MARKET IN MINUTES
Savills Research

Retail

Retail market reels as rents tumble

The market is unlikely to witness a major recovery soon as rents and demand are set to soften further.

- Retail sales (excluding motor vehicles) plummeted by a record 46.3% year-on-year (YoY) in May as receipts for categories such as watches & jewellery and departmental stores saw the worst YoY decline of over 90%.
- Food and beverage (F&B) revenue also declined sharply by over 50% YoY in April and May because of the ban on dine-in with restaurants and eateries being only be able to provide takeaway and delivery.
- Coupled with a contraction of net demand and addition of new retail space, overall retail vacancy rate soared to an all-time high of 9.6% in Q2/2020.
- While Savills monthly prime rents in Orchard Area declined 5.0% QoQ to S$27.40 psf, that in Suburban Area fell by 3.0% QoQ to S$27.70 psf in Q2/2020.
- This tightened the rental gap between Orchard and Suburban malls, marking the first time where Orchard rents are below Suburban rents since the data was constituted.
- It is dawning on landlords that the previous market practice of charging a high fixed and a low percentage turnover rent has to be recalibrated by increasing the latter component. This plus the uncertainties facing tenants may bring Orchard and Suburban mall rents in 2020 down 10% to 20% and 10% to 15% respectively.

"So long as social distancing measures are in place, even suburban malls will be negatively affected."

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MCI (P) No. 009/08/2019
Company Reg No. 198703410D

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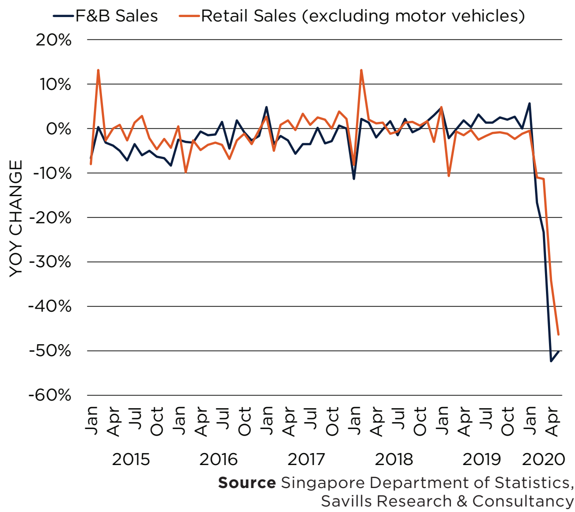
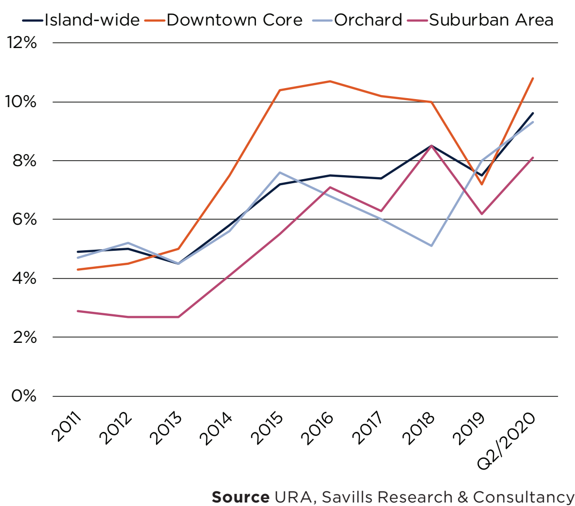
GRAPH 1: Retail Sales And F&B Sales Growth, January 2015 to May 2020



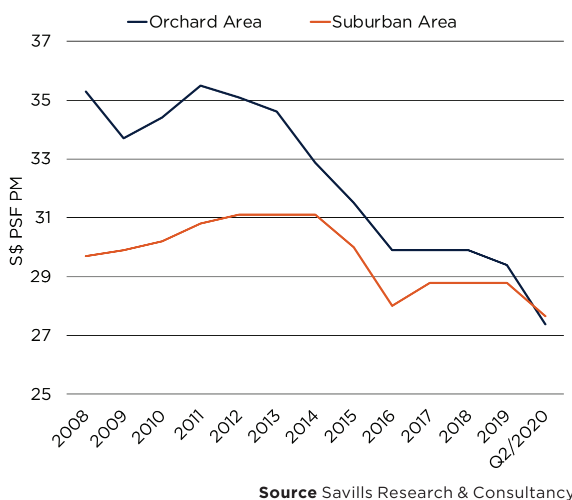
Source Singapore Department of Statistics, Savills Research & Consultancy

GRAPH 2: Vacancy Rates, 2011 to Q2/2020



Source URA, Savills Research & Consultancy

GRAPH 3: Prime Retail Rents, 2008 to Q2/2020



Source Savills Research & Consultancy

MACROECONOMIC OVERVIEW

From advance estimates released by the Ministry of Trade and Industry (MTI), Singapore's economy fell into recession in Q2/2020 with a contraction of 41.2% from the previous quarter. Compared with the same period last year, the economy shrank 12.6% in Q2, extending the 0.3% decline in Q1. The economic slowdown was largely due to the implementation of the Circuit Breaker (CB) measures beginning on April 7 which halted non-essential economic activities. In the light of the lockdown measures, the construction sector and services-producing industries shrank in Q2 along with lower construction output as well as weaker domestic demand in food and retail businesses.

Coupled with the sluggish local spending amid economic slowdown and job insecurity, visitor arrivals to Singapore also hit historic low levels in April and May, further aggravating the already poor retail sales prior to the lock down. Despite an uptick in online sales, overall takings continued to weaken in Q2, falling at a faster pace in April and May when most retail shops were closed due to the lockdown measures. Retail sales (excluding motor vehicles)[1] plummeted by a record 46.3% YoY in May as receipts for categories such as watches & jewellery and departmental stores saw the worst decline of over 90% from May last year. F&B revenue[2] also showed a sharp decline of over 50% YoY in April and May because of the ban in dine-in with restaurants and eateries only being able to provide takeaway and delivery. (Graph 1)

OCCUPANCY AND RENTS TUMBLE AS MORE RETAILERS EXIT

Compared with the early outbreak phase at the start of the year, the retail market felt full impact of the pandemic in Q2/2020. The effects were the result of the CB and social distancing measures. With the increasing number of retail and F&B closures as well as business consolidation which left more retail units vacant, island-wide net demand of retail space shrunk by over 1.0 million sq ft (nett), reaching the highest contraction since the data was constituted in 2011. Coupled with an addition of 43,000 sq ft of new retail space in Q2/2020, overall retail vacancy rate soared to an all-time high of 9.6%. (Graph 2)

Notably, vacancy level in Central Region rose by 1.7 percentage point (ppt) QoQ to its highest level of 10.3% in Q2/2020. As the pandemic forced more companies to adopt flexible and remote working arrangements, the office crowd in the Central Business District (CBD) has reduced significantly over the recent months. Owing to the sharp decline in visitor arrivals and closure of non-essential businesses in malls, the shopper traffic along main shopping belts like Orchard Area and Marina Bay Sands thinned visibly, further weakening the retail and F&B sales in those areas. As a result, vacancy level especially in Central Region escalated in the reviewed quarter as more businesses which have no financial cushion to weather the coronavirus storm left the retail scene. Besides, new leasing of retail spaces also took a hit from the lockdown measures, affecting the take-up of new retail space. The leasing of retail space was at a standstill as retailers suspended decision-making due in part to their inability to make site visits and also in part their efforts to try to contain cost. While some tenants and potential occupiers may be re-negotiating for lower rents, most leasing decisions are on hold or pending for re-evaluation.

Although there were no notable leasing activities or new deals signed during the lockdown period in Q2/2020, the overall sentiments and rental expectations weakened as retailers struggled with anemic sales. The rental index for Central Area fell 4.9% QoQ to its lowest point since the data series was constituted in 2011. This is in line with the rental trend in Orchard Area where most businesses switched over to survival mode in an effort to stay afloat amid the travel restrictions. In Q2/2020, Savills monthly prime rents[3] in Orchard Area was down by 5.0% QoQ to S$27.40 psf, marking its second consecutive quarter of decline. Even though Suburban malls are generally more resilient with the nearby local catchment and necessity shopping, Savills monthly prime rents in Suburban Area dropped 3.0% QoQ to S$27.70 psf in Q2/2020 alongside lower footfall and shift towards online grocery shopping. This tightened the rental gap between Orchard and Suburban malls, and this was the first time that Orchard rents fell below Suburban rents since the data was constituted. (Graph 3)

MORE MASSIVE CLOSURES AND CONSOLIDATION

As the pandemic hit the global retail industry, some long-established brands such as fashion label Esprit, have shut all their stores. Esprit has closed all its stores in Asia, including all the 12 outlets in Singapore. Home-grown sports retailer has also closed all the nine outlets in Singapore after 37 years.

Some retailers have also started to consolidate to manage their manpower and rental costs. In June, Muji did not renew their lease at its Marina Square store, which will be taken over Eccellente by HAO mart later this year. Lifestyle and design retailer Naiise continued with their cost-cutting measures and ceased the operations at its Paya Lebar Quarter store when its lease expired in July. The brand now has a last outlet at Jewel Changi Airport.

1 Retail Sales Index at Constant Prices, Monthly (exclude any online orders which are sent from foreign addresses). Updated as at 20 July 2020.

2 Food & Beverage Services Index at Constant Prices, Monthly. Updated as at 20 July 2020.

3 Savills estimated rent for a 1,000-sq ft prime ground floor unit let to a fashion retailer.

A Karaoke chain also planned to shut half of its 12 branches, starting with its Katong Shopping Centre and Sembawang Shopping Centre branches. Notably, some retailers chose to retain centrally located stores while shutting their suburb outlets, though footfall in Suburban malls are usually more resilient than city malls. Following the closure of Isetan at Westgate in March, another departmental store Robinsons will be shutting its Jurong outlet at JEM by August. In the same month, Tokyu Hands is also closing its Westgate branch, its first store in Singapore.

F&B SECTOR WELCOMES NEW FOREIGN BRANDS

F&B is one of the hardest-hit sectors due to loss in revenue from closures during the CB period. Local French patisserie Antoinette and Chinese tea brand Nayuki are the latest few to exit Singapore's market in end-June. Modesto, an Italian restaurant here with two outlets in Orchard Area will close once its lease runs-out. Notwithstanding the number of recent closures in the F&B scene, some overseas brands continued to venture into Singapore.

In July, Danish Confectionary Leckerbaer set up its first overseas outlet, a 36-seater patisserie, at Isetan Scotts in Shaw House. In the same location, another new-to-market brand, Luke's Lobster from New York, also opened a 23-seater in August. Los Angeles egg sandwich chain Eggslut is also set to debut in Singapore early next year, though the location is still unknown.

SUPPLY IN THE PIPELINE

According to Savills estimation, the island-wide supply pipeline[4] for retail space from 2020 to 2024 divides out to an average of around 545,100 sq ft of new retail net lettable area (NLA) per annum, accounting for less than half of the five-year (2015 to 2019) historical average of 1.3 million sq ft per annum. Even though construction works have gradually resumed operations when the CB measures eased, project completion is still likely to be delayed as companies have to comply to strict safe management measure at worksites. Thus, some of the supply from project completions this year, such as Northshore Plaza I and IMall, could be carried forward to 2021. (Table 1)

Given the heightened uncertainties about the future of the aviation and travel industries, the construction of the new Terminal 5 at Changi Airport will stop for at least two years. Hence, the project, which was scheduled to complete in the 2030s, is likely to complete significantly later than expected.

OUTLOOK

The containment measures to curb the virus outbreak have led to significant disruptions to global economic activities, with most of the major economies expected to see full-year recession in 2020. In view of the deteriorated external demand outlook and economic impact of the CB measures, MTI downgraded the economic forecast for 2020 in the latest revision in May to -7.0% to -4.0% YoY. As the pandemic has triggered a recession, the labour market is likely to soften with higher retrenchment level in the worldwide economic downturn.

While most businesses have resumed their operations from late-June when Singapore entered phase two of economic reopening, strict border controls and social distancing measures continued to limit mobility and malls' visitor capacity. Owing to lack of tourism and weaker local spending, the retail performance is still below the usual levels prior to the pandemic outbreak. In the face of challenges arising from the virus outbreak, more retailers started to diversify their sales channels by developing online strategies. Nonetheless, physical retail presence will still hold primacy in the new normal, even though ecommerce will undoubtedly play a major role in the future of retail. It was evident that retail and F&B sales saw significant declines that could not be offset by the sharp jump in online sales since March. As such, more retailers are likely to continue with business consolidation while retaining their key performing stores.

This could result in a more subdued demand for retail space in the near term, putting pressure on the overall occupancy rate. While some overseas brands may take the opportunity of softer rental market to expand their reach to Singapore, it will not be sufficient to maintain the overall occupancy level, especially if more retail chains were to leave the scene as economic woes continue to take a toll on consumer spending. To support occupancy levels and sustain footfall, landlords are likely to be more flexible with their rents and leasing terms. Some landlords are considering allowing more flexibility in their lease structures to share some risk with tenants and recover along with tenants' sales rebound in the future. They may offer lower fixed rents or propose rental payment structure based strictly on Gross Turnover (GTO) in the first year and subsequently include a fixed rent on top of turnover. For the less prime locations, negotiations for an abatement of rent may gradually become more common amongst landlords and tenants.

Unfortunately, if the market practice of charging rents begins to move towards a greater GTO rent percentage, during that evolution process, rental indices are likely to be under downward pressure. Also, during the process of finding a new equilibrium on the mix between fixed and GTO rents, these indices will not be reflective of the health of the retail space scene.

4 Savills estimated net floor area.

TABLE 1: Major Projects In The Pipeline, 2H/2020 to 2030

ESTIMATED COMPLETION	DEVELOPMENT	LOCATION	ESTIMATED NLA (SQ FT)*
2020^	Northshore Plaza I	Northshore Drive	62,200
2020^	IMall	Marine Parade Central	54,800
2021	A&A to existing i12 Katong	East Coast Road	188,800
2021	A&A to existing Shaw Plaza	Balestier Road	64,400
2022	The Woodleigh Mall	Bidadari Park Drive	96,800
2022	One Holland Village Residences	Holland Road	81,500
2023	Punggol Digital District	Punggol Way	175,200
2023	Sengkang Grand Mall	Sengkang Central	54,800
>2024	Integrated Development (Redevelopment of Liang Court site)	River Valley Road	90,400
>2030	Changi Airport Terminal 5	Tanah Merah Coast Road	435,400

Source Company announcements, URA, Savills Research & Consultancy
*Savills estimates, based on an efficiency rate of between 70% and 75%.
^Pre-pandemic year of completion

In the course of the transition, landlords will have to consider issues that may arise on the valuation front. The reason is that when income-producing properties find more tenants migrating to the new structure, the fixed rental component declines through the Weighted Average Lease Expiry period, but because of the pandemic, the GTO portion could not make up for the drop in the fixed rents. Whether one uses the income or Discounted Cash Flow approach to valuation, the effects are the same. Under this scenario, valuation numbers for malls in general will have to come off. Whether this is permanent is moot, but on paper though, if the industry moves towards adopting a greater GTO content in their leases, that should allow tenants to prosper. Over time, landlords should also perform likewise because for retailers, if a greater proportion of rents have turned into a variable cost, then they could not only offer their goods and services at a lower price, but also provide a greater range of goods and services which could not be offered if the rents were fixed at a high level. This should increase the number of transactions which, when the equation of exchange:

$$MV = PT$$

where,
M is the total nominal supply of money
V is the velocity of money
P is the price level
T is the aggregate level of transactions

is applied, leads to a more vibrant retail and F&B economy. Ultimately, if the price elasticity of final demand in the retail and F&B trades is high, these industries here should recover and perhaps even overreach themselves in the period just before the pandemic. There is a hitch to this argument through and this is not from the lack of elasticity but rather, if the pandemic drags on for too long, and landlords dither in the actual implementation of the increased GTO content model, the contraction in the economy and greater shop closures will reduce general disposable income levels considerably. Under such a scenario, the retail and F&B industries are unlikely to return to even pre-pandemic performance even if prices fall. On the contrary, given lower transaction numbers, there is the possibility that prices rise as entrepreneurs turn from increasing turnover to increasing margins instead. Nevertheless, a do-nothing approach to assist tenants by keeping to the old rental model is likely to increase the risk frontier more for landlords.

In the near term, even without factoring in the move towards a greater GTO content in the lease structure, prime retail rents are projected to edge down further in 2H/2020. As the global travel restrictions continue to be a severe drag on the tourism sector, Orchard prime rents are expected to see sharp decline of up to 20% YoY for the whole of 2020. The recent recovery of footfall after phase two of reopening is unlikely to recover the sales to the same pre-COVID-19 level in Orchard malls which was largely driven by tourist receipts. Despite a more stable shopper traffic and spending levels in Suburban malls, Suburban prime rents are poised to remain under pressure with consumers tightening their purse strings. Also, social distancing measures will limit the ability of malls and F&B outlets, even in the suburban areas to bring back the crowds/customers to pre-pandemic levels. (Table 2)

TABLE 2: Prime Rental Growth Forecast

PERIOD	ORCHARD AREA	SUBURBAN AREA
2020F	-20.0% to -10.0% YoY	-15.0% to -10.0% YoY

Source Savills Research & Consultancy