Asia Pacific Retail: Rethinking Post COVID-19

- Pandemic has accelerated the shift towards e-commerce by varying degrees
- Physical retail relevant but must continue to evolve with changing consumer lifestyles
- Malls catering to non-discretionary spend are the preferred investment choice

Introduction

In this paper, we take a closer look at the impact of the COVID-19 pandemic on Asia Pacific's (APAC) retail sector. We then discuss how landlords and retailers can reposition themselves to navigate through the fast-changing retail landscape as well as the implications for investors.

Bifurcation of APAC's retail sector

As both a health and economic crisis, the COVID-19 pandemic has significantly affected the way people live and work. This has in turn created a sharp performance divergence within APAC's retail sector in 2020. Sales across most discretionary retail segments (e.g. department stores, fashion) in APAC fell due in part to mobility restrictions and weaker spending by households whose income and/or employment have been adversely affected by the pandemic (Figure 1).

Figure 1: Retail sales growth by market and category

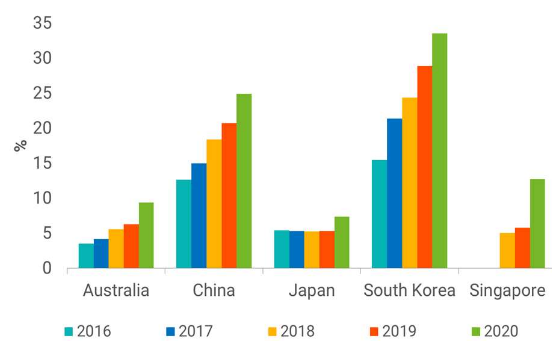
Source: ABS, METI, NBS, KOSIS, SingStat, KepCap Research

This was further compounded by a plunge in international tourism receipts as borders were closed around the world since early 2020 to stem the spread of COVID-19. Supermarket sales and sales of electronics and home appliances were relatively more resilient as consumers stayed, studied and worked from home longer as a result of the pandemic.

More shoppers went online amid pandemic

COVID-19 also accelerated the shift towards e-commerce in APAC as restrictions were imposed on the operations of retail premises and movement of people. The rise in online retail penetration rate was more pronounced in Singapore, South Korea and China which have higher population densities, strong supporting infrastructure (e.g. internet accessibility, postal reliability) and established e-commerce platforms[1] (Figure 2).

Figure 2: Online sales as a proportion of total retail sales



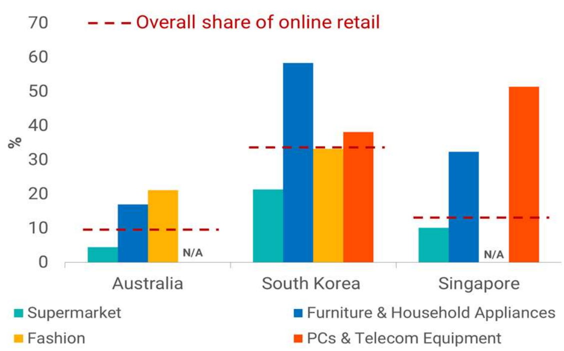
Source: ABS, METI, NBS, KOSIS, SingStat, KepCap Research

[1] The UNCTAD B2C E-commerce Index 2020, February 2021

In comparison, growth in e-commerce penetration rate was slower in Australia due to its sparse population, which hampers the efficacy of last-mile deliveries. Japan's aging population and low digital payment adoption have also inhibited the growth of e-commerce penetration rate.

A deeper analysis of Australia, Singapore and South Korea showed that the degree of e-commerce penetration rate varied between product types. For example, the ratio of online supermarket sales was lower than the overall e-commerce penetration rate of each market, reflecting consumers' preference to shop for fresh / perishable groceries in-store where they can see and feel the products. Being classified as essential businesses, supermarkets' premises were allowed to remain open during periods of lockdowns which further supported in-store sales (Figure 3).

Figure 3: Online retail sales ratio by category and market, 2020



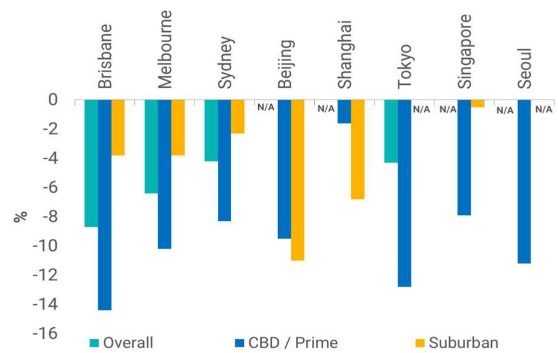
Source: ABS, NAB, KOSIS, SingStat, KepCap Research

In comparison, the share of non-food products sold online was considerably higher across the aforementioned markets. The implementation of lockdown measures, which had required non-essential retailers to temporarily shut their premises, was the main contributing factor behind the higher proportion of products such as furniture, household appliances and PCs being sold online in 2020. Consumers were arguably more comfortable buying non-food products online as the quality is relatively homogenous and consistent with the vendors' specifications, and do not degrade easily during transit.

Prime rents under greater pressure

Retail rents across all major APAC cities fell in 2020 as retailers negotiated for rental reductions and/or downsized amid a challenging business environment. Prime retail rents came under greater downward pressure in most major APAC cities on the back of a slump in international tourism receipts and local discretionary spend. Rents of suburban malls, which predominantly cater to domestic non-discretionary spending, fared relatively better (Figure 4).

Figure 4: 2020 retail rents, % yoy change



Source: CBRE, JLL, Nikkei Real Estate Market Report, KepCap Research

Prime retail rents in Beijing and Shanghai were relatively more resilient due to a tight supply pipeline. Prime retail rents in Shanghai, China's leading shopping destination were further supported by an early re-opening of China's economy[2] and the reshoring of discretionary expenditure which lifted footfall across the city's luxury malls[3].

The future of physical retail

While COVID-19 forced more consumers to shop online, e-commerce is unlikely to replace physical stores completely. Being social creatures, humans will seek out in-person interactions and experiences when restrictions are lifted.

Indeed, data from Google's Community Mobility Reports showed that visits to retail and recreation places across major APAC markets started recovering since June 2020 as lockdown measures were gradually eased.

[2] Being the "first-in, first-out" of the COVID-19 pandemic, China was able to gradually re-open its economy since late March 2020 while other APAC markets were entering into lockdowns.

[3] Footfall across Shanghai's luxury malls had returned to 96% of pre-COVID level in June 2020. Source: Savills, China Retail Spotlight – Luxury Takes Centre Stage, August 2020

With more people heading outdoors, the online retail sales ratios across most major APAC markets are now off their peaks in 2Q2020[4], though they remain higher than pre-COVID levels (Figure 5).

Figure 5: APAC online retail sales ratio[5] and visits to retail and recreation places

Note: Baseline covers the period 3 January to 6 February 2020; share of online retail sales has been adjusted for seasonal effects
Source: ABS, METI, NBS, KOSIS, SingStat, Google Community Mobility Reports, KepCap Research

Alongside the pick-up in footfall, retail leasing sentiments in APAC have also improved over the six months to April 2021, with increased tenant enquiries[6]. The CBRE Asia Pacific Leasing Market Sentiment Survey noted that well-capitalised retailers are taking advantage of the softer rents to seek new leasing opportunities in prime locations. Some slowdown in leasing queries was observed over May and June 2021 as certain markets tightened restrictions although overall leasing sentiment was still higher than in December 2020. Correspondingly, retail rents in APAC were down by just 1.0% YTD in 1H2021, compared to the 11.3% yoy decline in 2020[7].

Notwithstanding the gradual stabilisation in APAC's retail sector, retailers and landlords need to remain adaptable and nimble amid uncertainties over the trajectory of the pandemic, as well as seize opportunities arising from changes in consumption behaviour.

Prime malls: Creating immersive experience

With international travel restrictions likely to remain in place for the foreseeable future until a sufficient proportion of the global population has been vaccinated, prime malls will need to pivot to local consumers whose demand will recover earlier with the re-opening of the domestic economy. For example, discretionary and leisure spending intentions have steadily improved over the six months to May 2021 in China amid an improvement in households' financial situation. In particular, more consumers planned to increase spending on out-of-home and in-person activities such as cosmetics, dining out and entertainment[8].

Prime malls which are able to provide a diverse and immersive shopping experience are more likely to appeal to 'travel-starved' consumers. For example, prime malls could feature more pop-up stores which allow luxury brands to showcase their latest and/or limited-edition products in a unique and interactive environment. Being temporary in nature, pop-up stores are an effective tool for luxury brands to capitalise on the "fear of missing out (FOMO)", which is more prevalent among younger consumers.

Major luxury brands such as Burberry and Gucci are using pop-up stores in China to reach out to the country's increasingly affluent group of millennials[9]. Beyond luxury retailing, prime malls could also increase the mix of activity-based tenants and F&B tenants, as well as exhibitions to drive footfall and dwell time.

Suburban malls: Delivering convenience

With consumers leading increasingly hectic lifestyles, suburban malls can capitalise on their proximity and familiarity with the community to create a more convenient and tailored retail experience. Besides building a core base of essential retailers (e.g. supermarkets, convenience stores, pharmacies, household goods), landlords could add more consumer services (e.g. beauty and wellness, clinics, enrichment centres, gyms, preschools) in the tenant mix to provide more holistic offerings for the community.

[4] With the exception of South Korea where the daily rate of new COVID-19 infections remains at relatively elevated levels.
[5] Based on weighted average of Australia, China, South Korea and Singapore's online retail sales ratios
[6] CBRE, Asia Pacific Leasing Market Sentiment Survey, April 2021
[7] CBRE, Asia Pacific Marketview, 2Q2021, 5 August 2021
[8] McKinsey, Survey: Chinese Consumer Sentiment During the Coronavirus Crisis, 13 May 2021; UBS, What is Holding Back China's Consumption? 13 July 2021
[9] WMD, The Luxury Industry is Turning to Pop-up Stores to Win Over Chinese Millennials, 19 August 2020

As such consumer services are relatively less affected by e-commerce and in some instances require contiguous space (e.g. gyms and preschools), they will afford suburban malls greater leasing and rental stability.

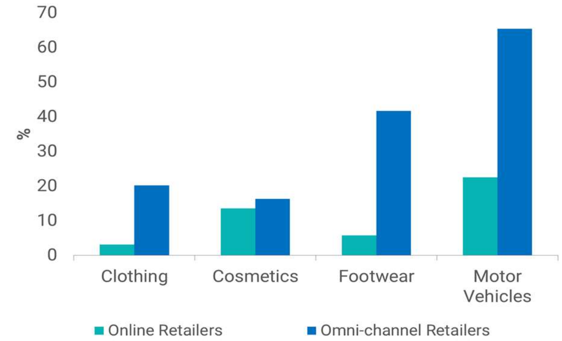
The value proposition offered by such one-stop / convenient centres is significantly higher in sparsely populated markets such as Australia where it is inconvenient for consumers residing in more remote towns to shop for daily essentials online due to the long delivery times. Not surprisingly, rentals of neighbourhood centres were the most resilient among other retail formats in Australia in 2020[10].

Strengthen omni-channel capabilities

Having experienced the ease and convenience of e-commerce, consumers may continue to shop for certain items online even as social distancing restrictions are eventually lifted in the future. This is especially the case for APAC's emerging group of Generation Z consumers, who spend considerably more time online researching about different brands and products as well as seeking out the best deals before making their purchases[11]. It is thus imperative that brick-and-mortar retailers invest in omnichannel platforms to maximise their customer reach.

Physical stores will play a different but integral role in retailers' omni-channel experience by providing a platform for shoppers to see, feel and try the merchandise, as well as getting in-person assistance from sales consultants[12] before making the purchase. These factors are especially critical when it comes to buying personalised and/or luxury products such as clothing, cosmetics, footwear and motor vehicles. Indeed, data from South Korea showed that omni-channel retailers' e-commerce sales outpaced that of pure-play online retailers during the period 2017 to 2020 for the aforementioned products (Figure 6).

Figure 6: South Korea online sales by retailers' operation type, CAGR (2017-2020)



Source: KOSIS, KepCap Research

A similar trend was also observed in Singapore, where online-to-offline shoppers on average spent 44% more than pure offline shoppers[13].

Implications for investors

While the COVID-19 pandemic has accelerated the adoption of e-commerce in APAC, we continue to believe that it does not spell the end of brick-and-mortar retail, as highlighted in our earlier papers (Asia Pacific Real Estate: It is Not Business as Usual, Australia Retail: Evolving in an E-commerce Era, Retail Real Estate: Brick-and-Mortar's Silver Linings).

Investor interest in retail properties has picked up recently. Retail investment volume in APAC rose by 136% yoy to reach USD20.6 billion in 1H2021, sharply outpacing the 39% yoy growth in overall transaction volume for the region[14]. This is not surprising as the roll-out of vaccination programmes and expectations of eventual easing of social distancing restrictions have led to an improvement in consumer sentiment and retail spending.

There are still some near-term challenges due to the evolving COVID-19 situation. Until herd immunity is attained, mobility restrictions are likely to be re-tightened every time there is a surge in COVID cases.

[10] JLL, Australia Retail Market Overview 4Q2020, 12 February 2021
[11] McKinsey, What Makes Asia-Pacific's Generation Z Different? 29 June 2020; Generation Z (born between 1996 and 2021) is projected to make up a quarter of APAC's population by 2025
[12] A survey of Chinese consumers showed that suggestions from in-store assistants play a critical role in influencing their purchases (49% of respondents), Source: McKinsey, China Luxury Report 2019, April 2019
[13] CapitaLand, CLSA Singapore Ecommerce Access Day 2021, 8 June 2021
[14] JLL, APAC Capital Tracker 2Q2021, July 2021

The re-tightening of restrictions is however expected to be less onerous than in 2020 given the national vaccination programmes already in progress, as well as improvements in testing and contact tracing capabilities. Over the medium to longer term, however, the retail sector will have to deal with the pre-COVID structural challenges posed by e-commerce.

In view of the above, we continue to prefer suburban malls as they predominantly cater to domestic non-discretionary spend. The prevalence of remote working arrangements in the near future would bolster the appeal of suburban malls. Beyond COVID-19 and over the longer term, it is "location, location, location". Well-located malls which are easily accessible by public transport and surrounded by a sizable community catchment should attract higher footfall and generate more stable income.

To illustrate, major retail and commercial REITs in Singapore (S-REITs) such as Frasers Centrepoint Trust (FCT), SPH REIT (SPHREIT) and Capitaland Integrated Commercial Trust (CICT) are seeing a sustained recovery in their suburban malls, with tenant sales holding close to pre-pandemic levels despite the retightening of certain social distancing measures over May and June. Notably, tenant sales across FCT's suburban malls rose by an estimated 43.2% yoy in the first five months of 2021, outpacing the 14.9% yoy growth in Singapore's overall retail sales (excluding automobiles)[15]. Similarly in Australia, Charter Hall Retail REIT (CQR) reported that tenant sales growth across its convenience-based retail centres (+7.1%) outpaced that of the country's overall retail sales (+6.2%) in 2020[16].

Looking ahead, both FCT and CQR expect tenant sales across their suburban malls to remain resilient, underpinned by stable demand for essential goods and services which account for more than half of the REITs' gross rental income[17]. Indeed, a separate study showed that supermarkets are expected to expand their store count faster than other retail segments in Australia post-COVID, backed by a structural shift towards work-from-home (WFH)[18].

We will be more opportunistic on prime retail malls and other retail formats. It was noted that tenant sales across S-REITs' downtown / Orchard malls have improved following the reopening of Singapore's economy in December 2020, but they are still around 25% below pre-COVID levels[19]. Likewise, Vicinity Centres in Australia indicated that tenant sales across its CBD shopping centres have picked up from 4Q2020 to 1Q2021 following the easing of social distancing measures but it would take some time to recover to pre-pandemic levels[20].

Prime malls in gateway cities with larger domestic markets can benefit from an earlier recovery in domestic tourism as well as the resumption of international travel over the longer term when vaccination reaches critical mass. Investors will however need to be more discerning about the location, quality and design of the mall in order to attract high-impact discretionary retailers which will be looking to operate out of fewer flagship stores in more prominent sites. For example, analysts noted that Paragon has a unique positioning among luxury brands due in part to the mall's strategic location in Orchard Road[21]. Larger prime malls will also provide operators with the scope to pursue agile leasing strategies (e.g. pop-up stores) as well as bring in more lifestyle and activity-based tenants to provide a unique experience for shoppers. For instance, Starhill Global REIT (SGREIT) has commenced asset enhancement works on Wisma Atria to position it as a premier lifestyle mall, with a specific focus on improving its F&B offerings.

Amid the near-term headwinds, CICT's downtown malls reported rental reversions[22] of -15.5% in 1H2021 compared to -4.6% for its suburban malls.

[15] Source: Company reports, SingStat
[16] Source: Company reports, ABS
[17] Source: Company reports
[18] Citi, How Have Retailer Store Count Expectations Change, 26 July 2021
[19] Source: Company reports
[20] Source: Company reports
[21] CGS CIMB, SPH REIT: Seeing Brighter Prospects, 13 July 2021
[22] Source: Company reports; rental reversion measures the change between incoming first year rents and outgoing final rents

The former can be attributed to CICT offering more flexible leases (e.g. higher variable component / lower first-year rents with step-ups in subsequent years) to support struggling tenants as well as attract new-to-market prospects with promising business models or concepts.

Creating value through proactive mall management

Above all, we believe that the quality and experience of the mall manager will be critical to the success of a retail mall. Every detail will matter. The ability to build a well curated mix of tenants and store concepts that cater to the community's demographic profile is essential to enhance the performance and value of the mall. Technologies such as big data[23] will be a key enabler in helping mall managers develop a holistic placemaking strategy as well as curate tenants.

With e-commerce adoption set to rise further over the longer term, developers and landlords need to be cognisant of the heightened need for online-offline offerings. The availability of a digital platform which provides seamless omnichannel experience could be integral in sustaining the mall's appeal amongst tenants and consumers alike. Such a virtual mall would enable tenants to reach out to customers beyond their immediate vicinity, who can either pick-up the purchases from the store or have them shipped directly to their homes and also offers a more effective and dedicated platform for tenants to grow their online presence as compared to online marketplaces where it is harder for their products to stand out.

Conclusion

As evident by the recovery in retail trips in the second half of 2020, people still crave for in-store shopping and interactions. Amid the near term COVID-19 headwinds and shifts in consumption behaviour, shopping malls can continue to thrive by creating a more immersive and convenient retail experience for consumers. From an investment perspective, well-located suburban malls remain our preferred investment choice, while we will be more opportunistic on other retail formats.

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[23] For example, managers can partner with telco operators to learn more about the interests and travel patterns of shoppers via anonymised data collected from their mobile devices