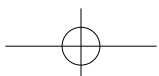


China Research - 2021

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Hainan Retail



HAINAN

A PIONEER IN TOURISM RETAIL

The retail market in Hainan has been on a steady upward trajectory, driven by local consumption and duty-free growth since 2011 when the Hainan off-island duty-free policy was first introduced. In 2020, a combination of travel restrictions, the reshoring of luxury spending and new duty-free policies helped Hainan record a 1.2% year-on-year (YoY) growth in retail sales, 5.1 percentage points (ppts) above the national average, which brings the total value to RMB197.5 billion. Boosted by duty-free and automobile sales, Hainan has seen a strong recovery in consumption, where the retail sales of enterprises above designated size rose by over 20%, while cosmetics and jewellery sales surged over 100%.

Tourism, one of Hainan's twelve key industries, is the third-largest tertiary-sector industry after real estate and education, accounting for 7.3% of Hainan's GDP in 2020. The strategic positioning of Hainan as an international tourism and consumption centre means tourism retail and tourist consumption will remain a focus of policymaking and industry development. Hainan has accounted for a growing share of duty-free sales in China since 2011. The nearly absent international travel in 2020 and the subsequent impact on duty-free sales at airports in Beijing and Shanghai means Hainan's share in duty-free sales could exceed 50%, up from 25% in 2019.

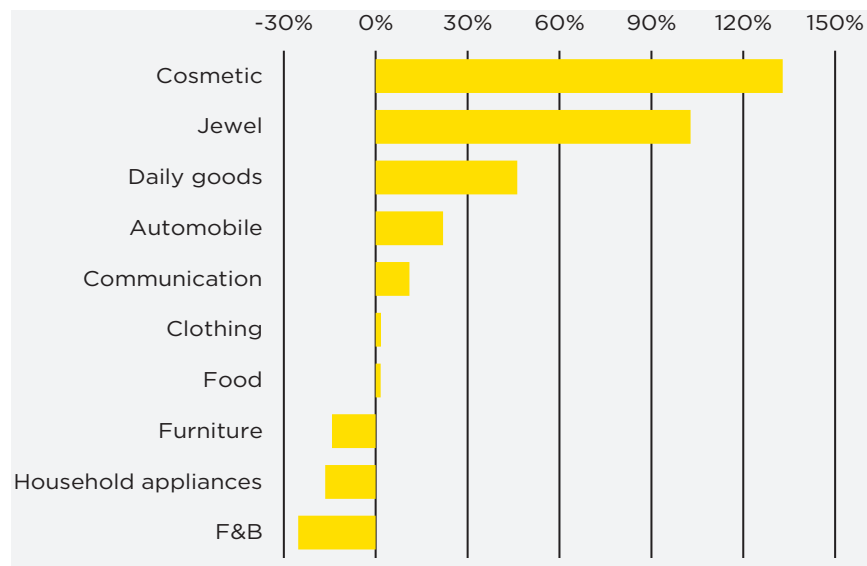
Haikou and Sanya are the two largest consumption markets in Hainan, accounting for 42% and 19%, respectively, of Hainan's total consumption in 2020. They are also

among the few cities in Hainan to recover rapidly from the pandemic, with YoY increases in retail sales—1.5% for Haikou and 12.1% for Sanya.

Hainan aims to roll out a zero-tariff regime across the island by 2025 when imported goods outside the imported taxable commodities catalogue will be exempt from import duties, according to the Master Plan for the Construction of Hainan Free Trade

Port (hereinafter referred to as “the Master Plan”) released in June 2020. The thriving duty-free scene in world-class destinations like Hong Kong and Dubai means there is much potential for Hainan over the longer term. The overall retail market, on the other hand, will likely see accelerated growth as household income increases on the development of emerging industries and the inflow of talented young people.

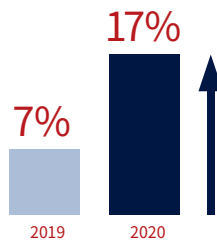
Retail Sales Growth YoY In Hainan, 2020



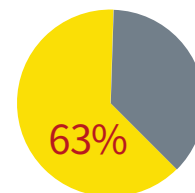
Source: Hainan Bureau of Statistics, Savills Research



Duty-free shops in Hainan recorded a 127% sales growth in 2020 (including related tax-paid sales)



Duty-free shops (tax-paid sales included) accounted for 17% of retail sales in Hainan in 2020, up from 7% in 2019



Haikou and Sanya accounted for a combined 63% of retail sales in Hainan in 2020



DUTY-FREE MARKET EXPANSION

Hainan's off-island duty-free policy, developed for tourists leaving the island (excluding tourists leaving the country), has loosened up over several adjustments since its introduction in 2011. Following the latest announcement that took effect on July 1st, 2020, the annual off-island duty-free allowance has been raised to RMB100,000 per person from RMB30,000, while the range of tax-free categories has been expanded from 38 to 45, adding electronic products and liquor, with a limit on the number of items purchased per visit for cosmetics, phones and liquor only.

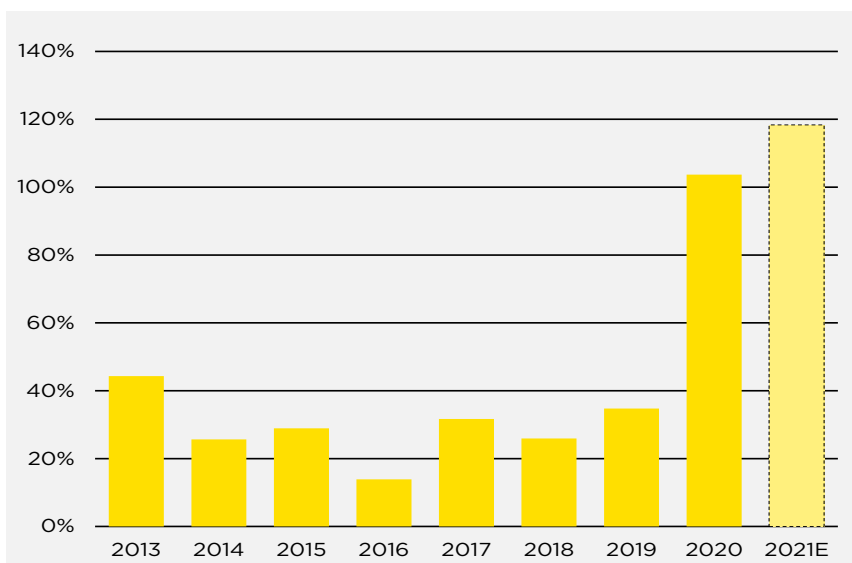
The new policy also allows qualified vendors to sell tax-free goods and take part in duty-free shop operations, which has led to a rapid increase in the number of brick-and-mortar duty-free shops. As of January 2021, Hainan has opened nine duty-free shops—four in Haikou, four in Sanya and one in Qionghai. Except for two at airports (Haikou Meilan Airport and Sanya Phoenix Airport), the other seven duty-free shops are all located in downtown areas.

Hainan has also brought mail delivery services for tourists to the island, in addition to the older option of pickup at airports when leaving the island; Hainan residents who purchase duty-free goods before leaving the island can choose to collect items when they return to the island. These pickup-facilitating measures are expected to boost duty-free sales going forward.

Multiple favourable policies have made Hainan a major destination of high-end consumption that would otherwise happen overseas. In 2020, duty-free sales in Hainan totalled RMB27.5 billion, which means a 14% share of full-year retail sales in the province and a sharp year-on-year increase of 104%, in contrast to an annual average growth of 27% over 2015 to 2019. Total sales at duty-free shops, including related tax-paid sales,

amounted to RMB32.7 billion in 2020, up 127% compared to 2019. According to Bain & Company estimates, duty-free shops in Hainan contribute 7% to 9% of total luxury sales in China in 2020. Hainan aims to attract RMB300 billion worth of duty-free sales during the 14th Five-Year Plan period (2021-2025), which means an annual average of RMB60 billion.

Duty-Free Sales Growth In Hainan, 2013 to 2021E



Source: Haikou Customs, Savills Research

THE DUTY-FREE BOOST

Duty-free operations in China are subject to government regulations. According to GACC measures (No.132) issued in 2005, operation entities refer to enterprises approved by the State Council (or its authorised departments) that are qualified for engaging in the business of duty-free goods, and they need to undergo a strict examination procedure for a license to run duty-free shops. Prior to 2020, only seven enterprises had been authorised to operate duty-free businesses, with no new licenses issued in eight years. In June 2020, Wangfujing Group was awarded a license to sell duty-free products, while Hainan Tourism Investment Development and Hainan Development Holdings both received an off-island duty-free trading license in August. So far, only China Duty Free Group (CDF) is entitled to establish all types of duty-free shops, including airport, harbour, off-island and downtown shops.

COOPERATION AND COMPETITION

Prior to July 2020, the Hainan duty-free market was solely dominated by China Tourism Group that operated through subsidiaries CDF and Hainan Duty Free (HDF) with only four duty-free stores. As the duty-free effect starts to play out, the Hainan government is bringing in more duty-free trading entities with new licenses in a bid to enhance market competitiveness and operational capabilities and to further attract consumption and invigorate the market.

CDF, with a market share of nearly 90% in China, enjoys a well-established presence in Hainan, where all its projects and shops sell self-sourced products. CDF expects to see competition from provincial-level state-owned enterprises in Hainan and operational entities from other parts of China. New entrants are likely to partner with more experienced players with competitive product offerings to secure market share.

Notably, most duty-free projects in Hainan (except for those at airports) are in shopping centres developed by the operators. It requires more than a license to sell duty-free products for the projects to succeed. In addition to a wider range of product offerings, operators also need to improve the overall retail space and bring in a more diverse mix of retailers to provide an enjoyable shopping experience. It is essential to offer experiential entertainment that caters more to tourists.

Competitive Advantage Is Obvious For Hainan In Terms Of Duty-Free Allowance

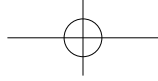
	Annual Off-island Duty-Free Allowance*
Hainan	RMB100,000
Jeju Island	Approx. RMB3,900 per person and an annual limit of six purchases
Okinawa	200,000 yen (approximately RMB12,500); unlimited purchases
Matsu/Kinmen	RMB23,000 per person and an annual limit of 12 purchases (to the island of Taiwan) RMB230,000 per person; unlimited purchases (to mainland China)

Note Currency conversion based on exchange rates on December 31st, 2020
Source Savills Research

Selected Licensed Duty-Free Operators And Respective Suppliers

Licensed operator	Supplier	Duty-free scope	Project
Hainan Development Holdings	Dufry	Off-island duty free; Duty-free for local residents	Global Premium Duty Free Plaza
Shenzhen Duty Free Group	DFS	Off-island duty free	Haikou Mission Hills
Hainan Tourism Investment Development	Lagardère, JD	Off-island duty free; Duty-free for local residents	Sanya Hailv Duty Free Shopping Centre

Source Savills Research



IN-ISLAND DUTY-FREE POLICY ON THE HORIZON

There remains a void in duty-free policies for Hainan residents as of March 2021. Nevertheless, the island is seeking to implement a zero-tariff policy on certain imported goods, which is one of the key tasks to be completed before 2025, according to the Master Plan. Positive list management will apply to imported goods consumed by residents in Hainan without charging tariffs, while goods and items under the zero-tariff list management will be exempt from import duties, import value-added tax and consumption tax. A positive list of imported goods will be available soon and apply to locally consumed imported goods only, mostly daily necessities.

The in-island duty-free policy, currently at its exploratory state, will be a strong complement to the relatively established off-island duty-free sector. It will give another boost to duty-free sales in Hainan and, more importantly, pave the way for the implementation of independent customs operations and zero-tariff policy throughout the island.

The in-island duty-free market has garnered strong interest from major players in the e-commerce sector. Cross-border online platforms are particularly well-placed to tap into the offline duty-free market by leveraging their existing strength in product

offerings and operation. JD Worldwide, the import e-commerce platform of JD.com, has opened a duty-free store at Sanya Hailv Duty Free Shopping Centre that mainly sells electronics and digital products. In the future, JD Worldwide will continue to work with Hainan Tourism Investment on imported daily products for local consumption in Hainan to provide a more convenient shopping experience for residents.

THE RETAILER PERSPECTIVE

We talked to a selection of luxury retailers, agencies and developers to understand their take on the Hainan market. Almost all retailers surveyed see a positive future and show a keen interest in Hainan after the launch of an independent customs regime. They have also expressed concerns over independent customs operations given the lack of precedent.

Brands		Will continue to focus on duty-free shops over the short term
		Will prefer projects by top-class developers for shopping centre free-duty shops
		Might allocate specialised management teams for the Hainan market after the implementation of island-wide independent customs operations
Developers		The policy remains unclear for the transition from pilot to full implementation of island-wide independent customs operations
		Have already actively sought suitable land plots to develop large scale shopping malls

A “TWIN-CITY” GROWTH ENGINE

HAIKOU

Department stores were among the earliest retail projects in Haikou, the capital city of Hainan, and they have remained popular among residents thanks to superior locations and diverse brand offerings. However, new developments have been exclusively shopping malls since 2016. This has resulted in a gradual change in the structure of the Haikou retail property market, where shopping malls dominate with a total stock of 1.2 million sq m.

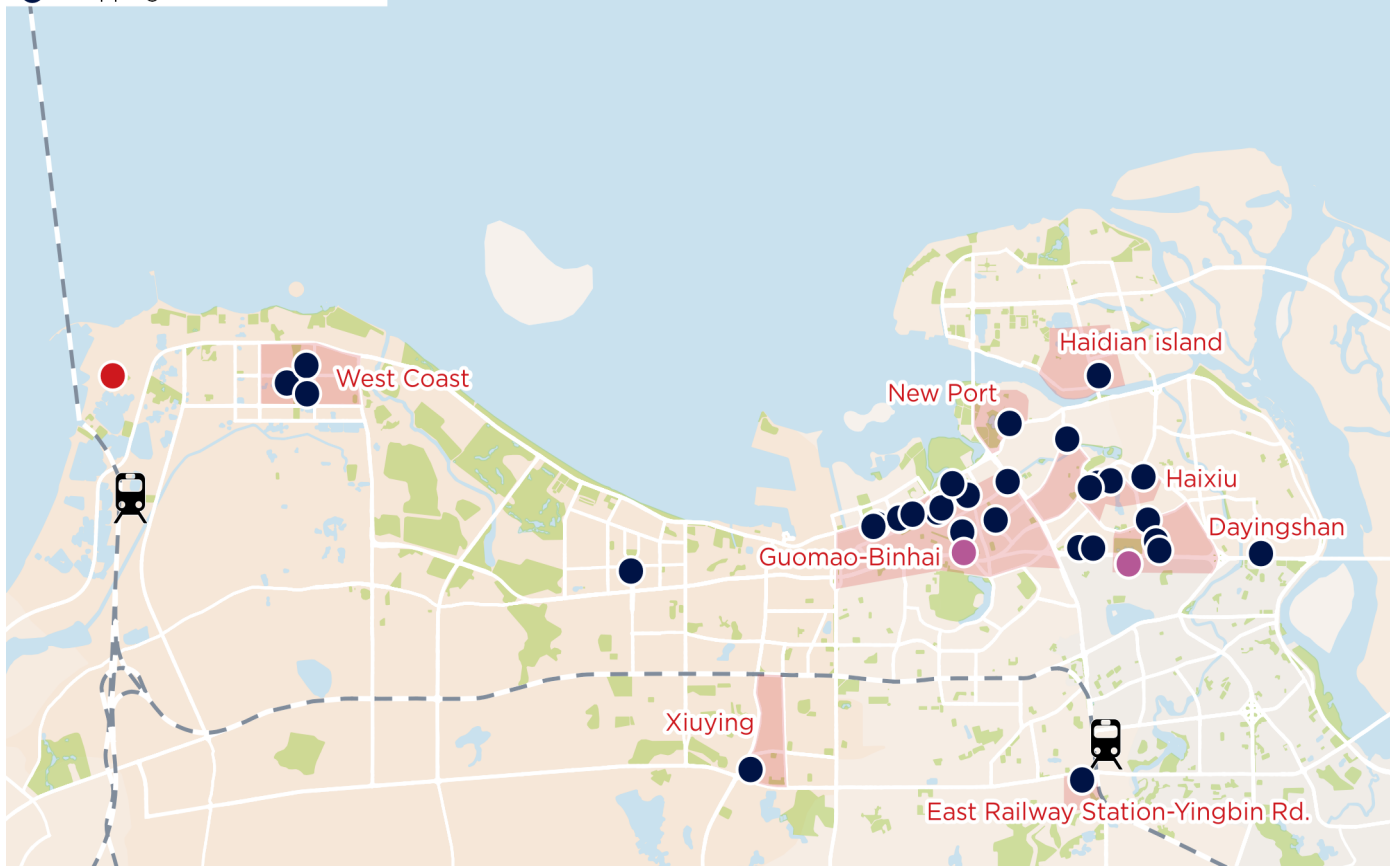
There are 10 major retail areas in Haikou, including four prime areas of Jiefang Rd, Guomao-Binhai, Haixiu and Dayingshan. The oldest among them are Jiefang Rd and Haixiu in downtown areas that have gradually developed on the back of concentrated urban consumption, while Guomao-Binhai and Dayingshan have benefited from the development of central business districts. Emerging retail areas are the result of new district planning, such as West Coast, or feature a concentration of large shopping malls around large residential projects or regional development projects, such as East Railway Station-Yingbin Rd, Xiuying and Mission Hills.

Most retail areas saw vacancy go up during the pandemic as projects struggled, especially those that were already underperforming prior to COVID-19. Citywide vacancy rate grew by 4.3 pts YoY to 16.9% by the end of 2020, while rent decreased to RMB340.6 per sq m per month. Nevertheless, favourable policies and improved market confidence mean the capital city will see an increasing number of well-known brands and operators explore new opportunities or expand market presence, which will bring new growth momentum for the retail market.

The Haikou retail market is expected to continue to expand, supported by new large shopping malls from well-known developers, such as China Resources, Longfor and OCT Group. The significant growth of shopping mall space will provide more choices for both domestic and international retailers.

Legend

- Duty free shop
- Duty free shop + shopping mall
- Shopping mall



SANYA

While COVID-19 has hit international tourism, Sanya has attracted numerous tourists on the effective pandemic containment and swift recovery in the domestic market. This, combined with improved consumer sentiment, has made Sanya one of the most popular tourist destinations in China. The passenger traffic at Sanya Phoenix Airport recorded monthly increases for five consecutive months from August to December in 2020.

Sanya's retail property market features a mix of property types, including shopping malls, department stores, retail streets, duty-free stores and outlets. Shopping malls account for the largest share with a total GFA of 424,000 sq m, and citywide vacancy rate was at 15.7% in 2020. Supply levels have remained stable but limited for many years. In the meantime, the retail property market is transitioning from a traditional department store-led model to a shopping centre-led model, bringing quality enhancement opportunities for shopping malls moving forward. While consumers are awaiting an upgrading of retail amenities, department stores and

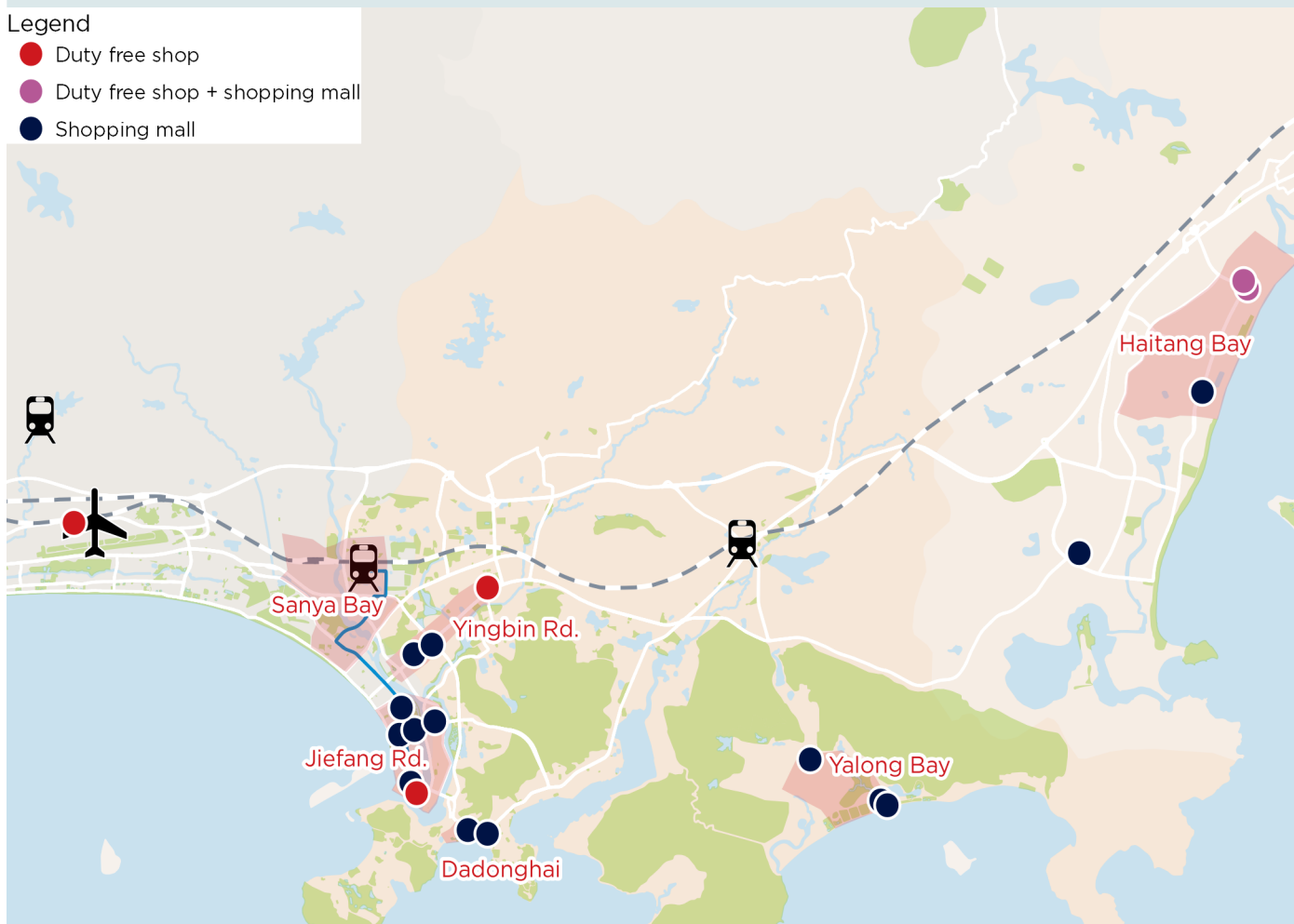
commercial ancillary stores remain the most-favoured venues for the time being for shopping and entertainment among residents.

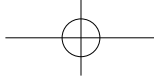
There are six major retail areas in Sanya, which are scattered mostly at the bay areas. Among them, Jiefang Rd and Dadonghai are the oldest, mainly serving local neighbourhoods. Sanya Bay, Yalong Bay and Haitang Bay areas are highly dependent on tourists, with Haitang Bay holding a higher positioning than the other two. Yingbin Rd area is well-placed to benefit from the development of Sanya's headquarters economy and central business district.

Sanya's economic dependence on tourism means tourist spending is the main driver of its retail market. Shopping malls that target tourists or feature an experiential theme (e.g., F&B, leisure and entertainment) will gradually rise to dominance in the local retail market. Duty-free shops and outlets, on the other hand, will also attract more shopping tourists with a wide variety of branded products at more competitive prices.

Legend

- Duty free shop
- Duty free shop + shopping mall
- Shopping mall





RESEARCH

James Macdonald

Senior Director - China

+8621 6391 6688

james.macdonald@savills.com.cn

Chester Zhang

Director - China

+8621 6391 6688

chester.zhang@savills.com.cn

Carlby Xie

Director - Southern China

+8620 3665 4874

carlby.xie@savills.com.cn

CENTRAL MANAGEMENT

Siu Wing Chu

China Chief Executive Officer

+8621 6391 6688

siuwing.chu@savills.com.cn

Woody Lam

Managing Director - Southern China

+8620 3665 4777

woody.lam@savills.com.cn

Cindy Wu

General Manager - Hainan

+86898 3638 4226

cindy.wu@savills.com.cn

RETAIL

Joey Chio

Senior Director - China

+8621 6391 6688

joey.chio@savills.com.cn

Dorian Zhi

Senior Director - Southern China

+86755 8436 7036

doriandl.zhi@savills.com.cn

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