Research &
Forecast Report

HONG KONG | RETAIL

2Q 2015

Accelerating success.

Rough Ride Tipped for Retailers

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Hong Kong's retail sector continues to face headwinds. The declining appetite for luxury items has already hurt sales of many big-ticket items, which resulted in weaker retail sales overall. The restriction on visits by Shenzhen residents comes on top of structural changes stemming from the mainland's anti-corruption campaign, a shift in consumption patterns by mainlanders, and declining tourist arrivals from the mainland into Hong Kong. It is our view that the hiccups in the retail market are caused primarily by those structural changes, not the restriction on multiple entries.

Aiming to crack down on parallel traders, who buy products in Hong Kong to resell at a profit across the border, on 13th April 2015 the Chinese government announced that it would cap visits by Shenzhen permanent residents to Hong Kong, a change that took effect immediately. The Ministry of Public Security stopped issuing unlimited multiple-entry visas to Shenzhen residents, who are now only able to enter Hong Kong once per week, and stay for no longer than seven days.

Retail Sales Expected to Slide in 2015

Hong Kong retail sales decreased for a second straight month in April, with jewellery, watches and luxury gifts the hardest hit. Total retail sales fell 2.2% year-on-year in April 2015 after the 2.9% drop in the previous month. Meanwhile, the sales of luxury gifts, jewellery and watches tumbled 19.5% YoY in April after an 18.6% YoY fall in March. For consumer durable goods, the value of sales posted a 23.8% YoY increase in April.

	Current	2015F
Overall Rental Index*	**97**	**-15.0%**
Central	**101**	**-10.0%**
Causeway Bay	**98**	**-18.0%**
Tsim Sha Tsui	**94**	**-20.0%**
Mong Kok	**96**	**-10.0%**
Yield	**2.4%**	**10 bps**

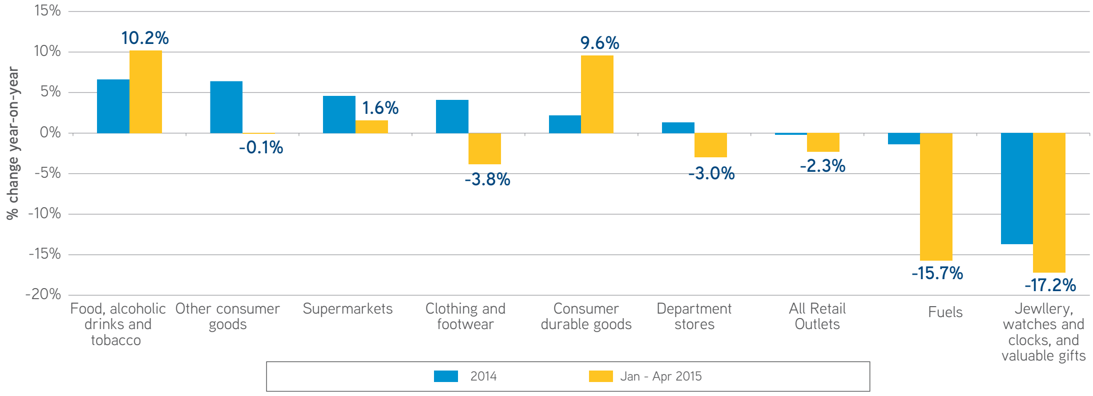
Index: Nov 2011 = 100
*Street level shops on key street segments
Source: Colliers; Rating and Valuation Department

Colliers View

The headwinds hampering Hong Kong's retail sales stem from structural changes in mainland-consumer behaviour. Mainland visitors account for about one-third of Hong Kong's total retail sales. The ones that do come to Hong Kong are now less willing to engage in conspicuous consumption.

Chinese tourists visiting Hong Kong have also been deterred. Depreciating currencies in Japan, South Korea and the Eurozone have accelerated the move away from Hong Kong as more adventurous Chinese tourists fly further afield in search of discounts. Hong Kong is losing competitiveness because of easier visa application processes in foreign destinations. Hong Kong's retail sales are expected to post a mild single-digit decline in 2015.

Value of Hong Kong Retail Sales (by type of outlet)



Source: Census and Statistics Department, HKSAR Government

Retailers Impacted by Falling Chinese Tourist Numbers

With tenant margins squeezed by falling sales figures, high-street retail rents are facing downward pressure. According to Colliers research, retail rents in the traditional top four shopping locations decreased 7.3% quarter-on-quarter in 2Q 2015, following a decline of 3.5% in the previous quarter, dropping back to 3Q 2011 levels.

Luxury retailers, especially in the watch and jewellery sectors, are scaling back operations as a direct result of sluggish business due to fewer tourist arrivals and less than exuberant consumption from mainland visitors. For example, City Chain – one of the largest watch retail chain stores in Asia Pacific – ended the tenancy for one of its outlets in Mong Kok, one of its two branches in Sai Yeung Choi Street South. The 350 sq ft site, with a monthly rent of more than HK$300,000, is located at no. 28, close to the second branch at no. 30. Meanwhile, Kowloon Watch abandoned its site on Percival Street in Causeway Bay as revenue declined by an average 20-30% across all its branches.

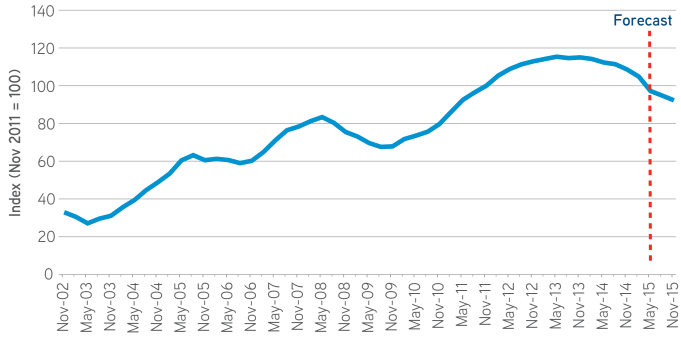
Colliers View

Rents of street level stores have climbed to such a high base over the past few years that they are very vulnerable to a downturn. Owners of storefront shop spaces are cutting rents by up to 20% to retain tenants as some of the top brands consider leaving when their leases expire. With more vacant shops available, rents of street-level stores in prime shopping locations are tipped to slide; we predict a further 15% decline in 2015, after a full year decline of 5.5% in 2014.

The softening retail leasing market is encouraging the gradual return of mass-market retailers and mid-range brands to prime shopping districts. Some mass-market retail chains, for example high-street fashion and affordable cosmetics brands, are taking advantage of the current market slowdown for opportunities to return.

On the other hand, rents in shopping malls will stay resilient due to the variety in their tenant mix and relatively high occupancy rates. Malls that are not heavily exposed to luxury brands will not be affected by a cut in the number of Chinese tourist arrivals and the structural changes in consumption patterns. Shopping mall rents will experience moderate single-digit growth this year.

Hong Kong Retail Rental Index



Source: Colliers

A Shift in the Market for Retail Deals

A lack of high-yielding investment stock resulted in slowing sales activity in the retail market, with no prominent transactions recorded during the quarter. Retail sales transactions contracted in 2Q 2015, with the total value of transactions for properties priced above HK$30 million dropping 6% from the previous quarter to HK$1.75 billion. That is well below the long-term average of HK$5.6 billion per quarter.

Colliers View

Factoring in the risk of an interest rate hike, most prospective buyers are seeking value-added properties that provide a greater reliance on defensive plays and income growth. Investors will continue to expand their search for opportunities in decentralised locations and are taking on more challenging development activity through refurbishments and repositioning of tenants. The record-high prices in prime retail districts have hit a ceiling. We predict they will start to soften this year considering the downside risks from impeding interest rate rises, the lowering of the loan-to-value ratio on mortgage lending, the slowing economy in China and the prospect of falling retail rents. We forecast that this will cause yield-hungry investors to turn their attention to shopping malls and stores in decentralised locations that sell mass-market goods.

The information contained in this report is a summarised version of our observations on the market in the past quarter. A more in-depth overview on specific sectors are available upon request.

FOR MORE INFORMATION

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