Quarterly Review

SINGAPORE | RETAIL

Q2 2016

22 July 2016

Accelerating success.

A relatively more positive quarter

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Leasing activity has picked up and the rental decline has slowed in Q2 2016. However, as the economic headwinds persist, we expect retailers to remain cost-sensitive. We think landlords should adopt proactive asset management strategies and focus on tenant retention and attraction in the coming quarters.

Forecast at a glance*

Demand

Demand should be supported by retailers looking for opportunities to secure choice units or expanding their physical retail footprint.

Supply

New supply could potentially increase in 2016; almost all supply will be located outside Orchard Road.

Vacancy Rate

We expect overall demand to lag supply. But vacancies at well managed malls with good locational attributes and immediate catchment population are likely to stay low.

Rent (ground level shopping mall rents)

RENT

Orchard Road: Fall by up to 2% in 2016
Regional Centres: Fall by around 1% in 2016

Price

Orchard Road: Fall by up to 2% in 2016
Regional Centres: Fall by up to 2% in 2016

*Refers to full year 2016 forecasts

Opportunities for landlords and tenants to position for future growth

In the wake of the heightened economic uncertainties following Brexit, intensifying competition for the retail dollar and manpower challenges, we expect most retailers to stay selective and cost conscious with regards to their physical space requirements going forward.

We also anticipate that landlords will maintain realistic rental expectations and stay flexible during lease negotiations, with a focus on tenant retention and attraction.

As such, we foresee a further softening in prime ground level shopping mall rents in H2 2016.

However, the easing rents bode well for local and foreign retailers which are keen to set up shop, relocate or expand their physical footprint in the coming months.

In addition, there should be opportunities to secure previously unavailable prime retail spaces at more affordable rental levels. Such spaces are likely to be freed up by existing retailers drawing up new strategies, consolidating and “rightsizing” their operations.

Meanwhile, we believe that landlords will stay focused on asset enhancement and mall repositioning initiatives to stay competitive in the face of falling rents.

By moving away from “cookie cutter” tenant mixes and investing in platforms to enhance the overall shopping experience, landlords should be able to strengthen the positioning of their malls, attract more visitors and generate more sales for the tenants.

However, we expect the decline in rents and cautious buying sentiment amid the persistent economic uncertainties to continue to weigh on the average capital values of prime retail space in H2 2016.

Leasing market and rental values

Leasing momentum picks up, while pace of rental decline slows

After a slow first quarter, the retail leasing segment saw more transactions in Q2 2016. According to available rental records sourced from the Urban Redevelopment Authority's Real Estate Information System (URA REALIS), there were a total of 2,382 retail leasing transactions in Q2 2016, up 35.6% compared to the 1,757 transactions a quarter earlier.

However, the 4,139 leasing transactions in H1 2016 were 19.6% and 17.2% lower than the 5,148 and 4,996 leasing deals closed in H2 2015 and H1 2015, respectively.

Notwithstanding the more active leasing segment in Q2 2016, prime retail rents continued to fall during the quarter, albeit at a slower pace. This was not unexpected as the retail industry continued to struggle with multiple challenges. These included a manpower crunch, high operating cost and intensifying competition for retail spending from both online and offline avenues.

Moreover, while tourist arrivals rose 15.1% year on year (YOY) in April and 9.8% YOY in May, the retail sales index (excluding motor vehicles) saw annual declines of 3.8% and 3.3% in April and May, respectively.

However, Q2 2016's retail sales could receive a boost from recent efforts to generate more retail spending and capture more tourist spending. The annual Great Singapore Sale (GSS) was extended from eight weeks to ten weeks, from 3 June to 14 August 2016, so as to coincide with the summer holidays of Asia Pacific countries.

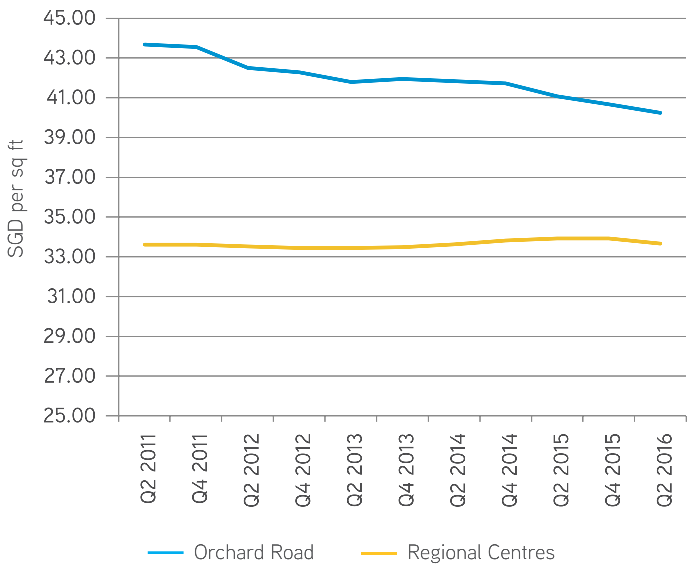
The Singapore Retailers Association (SRA) which organises the GSS also signed a three-year partnership with Chinese payments firm UnionPay International, in the hope of capturing more Chinese tourist spending during GSS 2016. In addition, the Orchard Road Business Association set up a WeChat account in April 2016 to promote Singapore's premier shopping street in China.

Against this backdrop and the tough retail operating environment, most retailers remained cost sensitive. Landlords also continued to exercise flexibility during rental negotiations with a focus on tenant retention and filling vacancies in Q2 2016. This weighed down prime retail rents.

Specifically, the average monthly gross rent for prime ground floor shopping mall space in the Orchard Road micro-market shed another 0.5% quarter on quarter (QOQ) to SGD40.21 per sq ft after easing 0.6% QOQ in Q1 2016. This brought H1 2016's decline to 1.1%.

Comparatively, the average monthly gross rent for similar space in the Regional Centres which enjoyed an immediate catchment population was more resilient with a 0.3% QOQ slide to SGD33.66 per sq ft, slightly slower than the 0.5% QOQ decline in Q1 2016. Overall, rents fell by 0.8% in H1 2016.

Average Monthly Gross Rents of Prime Retail Space (by Micro-market)



Note: A re-basketing exercise was conducted in Q1 2016 to update Colliers International's basket of properties that are used to compute retail rents.

Source: Colliers International Singapore Research

Local and foreign retailers exploit opportunities to secure choice spaces

Even as more consumers and retailers enter the digital retailing world, the physical retail store remains relevant to many retail companies which were actively opening and scouting for new opportunities in Q2 2016 as part of their business growth strategy. This signalled their medium to long-term confidence in Singapore's retail scene.

For example, April saw the Taiwanese fashion label iROO opening its fifth boutique at Raffles City. The retailer saw the availability of more vacant space as an opportunity to secure a suitable unit and plans to open its sixth boutique by the end of 2016.

Likewise, the German luxury brand Braun Buffel officially opened a flagship boutique at The Shoppes at Marina Bay Sands (MBS) in April 2016. The 1,500 sq ft outlet is Braun Buffel's fifth store in Singapore.

In the same month, Cortina Watch officially opened its largest Patek Philippe boutique in South-east Asia. Located in ION Orchard and spanning some 2,858 sq ft, the store is over four times larger than its first Patek Philippe boutique in the same mall. Cortina Watch is also working on the opening of its largest 5,500 sq ft Rolex outlet at Marina Square in H2 2016.

The quarter also saw the local womenswear label Beyond The Vines set up a 650 sq ft permanent shop in Mandarin Gallery on Orchard Road, after starting out as a pop-up store in the same mall.

Several Japanese retailers also opened new stores in Q2 2016. Examples included the Japanese label Christian Dada which opened its first flagship store (1,700 sq ft) at 268 Orchard Road, and the Japanese eyewear chain Owndays Singapore which opened its 18th outlet in Tiong Bahru Plaza as part of its plan to have up to 25 outlets within the next two years.

Meanwhile, John Little's impending exit from Jurong Point after about 20 years at the shopping mall provided BHG Department Store with an expansion opportunity. Besides taking over the two floors that will be vacated by John Little, BHG plans to lease an additional level to increase the overall floor space to 49,000 sq ft, which will make its Jurong Point outlet the largest in the western part of Singapore.

The Australian retail company Cotton On Group which already has 74 outlets in various malls is also expanding due to optimism over 2016's sales growth in Singapore. The retailer has said it is looking to open more stores in malls including those on Orchard Road, according to an article published in The Straits Times on 16 May 2016.

The Cotton On Group is also seeking opportunities to increase its physical footprint in malls like VivoCity and City Square Mall where it already has a presence. For example, it shifted its Cotton On store in City Square Mall to a larger 6,458 sq ft outlet in March, opened a new concept Rubi store at the previous space and plans to open a Cotton On Kids outlet in the same mall in July.

The Australian retailer has also refurbished its Cotton On outlet at Wisma Atria, which reopened in April 2016, with similar upgrading plans for its stores in VivoCity and Parkway Parade.

Foreign players active in F&B segment

Similarly, foreign food and beverage (F&B) players were also actively opening, preparing to open or committing themselves to new outlets in Q2 2016.

For example, the Japanese cheese-tart shop Bake Singapore opened its first outlet at ION Orchard in April 2016. This will be the company's Southeast Asia flagship store.

In May 2016, Hong Kong's Honolulu Café officially opened its first overseas outlet at The Centrepoint, while the Taiwanese chain Smoothie House opened its third and flagship outlet in Westgate Mall in Jurong East.

A new cluster of 16 Japanese restaurants will open on the fourth floor of the Isetan department store in Wisma Atria on Orchard Road in July 2016[1]. Called Japan Food Town, tenants include Sushi Takewaka, which is opening its first outpost, the udon restaurant Sato Yosuke, and Nabe Seizan, an offshoot of the two-Michelin-starred kaiseki restaurant Seizan in Mita, Tokyo. Many of these restaurants are the first overseas branches of popular eateries in Japan.

The world's first tourist-themed Japan Rail Cafe is also expected to open at GuocoLand's Tanjong Pagar Centre in Q4 2016. The cafe will be operated by Japan's largest rail operator, East Japan Railway Company (JR East).

Landlords stay focused on asset enhancement and mall positioning strategies

Meanwhile, landlords pressed ahead with their asset enhancement and mall repositioning/revamping strategies to stay competitive.

For instance, in order to differentiate itself from the competition, The Shoppes at MBS launched a new personal shopper service in June 2016. The by-appointment only service aims to meet the growing demand for customised shopping experiences.

Keppel Land Retail Consultancy had plans to change the rooftop water playground at its I12 Katong mall into a F&B area with a high ceiling and a skylight. The mall is currently undergoing a revamp and new tenants included the online store Megafash, the dim sum restaurant Tim Ho Wan (2,800 sq ft) and HomesToLife.

Other significant events during the quarter included the official opening of the 370,824 sq ft Waterway Point with 95% occupancy in Punggol in April 2016, as well as the closure of the Funan DigitaLife Mall on 30 June 2016 by its owner CapitaLand Mall Trust Management for redevelopment.

[1] Japan Food Town opened on 16 July 2016.

Strata sales and capital values

Unfavourable factors weigh down on strata-titled sales

The prolonged economic uncertainty and stock market turbulence, coupled with softening rents, the tough retail operating environment and the Total Debt Servicing Ratio (TDSR) requirement, continued to weigh down transactional activity in the strata-titled retail property segment in Q2 2016.

This was reflected in the preliminary caveat records downloaded from URA REALIS on 15 July 2016. In all, 46 caveats were lodged in Q2 2016, unchanged from Q1 2016, bringing the half year total to 92 caveats, 20.0% and 24.9% lower than the corresponding total in H2 2015 and H1 2015, respectively.

Even though Q2 2016's final caveat tally may be higher, we do not anticipate a major change. As such, it is unlikely that H1 2016's total caveats will exceed H2 2015's level.

Average capital values stayed firm in the Regional Centres

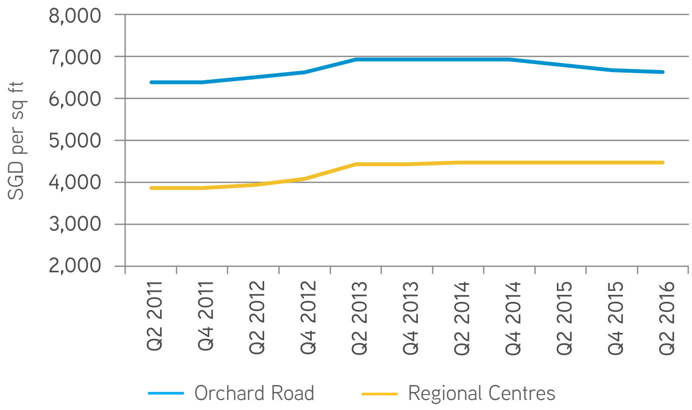
In the face of falling rents and the challenges faced by retailers on Singapore's premier shopping district, the imputed average capital values[2] of prime shopping mall space in Orchard Road continued to ease and at a slightly quicker pace of 0.5% QOQ in Q2 2016, from the preceding quarter's 0.3% QOQ dip.

This brought the imputed average capital values for prime shopping mall space in Orchard Road to SGD6,617 per sq ft as of Q2 2016, after a total decline of 0.7% over H1 2016.

In contrast, the imputed average capital values for similar prime retail mall space in the Regional Centres held steady for the ninth consecutive quarter at SGD4,491 per sq ft as of Q2 2016.

This was supported by the more resilient rents and high occupancy rates that are characteristic of these malls which enjoy a large ready catchment population and less reliance on transient tourist traffic than their Orchard Road counterparts.

Average Capital Values of Prime Retail Space (by Micro-market)



Source: Colliers International Singapore Research

[2] A valuation-based methodology is used to derive the average capital values.

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