will inevitably heighten challenges in the retail industry, thus forcing malls and retailers to focus on enhancing the physical shopping experience with innovative concepts. For example, REIT-managed mall Plaza Singapura has introduced NomadX, the first multi-brand concept store providing digital experiences across 11,000 sq ft laid out over two floors. The upcoming Funan will be the first 'online and offline mall' in Singapore, enhancing the overall shopping experience with the integration of new digital experiences. In addition to common anchor tenants such as Golden Village, FairPrice Finest and TrueFitness, Funan mall will also add to its tenant mix a foldable bike brand and farm-to-table concept restaurant. However, overall rental growth could be restrained by possible lower rents expected from such a retail mix and from anchor tenants.

It is perhaps apt to add a departing analogy that while the Singapore retail industry engine is functioning, not all cylinders are firing. However, since retailers (including F&B operators) as a group are still churning their tills, landlords have been able to keep rents aloft. But given this disharmony in the user landscape, a rental forecast – even one that goes down to the locational level – may not accurately depict the situation at a micro-location or specific mall. Therefore, we can only provide a range of rental forecasts for the retail space market.

Moving past 2019, with the gradual reduction of the foreign to local worker ratio in the service sector, only retailers with the deepest pockets are expected to survive as they have the wherewithal to invest in labour-saving devices, whatever that may be for their respective sub-trades. Owing to this policy, we expect greater tenant turnover at malls as some retailers flounder in the face of rising labour costs and/or their inability to compensate for declining foreign worker numbers. These concerns will likely become real not this year but from 2020 onwards. If economic indicators and thus wage growth do not rise beyond this year's expansion, then the comeuppance for retailers who ventured too aggressively will arrive next year. The year 2020 will also be when most tenants who signed up in malls opening this year begin to pay rent after their rental holidays expire.

Looking at rents by location for 2019, the Orchard Area will experience a shortage of new supply, and the annual prime retail rental growth may rise by up to 2.0% YoY. However, given the extreme flux retailers are facing from market disruptors, slowing economies and capital controls on major tourist-exporting countries, we expect volatility on the downside, and this may stretch the rental growth range to a possible downside of -1% YoY. For prime units in suburban malls, the rental market is likely to stay strong at a 2.0% YoY increase due to high shopper traffic and large catchment areas. Moving beyond 2019, the island-wide retail rental level may find some support from the limited pipeline supply.

TABLE 2: Expected Retail Rental Changes for 2019

PERIOD	PRIME ORCHARD ROAD RENTS YOY CHANGE	PRIME SUBURBAN MALL RENTS YOY CHANGE
2019	-1.0% to 2.0%	0.0% to 2.0%

Source Savills Research & Consultancy

3 Information accurate as of October 2018 (Funan) and March 2018 (PLQ Mall).