Spotlight | 2018

CHINA 20 RETAIL CITIES

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This Publication

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Savills China retail cities study, which began in 2014, uses 16 series to determine leaders in two categories: the “economic index” is based on city’s macroeconomic figures and the “retailer index” is based on how many stores that 50 international brands have opened in the city. The series are weighed and aggregated to give a final score to each city.

Great Expectations

Despite challenges ahead, the market maturity between different regions and the emergence of new property and retail technology is expected to bring new dynamics to bear on the retail market.

China's retail market looked to be in full recovery towards the end of 2016 when Alibaba launched its "New Retail" concept to invest into the physical retail market. With Tencent also entering the physical retail market in 2017—through partnerships with a number of department stores and supermarket chains—more capital and online players began seeping into the offline market and giving the physical retail market a facelift.

However, the recent turbulence and uncertainty in the property and stock markets, as well as continuous deleveraging of the financial market and trade disputes between China and US, are straining the underlying fundamentals of the economy and may impact consumer sentiment in the near future.

China has one of the highest e-commerce penetration rates in the world and is one of the most accepting of new technologies. China is also one of the most innovative markets in the world, combining online and offline experiences such as convenient mobile payments and fast delivery services.

Nevertheless, the physical market is far from reaching the levels of maturity seen in the West. Consumer habits vary significantly between different regions or tiers of cities, making it almost impossible for any single retailer to take significant market share in the overall China market. At the same time, new real estate projects continue to come along meaning that tenants often hold the upper hand in negotiations and landlords can never be complacent.

Complexity and uncertainty usually breed new business opportunities for those brave enough to seize them. Retailers need to stay on their toes to identify and respond to the next consumer trend that could come from any corner—they must be prepared to update or reinvent a product, service or experience to face new demands from their consumers.

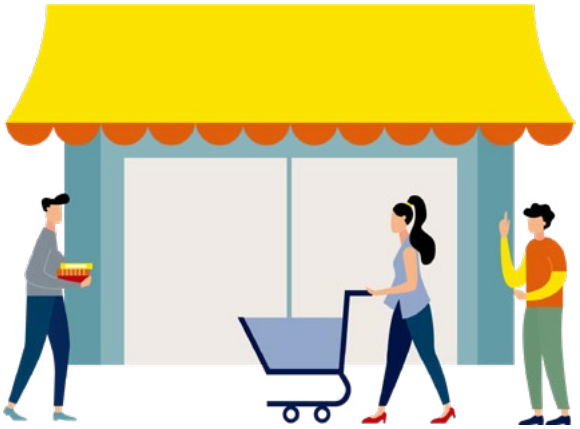
During the past 12 months, China saw balanced expansion rates across main retailer categories while central and western cities continued to outperform their peers in both economic growth and retailer expansion. We look at these retail trends in Chinese cities in this special report.

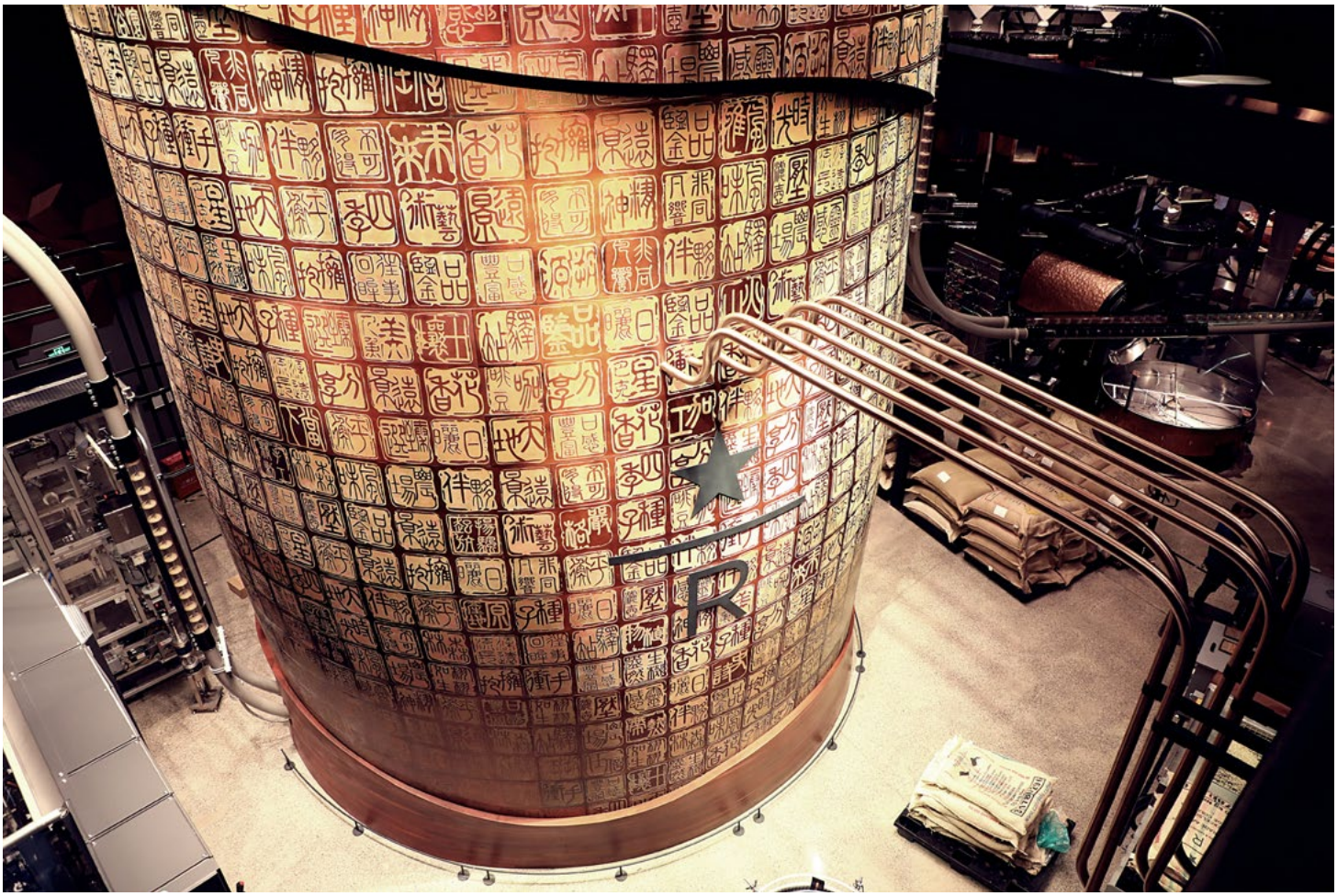
Retailers

F&B segment continued to outperform fashion sector. Three sub-sectors of fashion recorded most comparable growth rates in the latest five years.

Cities

Shanghai, Beijing and Shenzhen maintained leading positions while Hangzhou, Xi'an and Changsha moved up their rankings.





BRANDS

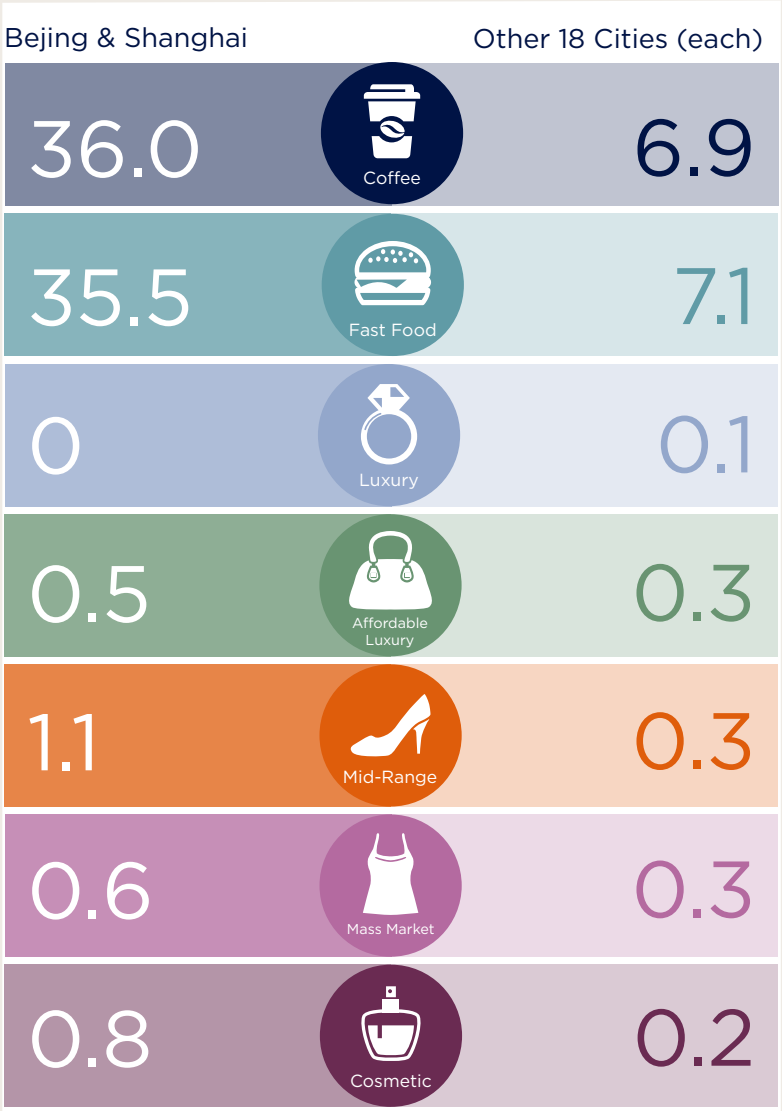
Key retailer categories recorded steady growth in 2018 with the F&B segment continuing to outperform.

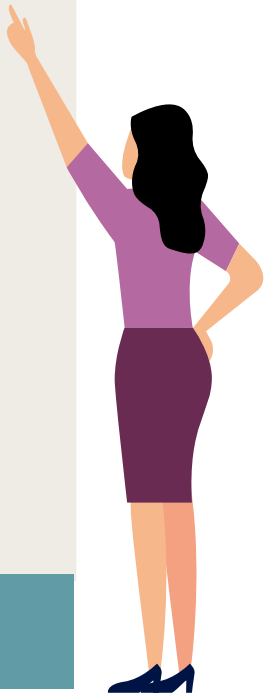
In the apparel segment, expansion rates among different sectors were as comparable as they have been over the last five years. However, the F&B segment continued to record higher growth than fashion and large-scale retailers. Despite the slowing pace of growth in some segments, China now represents the largest overseas market for a range of retailers including Starbucks, Inditex and Shiseido.

Luxury brands, having recorded better sales volumes over the last 12-24 months are once again looking for opportunities outside the country's two gateway cities—Beijing and Shanghai—with the average number of newly opened luxury and affordable luxury stores similar across the other 18 cities. A bigger variance can be seen in mass to mid-range market, where Shanghai and Beijing recorded four to five times the number of new stores openings per retailer than the other 18 cities. Consumers in lower-tier cities showed higher acceptance and preference of international luxury brands than mass and mid-range brands, which face stricter competition from online, value-for-money products and domestic brands.

NEWLY OPENED

Figure 1: Number of new stores per retailer per city, 2H/2017-1H/2018





SOURCE: SAVILLS RESEARCH, RETAILER WEBSITES

LUXURY

China has seen a sustained recovery in its luxury market since early 2016 and has benefited from the narrowing price gap between domestic and overseas markets, the rise of a new generation of sophisticated young consumers, and retailers' increasing online exposure. A recent Bain & Company survey shows that the mainland China luxury market grew by 20% in 2017, while sales in mainland China now account for 8% of the global market, with this figure expected to grow another 20% in 2018.

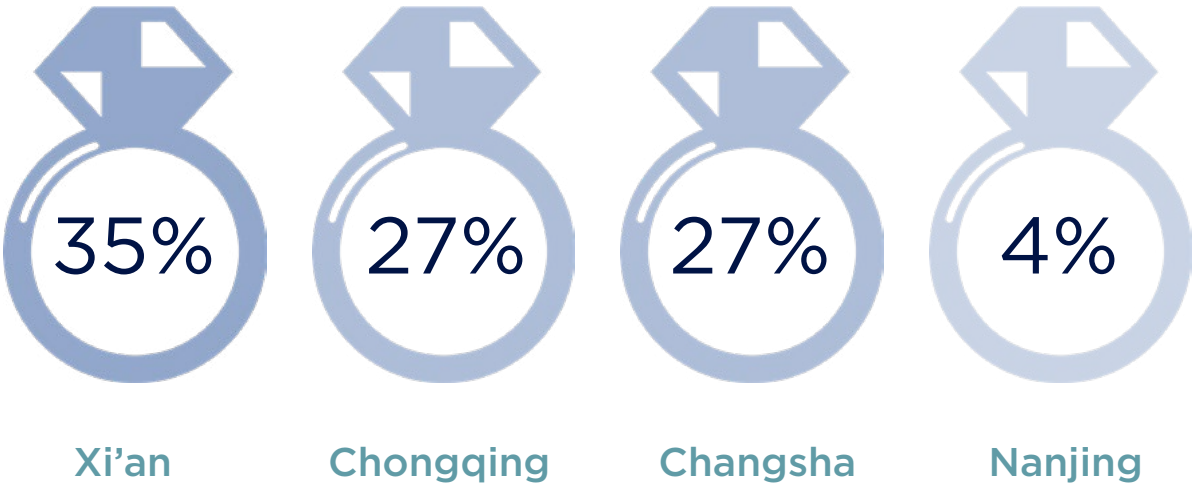
Premium Luxury

In the premium luxury segment, new store openings—which tend to lag behind retailer sales performance—have finally started to pick up after two consecutive years of store closures. Over the past 12 months, premium luxury retailers have an 8% increase in store count in the 20 cities surveyed.

86% of the new premium luxury stores opened in the last 12 months were in Xi'an, Changsha and Chongqing. These three second-tier cities, located in central and western China, all offer strong economic growth prospects and consumer market potential; however, it is the development of landmark projects that have played a more significant role in attracting retailers. Recent examples include SKP Xi'an and Changsha IFS, occupying core locations and built by prominent developers. Both projects launched in 2018, SKP Xi'an hosts the city's first Hermes store, while Changsha IFS is home to the first Dior and Prada stores in the city. The number of premium luxury stores in these two cities rose markedly in the last 12 months, exceeding the average for second-tier cities; this is also reflected in the rankings, with Xi'an rising to fifth place from eleventh and Changsha up to eighth place from eighteenth.

However, Beijing, Shanghai and Shenyang remain the top three markets in number of premium luxury brand stores, closely followed by Hangzhou.

Figure 2: Distribution of new luxury openings in China, 2H/2017 – 1H/2018



SOURCE: SAVILLS RESEARCH, RETAILER WEBSITES

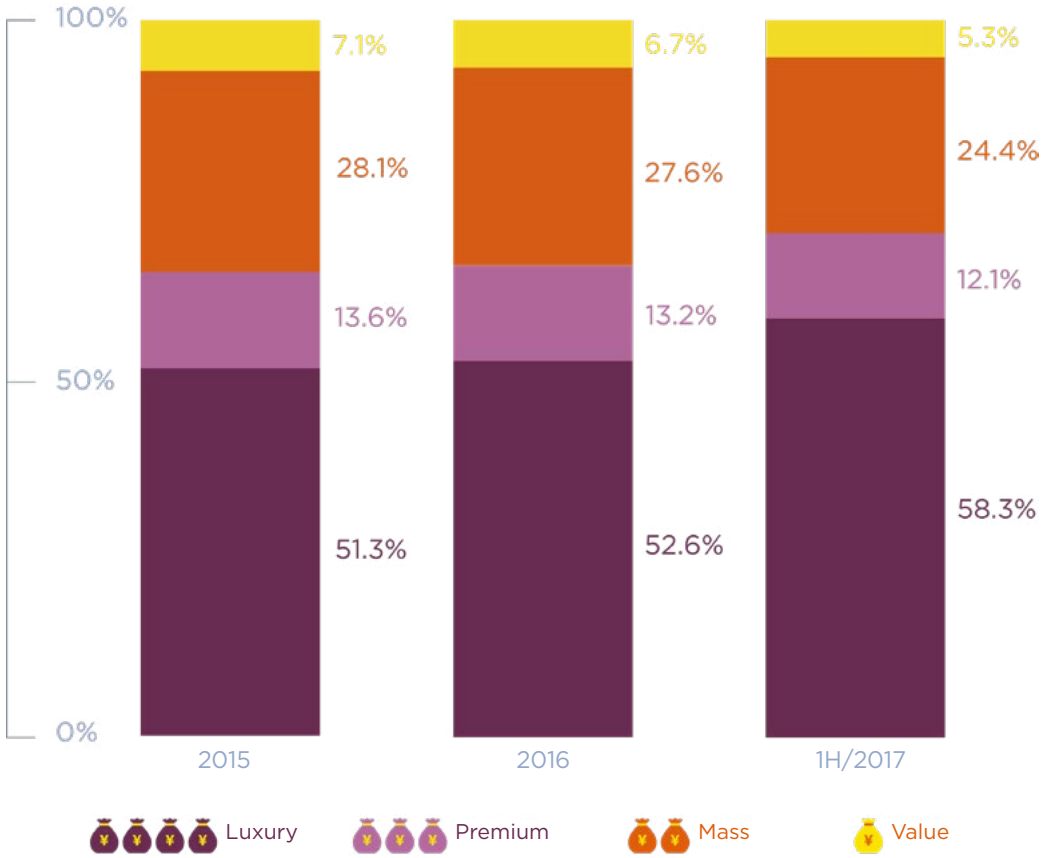
Affordable Luxury & Premium Beauty and Malls

Affordable luxury, along with premium beauty (cosmetic and skincare products), saw the pace of store expansion slow in 2018, after the highs of 2017, adding 0.3 and 0.2 store per city per retailer respectively. Beijing achieved the highest expansion rate in both categories, followed by Xi'an in affordable luxury and Shenzhen in premium beauty. Thanks to the sustained growth in the high-end retail market over the past few years, Beijing has come close to Shanghai in both the affordable luxury and premium beauty categories while maintaining its lead over Shanghai in the premium luxury sector.

Beauty products replaced sports and entertainment as the fastest growing retail sector in 2018, reporting a 17% year-on-year (YoY) sales growth in 2017. The strong growth was mainly driven by premier brands which accounted for over 50% of premium beauty segments. For example, Shiseido Group saw its sales grow by 20.1% in China in 2017, benefiting from a robust increase of Clé de Peau Beauté, Shiseido and Ispa. Estee Lauder Companies also reported double-digit sales growth in China, primarily driven by La Mer, Estee Lauder and Jo Malone.

A key issue facing luxury retailers in China is how to tap into the online market. McKinsey recently projected that, by 2020, online sales would account for 11% of luxury sales in China, and 36% of global online luxury sales. Although the authenticity of products from third-party online platforms remains a concern for some consumers, the fact that nearly 80% of consumers are omnichannel consumers indicates that online platforms have become an important marketing and sales tool in attracting younger consumers. In fact, most successful retailers have seen strong performance both online and offline and some skin care retailers say up to 20 to 30% of their revenue now comes from online sales.

Figure 3: Cosmetic and skincare market share by price range, 2015-1H/2017



SOURCE:GFK,SAVILLS RESEARCH

Luxury Brands & Top-class Malls

Top-notch developers, first-class retail projects and luxury brands seem to go hand in hand. However, in fiercely competitive markets, it takes more than a top-notch developer to convince retailers to launch another store.

It is commonly believed that the recent recovery in China's luxury market is sustainable and that it is supported by rising sales revenue per store rather than by new store openings. This recovery, however, is unlikely to translate into more stores openings as luxury retailers, already late e-commerce entrants, are now keen on developing their online presence. According to a BCG survey, around 77% of Chinese luxury consumers engage with luxury retailers via social media on a daily basis, 14 percentage points (ppts) higher than the global average. China's young, internet-savvy consumers are expected to become a major buying group of luxury products in the future, so there is a good reason for retailers to focus on building their online profiles and sales platforms.

While luxury retailers might not be opening new stores, this does not mean they are not investing in the bricks and mortar networks. They are instead focusing on upgrading and modernising their existing store networks. While retailers may not feel the need to have a physical presence in every market and submarket, they do require a physical presence in key markets to service clients and maintain/strengthen branding, and to that end these stores are not seen as much as sales centres but more service or engagement centres and will invest in them appropriately.

The lack of new demand for retail space means new challenges for landlords of high-end malls. Despite subsidies such as fit-out allowances and rent-free incentives, landlords need to come up with creative solutions to fill the vacant units when demand from luxury retailers falls short of expectations.

Perhaps developers or indeed the market needs to reassess what it means to be luxury. A decade ago luxury products were out of reach for the vast majority of people, unattainable, exclusive, but with stores having opened up all around the country, online platforms, rising incomes and reduced product premiums, luxury products and especially the affordable luxury products are not as unattainable as they once were.

BIG-BOX

Since 2014, big-box retailers continued to take their time opening new stores, with annual growth rates remaining below 5%. This segment includes conventional hypermarkets, department stores, category killers (retailers that specialise in a specific product category and offer an extensive selection of goods at competitive prices) and membership warehouse stores of more than 10,000 sq m.

The impact of e-commerce has forced foreign players to think outside of the box, either working with internet companies to expand online offerings or seeking strategic cooperation with local industry leaders. For instance, Parkson has partnered with China's luxury e-commerce platform Secoo to drive onmichannel sales; a strategic alliance between Walmart and JD.com (Walmart currently holds a 12.1% stake in JD.com) allows consumers to buy goods from over 140 Walmart stores directly through the JD.com platform and have them delivered within one hour.

The past 12 months has seen both store closures and new openings from major big-box players. Walmart has opened 50% of its new stores in third- and fourth-tier cities in central, western and southern China, with none in northern China. While most of Carrefour's new openings are convenience stores branded Easy Carrefour, and mostly in Shanghai, the retailer has also launched a new concept store Le Marche in Shanghai, with another two set to open in Shenzhen later this year. Membership warehouse clubs did slightly better on average, with only a few closings announced and a number of new openings mainly in second-tier cities. Costco, following Metro and Sam's Club, will be the third membership-only warehouse retailer to have a physical presence in China, with the very first store expected in Shanghai in 2020.

Almost all conventional big-box retailers are shrinking the size of their stores. In Shanghai, supermarkets inside shopping centres now occupy roughly 22% less space on average than they did two years ago. As the retail market and spending patterns continue to evolve, supermarkets also have to adapt to stay relevant. Operators are stocking more and more fresh produce while also developing and expanding their online order-and-delivery platforms. They are also devoting more space to F&B, including freshly prepared meals, stalls and on-site cooking. At the same time, they are reducing the amount of space given over to traditional major categories such as appliances and affordable clothing.

Why fresh?

While e-commerce in China by some reckoning started in 2003 with Taobao, online grocery markets started roughly ten years ago in 2008 with Yihaodian. While traditional supermarkets struggled to cope with these new competitors given their convenience, product variety and prompt delivery services, Fujian-based Yonghui Superstore outperformed its peers with a successful fresh produce business. Supermarket peers, observing their success have taken the learnings to heart.

Alibaba set a new benchmark in the industry with the launch of Hema Fresh in 2015 and continued its offline expansion via an investment in Sun Art Retail Group in early 2018 for US$2.88 bn as well as investments in New Huadu and supermarket giant Lianhua. Tencent, Alibaba's fiercest rival, has also bought stakes in Carrefour, Better Life and Yonghui while maintaining its stake in JD.com and through it a number of affiliates. Such moves have in turn led to the upgrading of traditional supermarkets.

Supermarkets in the New Retail era differ greatly from more traditional ones. They are much smaller, usually less than 4,000 sq m, with an enlarged storage space to support short-distance delivery services; they tend to offer better value products and imported goods and ingredients as well as providing cooking and delivery services. At least 50% of orders take place online while they utilise big-data-supported stock keeping units system to manage inventory and allow digital payments via facial recognition and QR code scanning.

The evolution does not stop there. Hema Fresh has also introduced F&B chains to some of its stores, hoping to attract greater footfall and encourage shoppers to stay for longer. Carrefour has opened its first smart supermarket Le Marche in Shanghai in partnership with Tencent, with two more soon to launch in Shenzhen.

The new generation of supermarkets are looking like a logistics hub and warehouse for fresh produce that is tailored to the requirements of the respective catchment areas and supported by a massive, efficient membership management and logistic system. Supermarkets are positioned at the premium end of the market, with pricing to match, so that enough profit margin is made on the products to pay for the higher logistics/delivery costs which are typically not passed on to consumers as an explicit cost.

Mass & Mid-range Market

Mass and mid-range markets recorded mixed performances over the past 12 months. Mass market retailers expanded store networks by 4%, the second lowest rate among all categories. Nevertheless, given their extensive network, this still represents 5.5 stores per retailer per city more than any other category. On the other hand, mid-range retailers opened only 3.7 new stores per retailer per city, but given their smaller existing network, this represents an 11% expansion rate, the highest in the past four years.

Shanghai and Beijing are first in mass market and mid-range retailers, respectively, and Shenzhen comes in second in both categories.

The mass market's pace of growth has slowed in recent years, partly as a result of increasing competition from domestic brands and the increasing popularity of athleisure brands. In Shanghai, the share of sports and outdoors retailers in shopping centres rose by 0.5 ppts compared to two years ago, while fashion retailers saw their share of retail space decrease by 2.3 ppts.

While expansion rates for mass market brands might have slowed, in some markets they are close to reaching a saturation point; some of these retailers have been growing steadily for five to ten years, which means there are few—if any—submarkets left untouched. These retailers, instead of opening new stores, are doubling down on their best locations, exploring new sales channels or trialling new concepts. H&M made its Tmall debut earlier this year, Gap opened several factory outlets, while Zara actively expanded Zara Home and launched new concept store to provide digital services.

Made for China

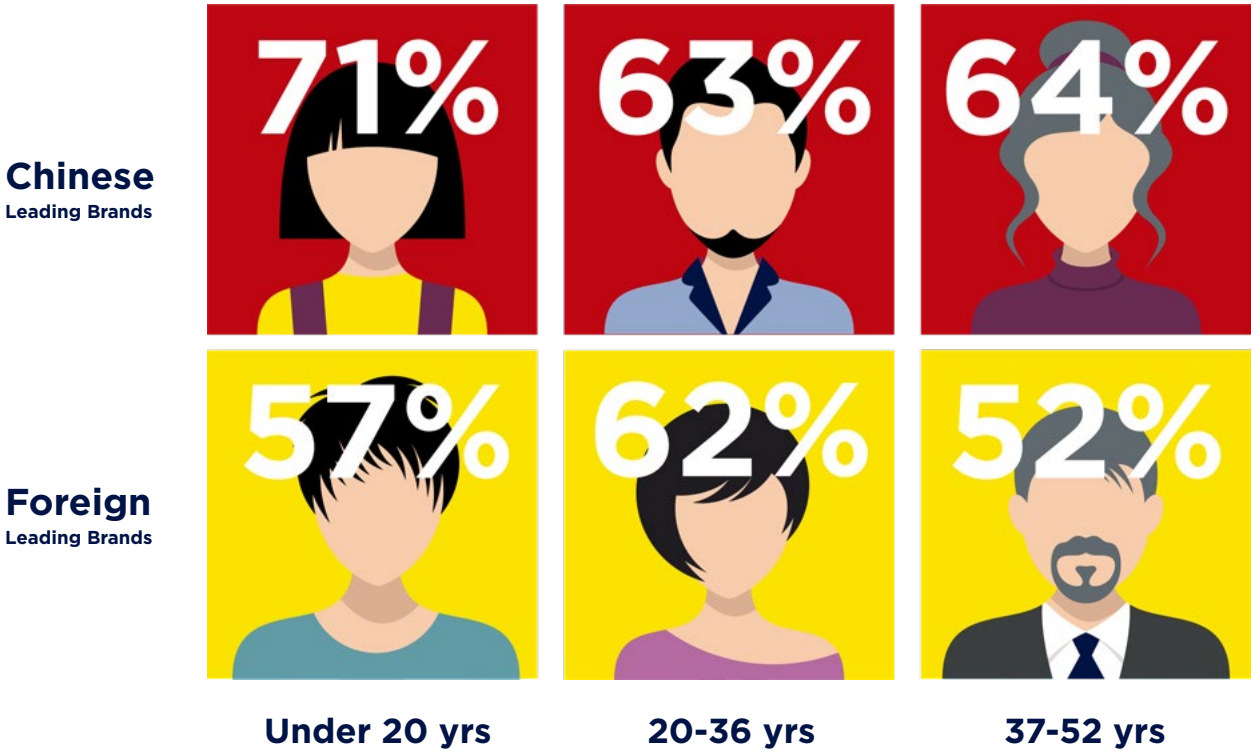
China is known over the world as the largest textile and apparel exporter. What started out as a manufacturing business, however, has gradually evolved into a retail industry as China develops its brands, trademarks and IP. Nevertheless, the lack of brand heritage and awareness has put domestic brands at a disadvantage to established overseas brands. In recent years, however, things are starting to change as domestic brands mature and gain support from internet giants. Some retailers are attempting to scale the value chain. One example is Anta SEED 2018 NASA 60th Anniversary shoes priced at RMB700-800, double or triple the price of its lower-end series. 10,000 pairs were sold online in the first 24 hours after launch.

The rise of domestic brands will likely wrestle market share from international retailers that are struggling to maintain growth in a saturated market. Home turf advantage, original concepts, shorter supply chains, speed to market, and indigenous style could tap into a new consumer market that is starting to surface.

As the novelty of international brands fades, more effort will be needed to enhance retailers' presence in China. Consumers in first- and second-tier cities are better-informed and experienced, while lower-tier cities have access to online resources. Retailers need to strike a balance between international trends and local tastes while exploring both online and offline marketing approaches.

A large number of international retailers have been lured to mature e-commerce platforms, such as Tmall and JD.com, to test the potential of expanding their business online. Those who have succeeded have no intention to become pure-play retailers. While many retailers are familiar with building an independent online platform in their home markets, more needs to be done if they want to get comfortable in a highly local online market as in China.

Figure 4: The percentage of customers with greater trust in retailers



SOURCE: A. T. KEARNEY, RETAILER WEBSITES

Food & Beverage

China's F&B sector recorded nearly RMB4 trillion sales in 2017. Shopping centres increasingly rely upon restaurants and other eateries to attract crowds. F&B now accounts for roughly 29% of a shopping mall's net leasable area (NLA) on average in the four first-tier cities. Recently completed malls have generally allocated more space to F&B tenants, taking as much space as half of total NLA for some malls.

Significant differences in palates and spending power have made it difficult for national operators to emerge. Those that have typically fall into one of three categories: fast food, hotpot and cafes. With over 5,000 restaurants, KFC is now the largest foreign fast food chain in China, while the largest hotpot chain is Xiabu Xiabu with over 650 restaurants. When it comes to coffee, Starbucks leads the way with roughly 2,800 stores, making China the company's second largest market after the US.

Over the past 12 months, foreign fast food and cafe chains grew store networks in the 20 cities surveyed by 12% and 18%, respectively. Shanghai, Hangzhou and Kunming recorded growth of over 15% in both sectors.

Western-style fast foods are increasingly creative in attracting consumers. KFC opened its first green-and-healthy store, K Pro, in Hangzhou. The store features an open kitchen as well as more salad and dessert options. McDonald's is also upgrading its restaurant interiors by making them brighter and livelier while optimizing layouts and customised services to provide a more enjoyable dining experience.

Consumers, spoilt for choice, are becoming increasingly discerning when it comes to eating out and, moving forward, F&B operators will continue to face fierce competition.

Diversity

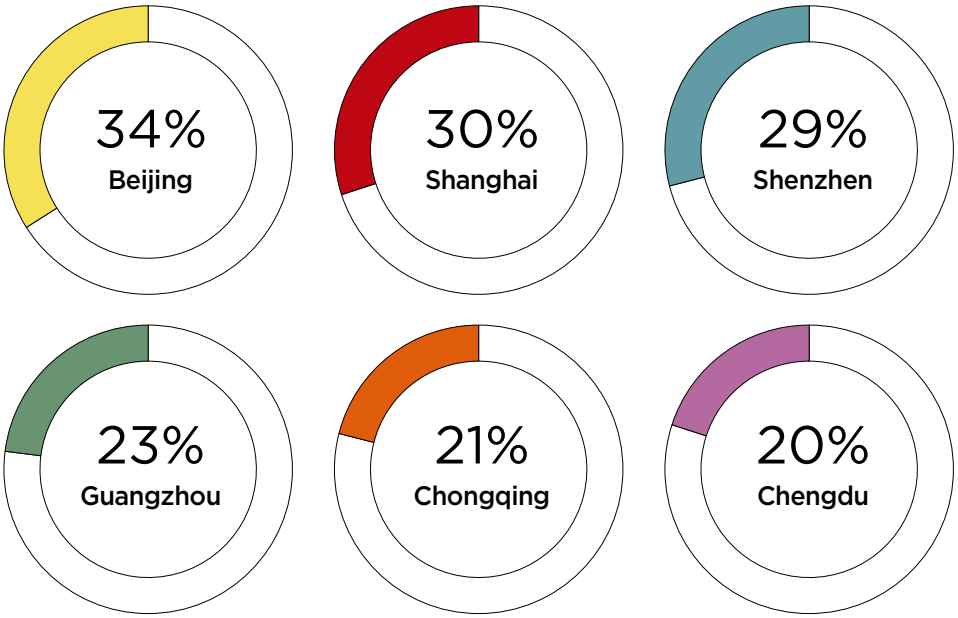
Chinese cuisine is an important part of Chinese culture, featuring "Eight Great Cuisines" among thousands of local delicacies. ("Eight Great Cuisines" are cuisines originating from Anhui, Cantonese, Fujian, Hunan, Jiangsu, Shandong, Sichuan and Zhejiang provinces.)The Chinese F&B market is still up for grabs with the sector dominated by a host of small and mid-scale operators; the top 100 chain F&B retailers accounted for just 7% of the total F&B market in 2017.

In Beijing and Shanghai, even the most popular cuisines only account for 12% of market share, while inland markets are more regional; for example, restaurants selling local food account for over 40% of the Changsha market. The diversity of a city's F&B market can be seen as an indicator of a market's maturity and could attract retailers looking to move into new markets.

The past few years have seen many more overseas F&B operators enter China, spanning a wide spectrum of subsectors and cuisines. Shanghai, in particular, has proved extremely attractive to international operators. Roughly three-quarters of new F&B outlets that opened in 2016 and 2017 were located in Shanghai, while Beijing, Hangzhou, Chengdu, Shenzhen and Guangzhou combined accounted for the remainder. New retailers include United States specialty coffee roaster Peet's Coffee, Ramen Naji from Japan, as well as The Butcher's Club from Hong Kong and Song Fa from Singapore—both Michelin-starred restaurants.

F&B retailers who have been in China for over three years are now seeking out new opportunities to expand their business, not necessarily in terms of the total number of locations but more in terms of exploring new city markets. Since 2017, Cova has opened locations in Guangzhou, Shenzhen and Changsha, in addition to their existing stores in Beijing and Shanghai. TWG Tea expanded to Beijing, Guangzhou and Xi'an while Michelin one-star Crystal Jade celebrated new openings in Wuhan, Suzhou and Xiamen.

Figure 5: Overall proportion of F&B tenants in shopping malls, 1H/2018



SOURCE: SAVILLS RESEARCH

Meet me at the coffee shop

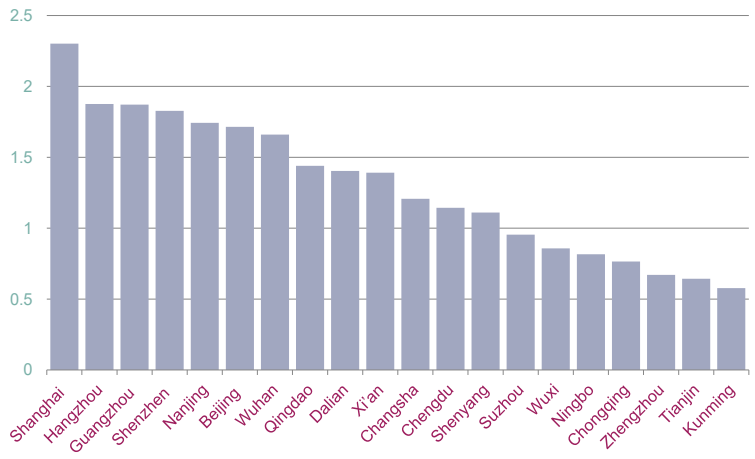
Starbucks and Costa Coffee both bought out their joint venture partners in China in 2017, as they redoubled their efforts in one of the fastest growing markets for coffee consumption. Coffee and tea imports recorded a 192% increase compared to five years ago, becoming the fastest-growing foodstuff category. Many believe that the market is still in its early stages of development and has the potential for sustained growth.

Like the fast food industry, the cafe industry is also dominated by a handful of international retailers capturing a wide range of Chinese consumers. Success did not come easy, however. There are numerous cases where retailers were too hasty in their expansion and lacked adequate quality controls which resulted in consumers losing confidence in the brand. Meanwhile, new concepts and business models backed by venture capital continually emerged, such as vending machines, online coffee delivery services and mobile coffee booths. Specialty coffee shops are also on the rise in leading cities to meet the increasingly refined tastes of pickier consumers. Beijing-based Greybox Coffee and Shanghai-based Seesaw Coffee have already completed Series A financing and established a good reputation through word of mouth. Overseas specialty coffee brands Peet's Coffee, % Arabica and Horiguchi Coffee also entered the market in 2017.

With competition brewing, even leading brands such as Starbucks are sparing no effort in launching new products, services and stores. In 2017, Starbucks opened a 2,700 sq m Starbucks Roastery Reserve in Shanghai, which brings a one-of-a-kind experience as customers watch the bean-to-cup story. The store has become one of the most popular retail attractions in the city, is enormously instagrammable and extends the brand's potential reach to the higher-end specialty market.

Shanghai, the most western dominated F&B market in China, has 2.3 coffee shops per 10,000 people, followed by Hangzhou at around 1.9 shops. The two leading coffee brands, Starbucks and Costa, have a combined market share of around 11% in each city. By contrast, Nanjing and Wuhan have 1.7 coffee shops per 10,000 people, with Starbucks and Costa combined accounting for only 7% market share. While more cafe operators seek opportunities in lower-tier cities, the market potential in some second-tier cities should not be overlooked.

Figure 6: Number of coffee shops per 10,000 persons, 1H/2018



SOURCE: DIANPING, SAVILLS RESEARCH

Retail Innovation

1 MULTI-BRAND, MULTIFACETED RETAILERS

More retailers are combining multiple categories within one store to attract consumers. Suning opened Jiwu in Nanjing, combining digital, home and beauty products within the 400 sq m space. The store also has a restaurant and juice and coffee service. Technologies such as facial recognition, VR and holographic display can also be seen throughout the store.

2 HOTEL RETAIL

Retailers are trying to integrate their products and brand image into real living spaces, bringing an impressive experience to consumers and potential lodgers. Muji opened Muji Hotel in Shenzhen and Beijing, where branded articles can be found in each room. The hotels also incorporates restaurants, bookstores and retail shops. Netease Yeation is cooperating with Atour which allows consumers to buy online the same products in rooms at the Atour Yeation Hotel. Retailers could potentially find more opportunities in the sector as more multi-family projects and hotels come to the market.

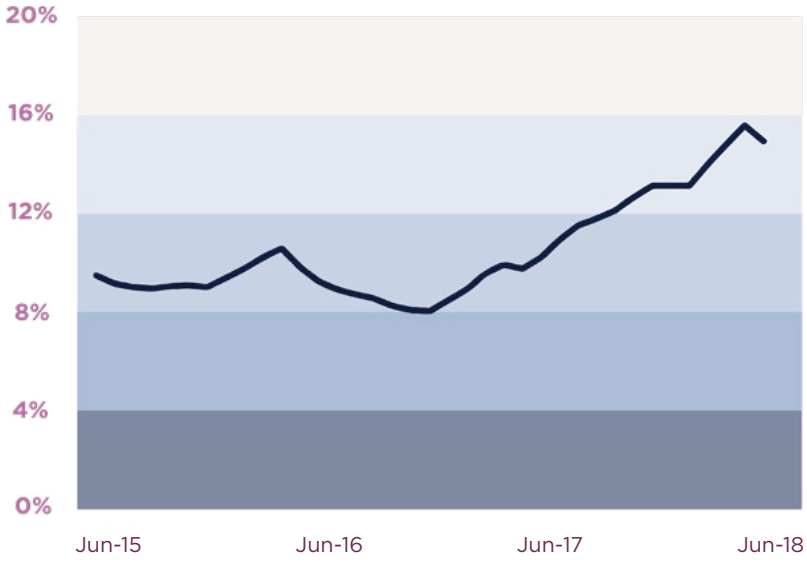
3 HEALTH RELATED

Health related categories retain a high popularity among consumers. It is not only fitness and healthy eateries, but also more niche sectors are emerging. Glo Kitchen + Fitness, which owns two stores in Beijing, combines healthy eateries and a Crossfit box. New Balance and Puma have also opened stores combined with gym spaces. Shopping malls are also re-planning existing space, combining a traditional anchor fitness centre with a number of specialised sports centres to meet the demand from more sophisticated consumers.

4 DEPARTMENT STORE BRANDED COSMETIC

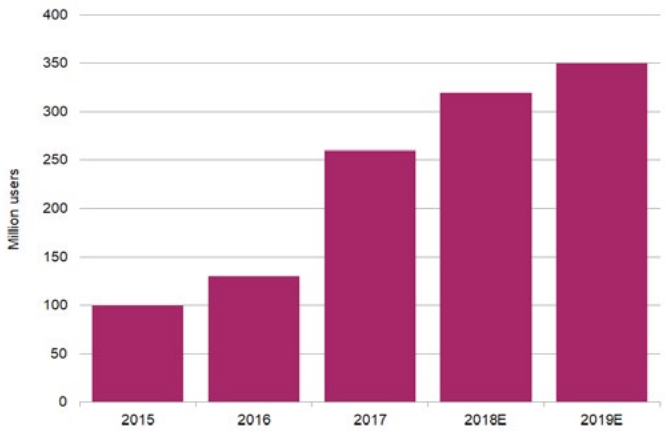
The cosmetic and personal care market has showed stronger growth in recent years compared to traditional apparel. High-end products are particularly welcomed by consumers. Traditional department stores are capitalising their long established relationships with brands in this sector and delving into new opportunities. Parkson opened Parkson Beauty in Changsha IFS and Isetan opened Isetan Beauty in Shanghai Jing'an Joy City.

Figure 7: Growth rate of skincare and cosmetic products, Jun/2015-Jun/2018



SOURCE: CEIC, SAVILLS RESEARCH

Figure 8: Revenue of offline entertainment, 2015-2019E



SOURCE: IRESEARCH, SAVILLS RESEARCH

5 OFFLINE ENTERTAINMENT

Online entertainment has already overtaken the offline market thanks to rich content and high penetration of mobile usage. However, the offline market sees huge potential for upgrading both its hardware and content. New types of entertainment spaces have already gained traction among younger consumers such as Cinker Pictures (三克映画), a social place screening independent movies and F&B offerings, and Good Time, combining E-sports, F&B, webcast rooms and Tencent IP. Other sports activities such as vertical wind tunnels and indoor surfing may also prove appealing to families.

6 BOTTOM PRICE

With mainstream e-commerce market saturating, some online players are turning to the discount market or innovative models such as social e-commerce. Pinduoduo, which recently listed on Nasdaq after only three years of phenomenal growth despite of fierce competition from e-commerce incumbents. Although the product quality has seen some complaints, its success proves that the low price range market is still full of opportunities considering 50% of Chinese families are reported with annual income lower than RMB69,700.

7 TECHNOLOGY LED

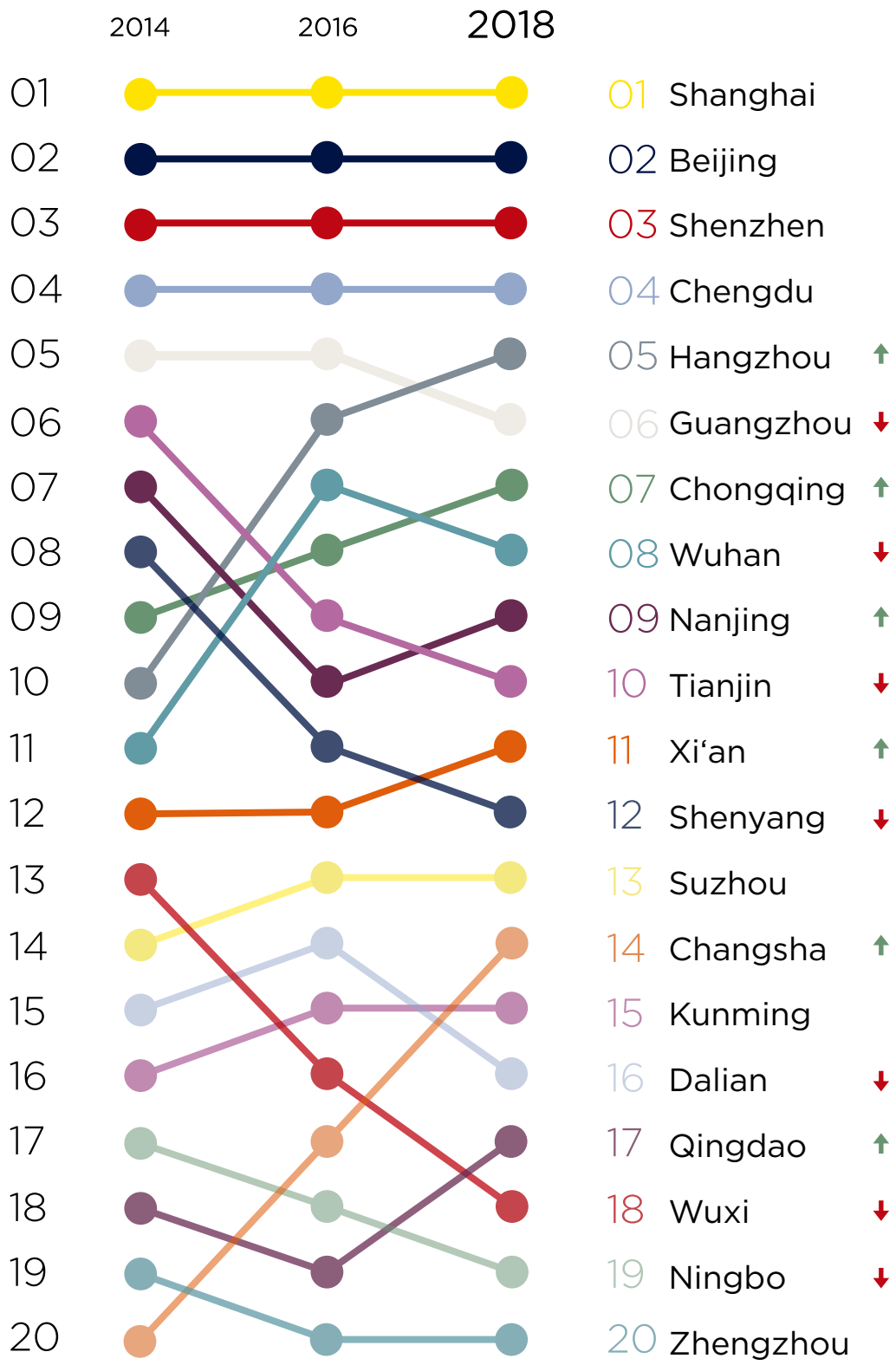
For some retailers, especially those started online, technology is constantly being introduced into physical stores to attract consumers. Kerr & Kroes cooperated with Tmall to introduce VR dressing rooms, facial recognition, and AI-style matching service in stores. Through background consumer data, the store can also arrange products and promotion plans based on accurate analysis of its customers' daily consumption behaviour. Although many platforms still have teething issues and sometimes look more like gimmicks, the technological retail trend is here to stay.

8 F&B SPECIALISATION

Small F&B outlets focusing on single segment of a particular cuisine are springing up everywhere. Indeed, consumers are now often faced with more than ten restaurants in a single shopping mall that only serve noodles. Mature F&B brands are launching new sub-brands with more affordable prices and a shorter menu such as "The Dining Room" by Shanghai Min and "Taste of Dadong" by Dadong. F&B specialisation helps the operators to achieve economies of scale, improve preparation quality and speed of service, while also reducing food waste.

Cities Aglow

Shanghai, Beijing, Shenzhen and Chengdu have been on top of the retailers index ranking for five consecutive years. While Hangzhou and Xi'an maintained upward moving, Changsha is the one that leaped most.



The Final Four

上海 SHANGHAI

北京 BEIJING

深圳 SHENZHEN

成都 CHENGDU

Future economic, business and societal prospects are going to increasingly rely upon technological advances, whether that be blockchain, AI, robotics or renewable energy production. According to Business Insider's top global 20 high-tech cities ranking, China's leading tech cities are Beijing (16), Shanghai (17) and Shenzhen (20). These cities also come out on top of the retailer index ranking, where they have maintained their top positions for the last five years.

Beijing, while still in second place behind Shanghai in the overall ranking, maintains a comfortable lead ahead of Shanghai when it comes to top-tier luxury store numbers. Beijing is also catching up to its peer when it comes to affordable luxury and premium beauty stores. Since the global financial crisis in 2008, Beijing's bank deposits (an indicator of a city's wealth) have recorded much higher growth than Shanghai while at the same time Beijing is home to 48 of the 100 most valuable Chinese internet companies. The tech and internet revolution, combined with the sustained growth of the services industry, has attracted VCs, PEs and angel funds and has created a phenomenal amount of new money, which has greatly supported the recovery and expansion of the luxury market.

Shanghai has seen more activity in the mass and mid-range markets. Shanghai has positioned itself as an international business and finance city as well as the bridgehead for the online retail market's expansion into the offline market given its proximity to Alibaba's headquarters. On top of this, the city is also a mecca for the F&B industry.

Both Shenzhen and Chengdu are expected to record annual supply levels in excess of over one million sq m for both 2017 and 2018. Both cities have maintained their respective third and fourth place ranking in the retailer index. However, third-placed Shenzhen slightly extended its lead over Chengdu thanks to the opening of two landmark projects—MixC World and Raffles City. Similar to Shanghai, Shenzhen saw very little activity in the luxury market over the past 12 months but recorded the highest rate of expansion in the mass and mid-range market among the 20 cities covered in this report.

Chengdu, on the other hand, has seen more openings of neighbourhood and community malls in the last 12 months and, as such, has focused more on the local retailers . During the past few years, the opening of landmark projects has sucked in leading retailers, concentrating them in one or two projects and areas in the city, placing a significant amount of pressure on other landlords to adapt and develop their unique selling points.

The Gainers

The new retailer index saw Hangzhou, Xi'an and Changsha rise in the rankings.

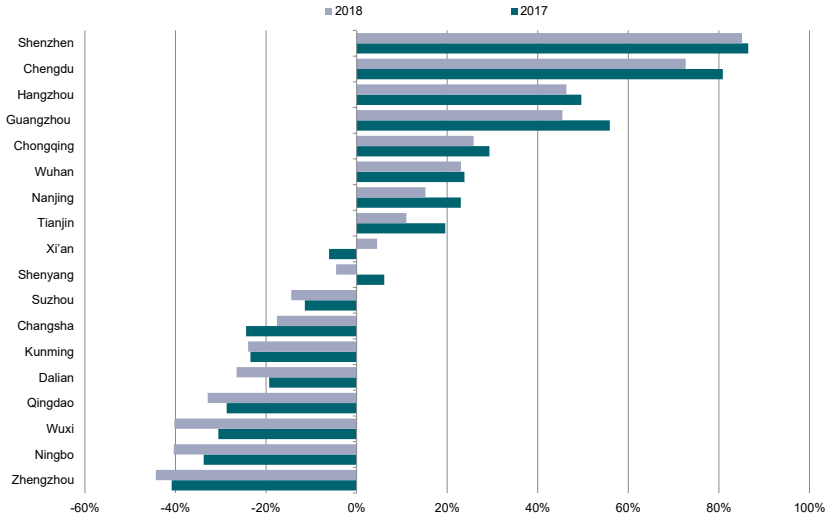
Hangzhou overtook Guangzhou to claim fifth place on the retailer index in 2018. Despite Hangzhou remaining weaker than Chengdu in the fashion category, the city showed more appetite for, and diversity in, its F&B offerings, with the second most coffee shops per capita after Shanghai. Hangzhou's existing retail stock is ranked only 16 out of the 20 cities, significantly lower than its retailer index score, giving developers confidence in the prospects and scope for expansion in the city. Indeed Hang Lung Properties spent RMB19 billion to acquire a centrally located commercial land plot to build a 194,000 sq m retail-anchored, mixed-use development, the equivalent of RMB55,300 per sq m, the highest price recorded nationwide since 2017.

Changsha is the only city out of the 20 that has been steadily and consistently moving up the rankings over the last five years (admittedly from the bottom of the pack). Best known for its prosperous entertainment market, Changsha's average retail sales per capita ranks fourth out of the 20 cities surveyed given its relatively small permanent population (No 16; 7.9 mn) and more respectable retail sales figures (No 12; RMB455 bn). The recently opened Changsha IFS is well received by the market as one of the first international developers in the city's retail market. The completion of the IFS mall gave retailers the opportunity to open new locations, catapulting Changsha up to 14th position on the retailer index. Nevertheless, the 2018 increase was driven mainly by luxury brands with the average store count per retailer increasing by 117%, while mass and mid-range brands expanded by just 12%.

Both Changsha and Wuhan, the other city in central China included in our analysis, have roughly the same number of luxury and affordable luxury stores. Nevertheless, Wuhan, the bigger of the two with a population of 10.9 mn, has close to 25-40% more stores from the mass and mid-range brand segments while also surpassing Changsha by roughly 30% in terms of economic indicators such as retail sales and tourism income. Whether Changsha will continue to punch above its weight in the luxury segment will depend on the impact the new store openings have on existing store networks and whether or not competing projects can match the quality of the retail environment offered by Changsha IFS.

Xi'an is the only city to rise in both the economic and retailer index rankings in 2018. Xi'an recorded an expansion rate of over 20% in six out of the eight retailer categories. Last year the city was very publicly making an effort to attract a talented workforce as well as marketing the city as a whole through an array of "#Xi'an" popular videos on Douyin App—a popular short video sharing mobile app in China, known as Tik Tok outside of China. Of the six central and western cities included in the survey, Xi'an saw its Baidu search index surpassing that of Chongqing as the second most searched cities after Chengdu. Xi'an saw its permanent population increase by 800,000 over the last two years, while another 210,000 individuals registered their Hukou in the city in the first three months of 2018. To meet the increasing needs of the expanding population, Xi'an will see 950,000 sq m of premium retail supply completed in the coming eight years, the second largest supply expected of the 20 cities, after Shanghai.

Figure 9: Retailer index gap: City VS 18-city median* (excl. Shanghai and Beijing)



This chart excludes Beijing and Shanghai.

SOURCE: DIANPING, SAVILLS RESEARCH

The Outsiders

International brand exposure in China is not limited to these 20 cities but extends much further into the hinterlands of China. Starbucks is reported to have about 3,300 stores in 141 cities in China and employ 45,000 staff. Apparel brands such as Uniqlo and H&M already cover over 100 cities and all stores are self-operated.

Certain retail segments have penetrated different cities to different extents. Foshan is awash with fast food chains to the level that would have placed it on a par with some cities in the top 20, while mid-range fashion brands' penetration rates would place it closer to 30th. Meanwhile, Guiyang ranks in the top 20 for mid-range fashion but closer to 30th when it comes to fast food.

Recent fortunes have not favoured all cities equally. While Shenyang and Dalian continue to slip down the rankings, Harbin, another leading city in Northeast China, has performed better in both economic and retailer terms. In 2018, Harbin could have been ranked 20th in both indicators, only a stone's throw from its peers. Harbin, the capital city of Heilongjiang, accounts for almost a third of the provincial population, while it is also the only city in Northeast China with a population of over 10 million. Nevertheless, given the recent economic hardships suffered by many communities in the north east, it is hard to predict the prospects for the city.

Further to the south, in Fujian province, Xiamen and Fuzhou both have much rosier prospects. Xiamen is much smaller than any of the other cities in the survey at only 4.0 million people, and 41% smaller than Kunming, the next smallest city in our survey. While economic indicators fail to match up with the other cities given its smaller population, the city's openness, climate, historical and leisure qualities result in the minnow city recording impressively high figures for income per capita, tourism income and airport passenger throughput. Xiamen also has the highest number of coffee shops per capita among the main cities, adding additional flavour to the city's overall retail environment.

Fuzhou is a more typical city—an active coastal city of 7.7 million people that has relatively balanced economic indicators and healthy store count in the various retail categories. Further south still, Foshan and Dongguan, in Guangdong Province, recorded similar economic indicators to Fuzhou, but have less developed retail markets, possibly given their proximity to Guangzhou and Shenzhen.

New Beginning

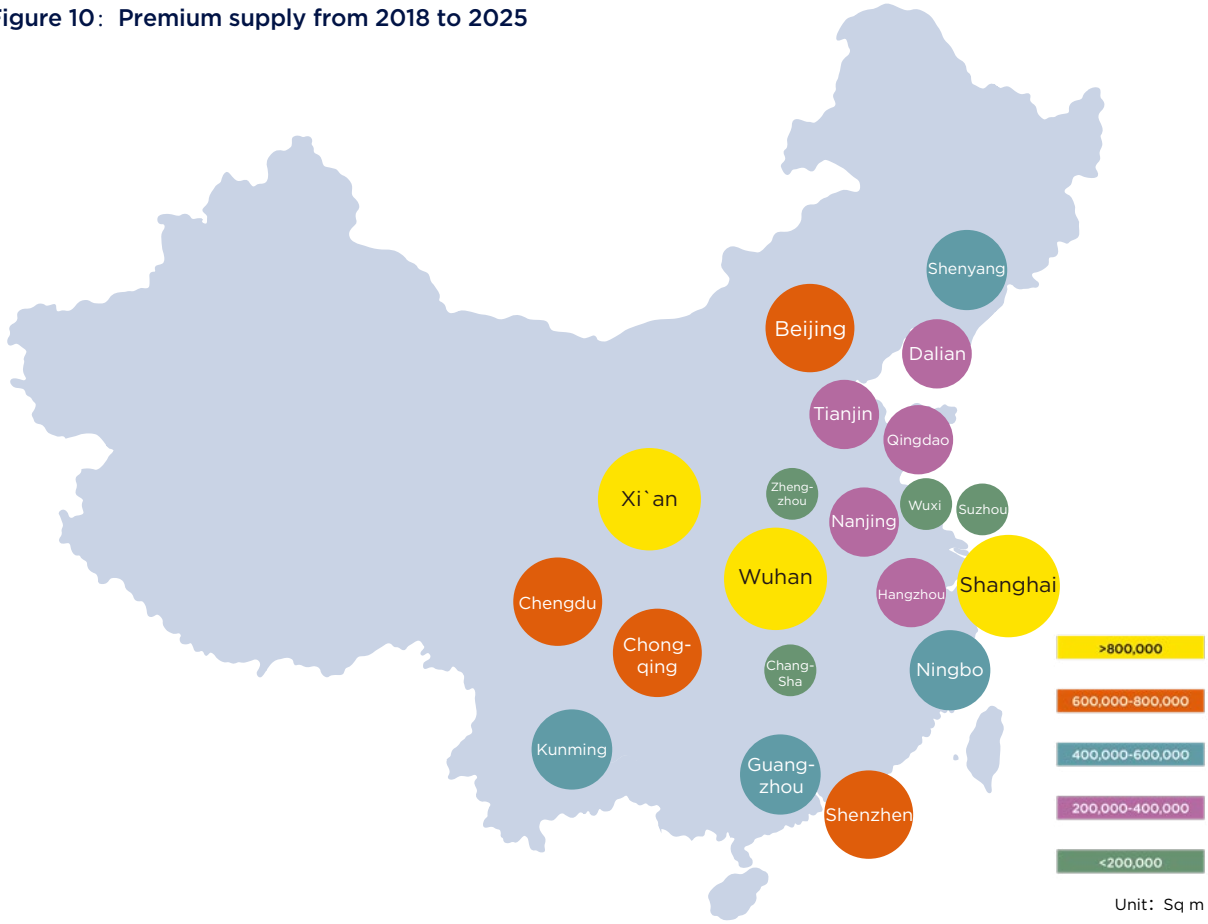
The changes in a city's retailer index often denote the opening of new landmark projects. Particularly in central and western regions, the opening of new international-level projects in Xi'an and Changsha have helped the two cities enhance the overall retail atmosphere and bring them closer to other key cities in China.

A look at the 12 leading retail developers and their existing and future projects shows us that all of the 20 cities covered now have at least one international-level project. Now that all cities have good quality retail stock available for retailers—something that previously was not true—how do retailers differentiate opportunities between the cities? Retailers will have to gauge the response from consumers to the malls and enhanced retail offering to see if they evolve/change their consumption habits in line with the upgraded retail offering. If this is the case, an argument may be made for continuing growth of the retail market beyond the original mall.

In the coming eight years, four of the five cities with highest premium supply are from central and western China, namely Xi'an, Wuhan, Chongqing and Chengdu. Compared to Wuhan, Chengdu and Chongqing's retail stock are already sizeable, having seen their markets proliferate in the last five years and should be able to accommodate the new supply. However, whether or not Xi'an can accommodate all the new projects will still have to be seen.

The second tier cities of the Yangtze River Delta – Suzhou, Ningbo and Wuxi – are expected to develop along different lines than central and western cities. These cities are not provincial capitals and they have not seen their retail markets grow as rapidly as some of the central and western cities. International retailers and developers also entered these markets much earlier, with their supply peaks proving to be less challenging. The question for these cities will be less about how the market absorbs new supply and more about how they can revitalise existing stock and uplift the overall retail environment while keeping their individuality.

Figure 10: Premium supply from 2018 to 2025



SOURCE: SAVILLS RESEARCH, INCLUDES RETAIL PROJECTS OF 12 MAJOR DEVELOPERS

City
Development

Community: Where the heart is

The addition of premium quality retail developments in various cities and the upgrade in retail offerings have led consumers to expect more from the city's existing stock. Investors are looking for ways to capitalise upon this demand through the renovation and revamping of smaller retail development in prime locations, but this often proves to be tricky and time-consuming as a result of prolonged planning permission.

From 2000 to 2017, Chengdu expanded its urban construction area three-fold while also attracting five million new residents. Construction of new neighbourhoods and support from the local government continues to create more job opportunities and attract more residents to the city's suburban business districts and residential communities. Increasing densification of these areas has also given rise to retail hubs with community and neighbourhood malls launched to service the growing population.

Chengdu's urban area saw the completion of five new community malls in 2017. With a total retail GFA of 378,000 sq m, these projects accounted for 63% of new retail supply. Developers include Chengdu-based Huasheng Investment, Chinese developers C&D and Future Land as well as Singapore's CapitaLand. Most community malls offer leasable areas of around 30,000 to 40,000 sq m and are well-suited to meet the full range of needs for the surrounding residents.

Even some smaller projects are catching the attention of the market. These compact projects are smaller than 30,000 sq m retail GFA and are built to provide more convenience and leisure options to the consumers. The list includes Pebble Walk and Joy Street which created leisurely outdoor spaces to service the surrounding neighbourhood, as well as UniFANs and Shimao Mini Mall which are podiums of office buildings and mainly serve the office workers. Upark+, a new project opened in 2018, also incorporates a 600m running track around an outdoor park. Consumers can enjoy sports activities, art space, dining and landscape all in one location.

These community and neighbourhood malls are likely to become fixtures of the market in the future. Retail centres as a whole have evolved from department stores to mid-sized retail centres as part of mixed-use developments, to mega malls hosting everything under the sun and now to smaller scale retail centres that offer more targeted, customised services and product offerings within a community. While this may prove challenging, it has a better chance to stand out from the crowd than a generic all-in-one retail mall.

Diamonds in the Rough

The past five years have seen 85 new retail centres open in Shanghai with only five of them located in prime retail areas. Retail development in city centre locations has decidedly shifted from new build to renovation. Old factories, disused R&D buildings and historical structures all have potential appeal. Since 2016, there have been quite a few renovated projects launched onto the market in prime locations. Even projects in non-prime retail areas are planning to incorporate historical aspects during renovations or integrated into new projects.

The assimilation of historical structures lends greater character to a retail project and gives consumers a pleasant surprise and contrast to newer developments. Backstreets and secondary streets of main high streets have already been able to attract international mainstream brands. In 2017, Prada launched Rongzhai, a renovated 2,000 sq m historical garden house, as a brand exhibition and art space, and the project is located only 100m away from its flagship store on Nanjing Road (W). Fengshengli, located on Maoming Road (N), just off Nanjing Road (E), has not only gathered overseas F&B brands such as Goose Island and Taco Bell, but also saw one of its walls painted with works from Gucci Art Wall.
Further afield and often in secluded locations, these boutique projects are often used by niche brands as a launching pad for the China market. Menswear brand Gentspace opened its first store at Jianyeli, a large preserved Shikumen area; furniture brand Zaozuo and designer brand Urlazh entered Xingfuli, which was originally the office of Shanghai Institute of Rubber Products built in 1970s; specialty café % Arabica opened its first store in mainland China in Ferguson Lane in former French Concession; Blackbird, a popular brunch restaurant, has relocated to Columbia Circle near Jiaotong University which used to be the social hub for Americans in Shanghai in 1920s.

The success of rejuvenated boutique projects relies on integration and connectivity with the surrounding environment and communities. The issue of property ownership and transition of usage type can also prove to be very challenging. However, the success of these smaller projects could led the way to a new type of retail format celebrating a city's history and architectural legacy.

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