

Doubling down on retail experience

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Whether brand or property developer, the local retail industry is visibly investing more into new designs, concepts and technologies to capture the massive potential of the millennials' spending power and willingness. New enticements range from cleverly installed in-store tech, such as smart mirrors, that are increasing customer interactions, up to entire retail complexes designed to entice this consumer group. Continued double-digit retail sales growth of 12.4% YOY in Q2 is spurring retailers' expansion activities across different sectors. As demand for prime locations remains firm, high-street retail rental growth has returned to positive territory. As we expect consumer sentiment to remain strong, overall retail rents should edge up by 1-3% in 2018. The strengthening business environment coupled with the adjusted rents gives more brands an opportunity to strategically evaluate how to expand their footprint in the city.

Forecasts



Demand

Demand for lifestyle fashion brands, health and beauty-related products is thriving, and the appetite for new F&B concepts continues to rise.



Rent

In 2018, we expect a slight rise of 1-3% YOY for overall high-street rents, led by rental growth on first-tier high streets. For 2019, we expect overall rents to rise by 3-5% YOY.



Supply

In 2018 we expect a total of 383,700 sq ft (35,700 sq m) and in 2019 1.37 million sq ft (127,100 sq m) of new retail space in core retail districts, led by H Code in Central (2018), and K11 Musea in Tsim Sha Tsui (2019).



Retail Sales

Retail sales grew 12.4% YOY in Q2, driven by jewellery and watches, cosmetics and fashion sales. For 2018, we revised our projection upwards to 8-10% YOY with high single digit annual growth through 2020 and a further positive outlook up to 2022.



2018 High-Street Retail Rents Projection

District	QOQ	2018F
Overall Rental Index*	+0.7%	+2%
Central	-1.1%	+2%
Causeway Bay	+0.9%	+2%
Tsim Sha Tsui	+0.2%	+3%
Mong Kok	+3.2%	+5%

Index: Nov 2011 = 100. * Street level shops on key street segments
Source: Colliers

It's all about millennials

Millennials, both locals and tourists, have become a significant force in the retail industry. Since the recent slump of local retail market, retailers have spent considerable effort to understand millennials' shopping preferences to improve engagement via new shopping experiences. Starting with pop-ups and new social media promotions, the range of new shopping enticements is expanding rapidly and is becoming increasingly visible in the retail landscape. We are seeing the following trends:

Personalised technology in physical stores: In corporation with Alibaba, the lifestyle label Guess has presented a new artificial intelligence-driven store format on the Polytechnic University campus. Offering a comprehensive digitised in-store experience with mobile check-in and payment, customer interaction during shopping has been taken to the next level. RFID-tagged items can be identified by smart mirrors and smart fitting rooms, giving product information and personalised style recommendations. Guess plans to expand the concept to further shops in the region with a first test store planned in Tsim Sha Tsui this year.

Concept stores: Starbucks has recently opened its *Starbucks Reserve* flagship store in Hong Kong, located at Lee Garden Three. With design inspired by coffee plantations and positioned as an urban retreat, the new concept in Causeway Bay features the city's first standalone Teavana Bar, premium and expanded coffee offerings as well as coffee-inspired alcoholic beverages along with an extended food menu.

Elaborately designed pop-ups: Allowing shoppers to experiment with new retail technologies and concepts, pop-ups have become an integral part of Hong Kong's retail market. Recently having been the location for a Givenchy pop-up, Pacific House on Queen's Road Central was previously the host location

for Chanel's beauty arcade pop-up called *Coco Game Center*. Shoppers could play games to win the luxury brand's cosmetics and skincare products. Another game centre-themed pop-up was *247 store* from the footwear brand New Balance. Covering two floors in Tower 535, Causeway Bay, customers were able to indulge in a neon-lit space equipped with virtual reality games. In another example, IWC Schaffhausen, the prestigious watchmaker, has opened an interactive, vintage style pop-up in Fashion Walk in Causeway Bay. The pop-up space spans two floors, featuring an exhibition, live watchmaking, games with chatbots and a small café, in collaboration with Urban Coffee Roasters.

Merging shopping with arts: Developers are also acknowledging the millennials, dedicating entire commercial complexes to this target market. The latest examples include H Queen's in Central which offers the exclusive combination of lifestyle shopping with international galleries and cuisines under one roof, as well as the newly opened Lee Garden Three and T.O.P. in Mong Kok. Victoria Dockside's K11 Musea, promoted as a high-end experiential art, culture and retail landmark for local and international millennials, will feature world-class public arts collections, an amphitheatre like sunken plaza, green walls, and numerous concept stores.

Doubling down on new retail experiences allows retailers and developers to stay ahead of consumer expectations and capture this target market's growing spending power. Therefore, we believe that more exciting concepts, such as the jewellery vending machine, presented by Chow Tai Fook, are about to transform the city's retail landscape.

Booming retail sales propel expansion activity across sectors

We have been recording increasing expansions across several retail sectors in H1 2018. Athleisure brands remain active in Hong Kong. Leveraging adjusted rentals

on high streets, various local and international sports brand operators have continued with a cautious expansion strategy over H1 2018. Fila, for instance, took a flagship corner space in Causeway Bay surrendered by Fossil, for a monthly rental of approx. HKD880,000 (USD112,100), a 41% drop from the previous rent paid by Fossil. In another example, Esprit at Leighton Centre in Causeway Bay has been replaced by Nike with Royal Sporting House as operator. Nike's monthly rent of HKD1.1 million (US140,100) is a 45% discount compared to Esprit's rent for the shop. Setting up its first presence in the city, Foot Locker took over the previous Esprit flagship at 7 Ashley Road in Tsim Sha Tsui.

Fuelled by booming sales, major drug stores including Watsons and Mannings, cosmetics retailers and pharmacies are on a strong expansion course. Bonjour has taken up two new shops on Sai Yeung Choi Street South in just one month and returned to its previous shop on Yun Ping Road in Causeway Bay.

The fast-growing popularity of light refreshments, particularly Taiwanese tea brands, has led to a flurry of new store openings. Well-known tea brands including Comebuy Tea and TenRen Tea are expanding their shop network while new brands are entering the market, with Causeway Bay being the preferred location for the first set-up. Tiger Sugar on Jardine's Bazaar, Milksha on Lee Garden Road and Mr. Tea on Great George Street are among the latest additions in Causeway Bay. Given monthly rental budgets of around HKD150,000-300,000 (USD19,100-38,200), these tea brands are primarily concentrated on second-tier high streets in core retail districts.

With positive consumer sentiment likely to persist, we should continue to see an accelerated expansion of lifestyle fashion brands, health and cosmetics retailers and light refreshment concepts over H2 2018.

Selected lease transactions in Q2 2018

District	Tenant	Address	Floor/ Unit	GFA (sq ft)	Lease Type
Central	Accessories	Parker House, 72 Queen's Road C	G/F & 1/F	3,060	New Lease
Causeway Bay	FILA	Hong Kong Mansion, 2-10 Great George St	G/F & C/L	2,100	New Lease
Causeway Bay	Swatch Group	Lai Yuen Apartment, 59-61 Russell St	G/F	600	New Lease
Tsim Sha Tsui	Mannings	Manley House, 86-98 Canton Rd	G/F	2,518	New Lease
Tsim Sha Tsui	Foot Locker	Yue Hwa International Building, 7 Ashley Rd	G/F – 3/F	26,836	New Lease
Mong Kok	Mannings	Yuen King Bldg., 26-36 Sai Yeung Choi Street S	G/F	1,580	New Lease

Source: EPRC, Colliers

Retail sales in H1 close to last peak

Continuing firm local demand backed by a robust labour market and a noticeable increase in tourist arrivals, particularly from mainland China, has boosted retail sales growth to 13.4% YOY in H1 2018. In fact, the retail sales value over the first six months was similar to the total in the corresponding period of 2013, which was the peak year for retail sales in Hong Kong. Sales drivers in Q2 were cosmetics, young fashion apparel as well as premium accessories and jewellery and watches. Jewellery and watch sales continued to rebound, with sales soaring 25.4% YOY Q2. Demand for cosmetics and medicines is continuously rising for both residents and tourists alike. Sa Sa, a major local cosmetics retailer, announced that retail sales soared 34.4% YOY during the Labour Day holiday. Driven by the recent surge in retail sales, retailers are getting more confident about their market prospects. We believe that there is a high probability that the ongoing trade tensions between the US and China will have only a limited impact on the local retail market. In line with Oxford Economics' projection of a stabilisation of the RMB¹, this would allow for a continued increase in the number of mainland tourists coming to Hong Kong. We therefore reaffirm our projection of 8-10% sales growth in 2018.

Overall high-street rents return to positive territory

For the first time since the retail market downturn overall high-street retail rental growth returned to positive territory, edging up 0.7% QOQ in Q2 and representing a growth of 0.3% YTD. Due to sustained robust demand for prime locations, we recorded a continued upward momentum for first-tier high-street rents in Mong Kok and Causeway Bay. We expect high-street retail rents to edge up by 1-3% YOY in 2018 following the strong take-up of shops in first-tier streets in major retail districts. Second and third-tier retail high-streets are slowly turning positive which should narrow their year-end rental decline. Rents in Central are still showing the weakest performance in 2018, -2.5% year to date. With retailers' requirements for smaller shops and a budget

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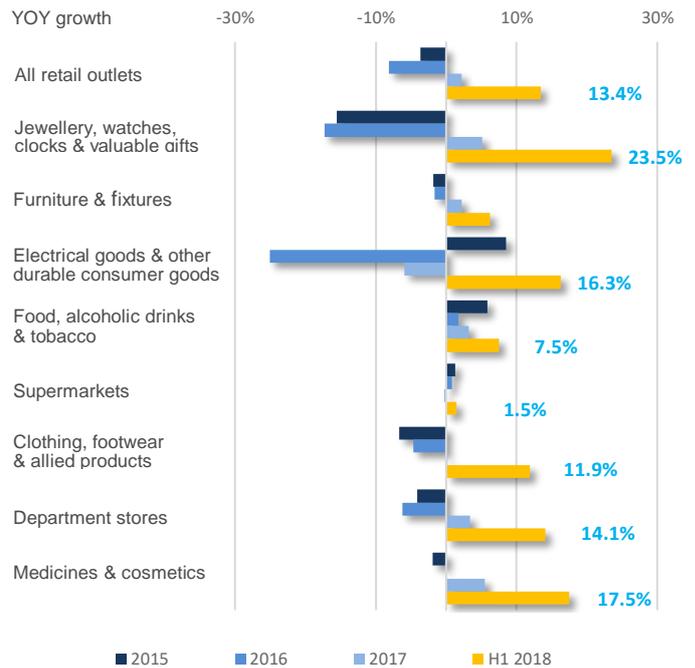
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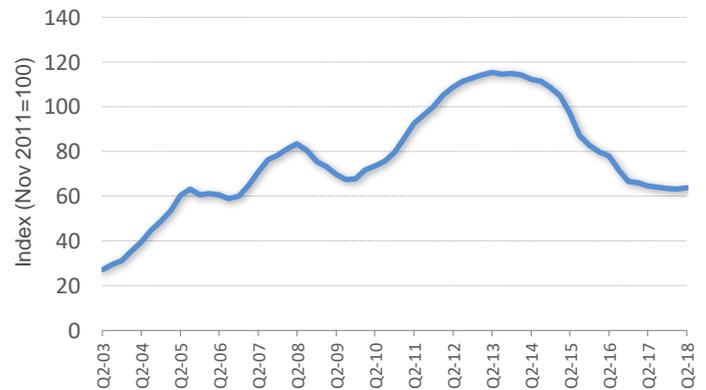
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Hong Kong's Retail Sales Growth by Subsector



Source: Census and Statistics Department, Colliers

Hong Kong High-street Retail Rental Index



Source: Colliers

within the range of HKD1.0-1.5 million (USD127,500 - 191,200), large shops along Queen's Road Central are still at a disadvantage under the current market conditions.

¹ Source: Oxford Economics, Country Economic Forecast China, July 2018

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