Intelligent Investment

Retail in the Post-Pandemic Era: Trends and Opportunities

REPORT

CBRE
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Consumption and retail property markets recover as expected

China's consumer market leads economic recovery in H1 2023; momentum expected to accelerate over remainder of year

The consumption recovery witnessed since the first half of the year has become the main driving force of economic growth.

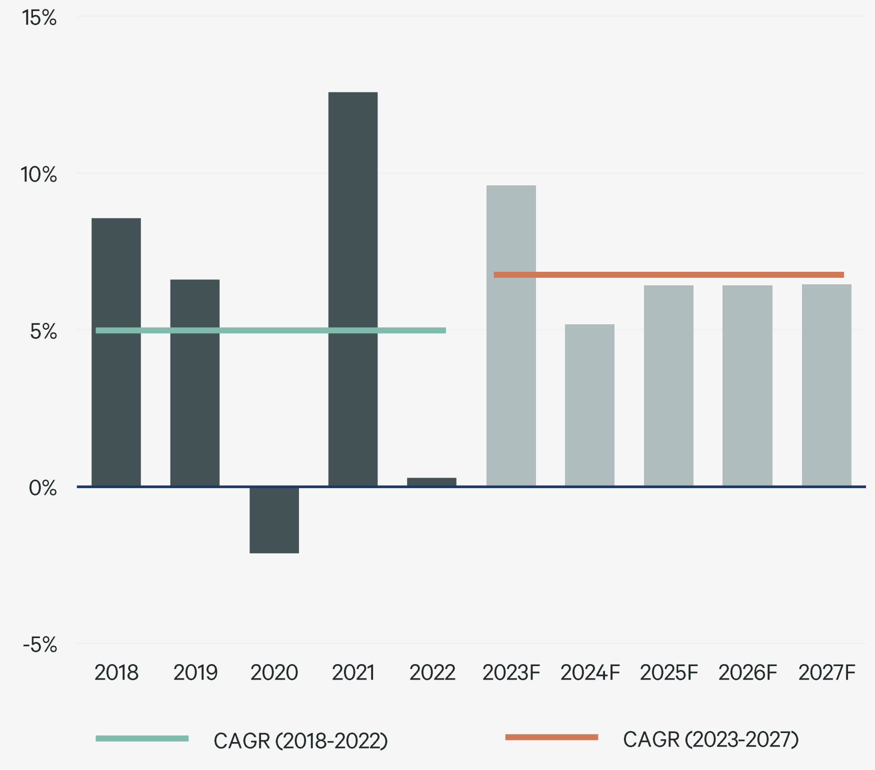
Following the lifting of pandemic control measures at the end of 2022, China's consumer market has enjoyed a strong rebound. National total retail sales of consumer goods grew by 8.2% y-o-y in H1 2023, with the contribution rate of final consumption expenditure to economic growth reaching a record-high 77.2%. Domestic demand has emerged as the main engine of economic growth.

The various segments that comprise overall consumption have experienced an uneven recovery. Contact consumption categories such as catering, entertainment, and tourism have benefitted greatly from the recovery in consumption and have been driving the rebound. In H1 2023, the number of domestic tourists and income both achieved their highest first half totals since the onset of the COVID-19 pandemic, while also recovering to 80% of the levels witnessed in 2019. Catering and cinema box office receipts increased by 21.4% and 52.9% y-o-y, respectively. In contrast, retail sales of goods registered moderate y-o-y growth of just 6.8%, while sales of optional consumption such as clothing and cosmetics have been weak. At the same time, consumer confidence and willingness to spend among domestic residents have not yet fully recovered. According to the People's Bank of China's (PBoC) Questionnaire Report on Urban Depositors in the Second Quarter of 2023, 24.5% of residents tend to "consume more", which marked an improvement on a y-o-y basis. However, the proportion of residents who tend to "save more" remained largely unchanged at 58%.

The post-pandemic recovery in other countries has generally consisted of three stages: the restoration of consumption scenarios and improvement of residents' income; the decline in the savings rate; and the release of excess savings. Data for domestic residents' consumption and savings in the first half of the year indicate that China's post-pandemic consumption recovery is still transitioning from the first stage to the second stage. With the promotion of consumption of automobiles and electronic products and extension of personal tax incentives and other policies to expand domestic demand and promote consumption gradually taking effect, the economic and employment outlook will continue to brighten.

CBRE expects the overall recovery of consumption to drive China's economic recovery over the remainder of the year and into 2024. China's total retail sales of consumer goods are forecasted to grow by 9.6% in 2023, with the Compound Annual Growth Rate (CAGR) over the next five years (2023-2027) projected to reach 6.8%, significantly higher than the 5.0% recorded for the past five years (2018-2022).

Figure 1: Y-o-y change and forecast for total retail sales of consumer goods



Source: National Statistics Bureau, Euromonitor, Statista, CBRE Research, September 2023

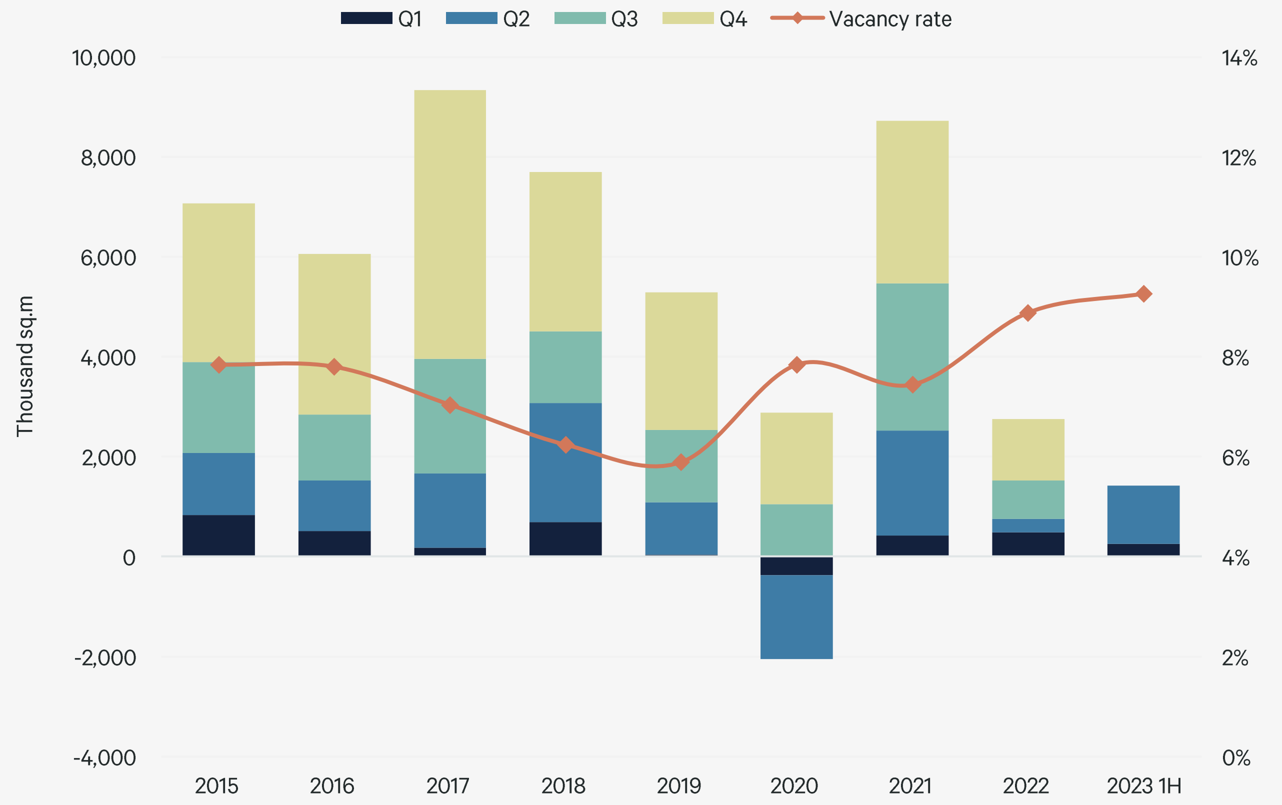
Retail leasing demand rebounds significantly; rents show signs of stabilising

The recovery of China's consumer market had a positive knock-on effect on retail leasing demand in Q2 2023, with nationwide net absorption volume increasing by more than 3x on both a q-o-q and y-o-y basis. Cumulative net absorption reached 1.42 million sq. m. in H1 2023, an increase of 189% over the same period of 2022, returning to a level slightly above 75% of the average value for the same period in the five years prior to the onset of COVID-19.

The rebound in demand ensured vacancy fell to 9.3% in Q2 2023 after rising for four consecutive quarters. At the same time, the decline in nationwide ground floor shopping mall rents narrowed to just 0.2% q-o-q, underpinned by the stabilisation of rents in Beijing, Shanghai and tier-II cities in East China with strong consumer fundamentals.

Following a challenging three-year period during the pandemic, China's retail property market recover is now underway. At the same time, the impact of COVID-19 on the consumption, lifestyles and values of domestic residents will accelerate the emergence of structural trends that will have a far-reaching impact on retail brands, in areas ranging from store strategy to sustainable development. These trends will also influence demand for retail properties and asset management.

Figure 2: Nationwide retail net absorption and vacancy rate



Source: CBRE Research, September 2023

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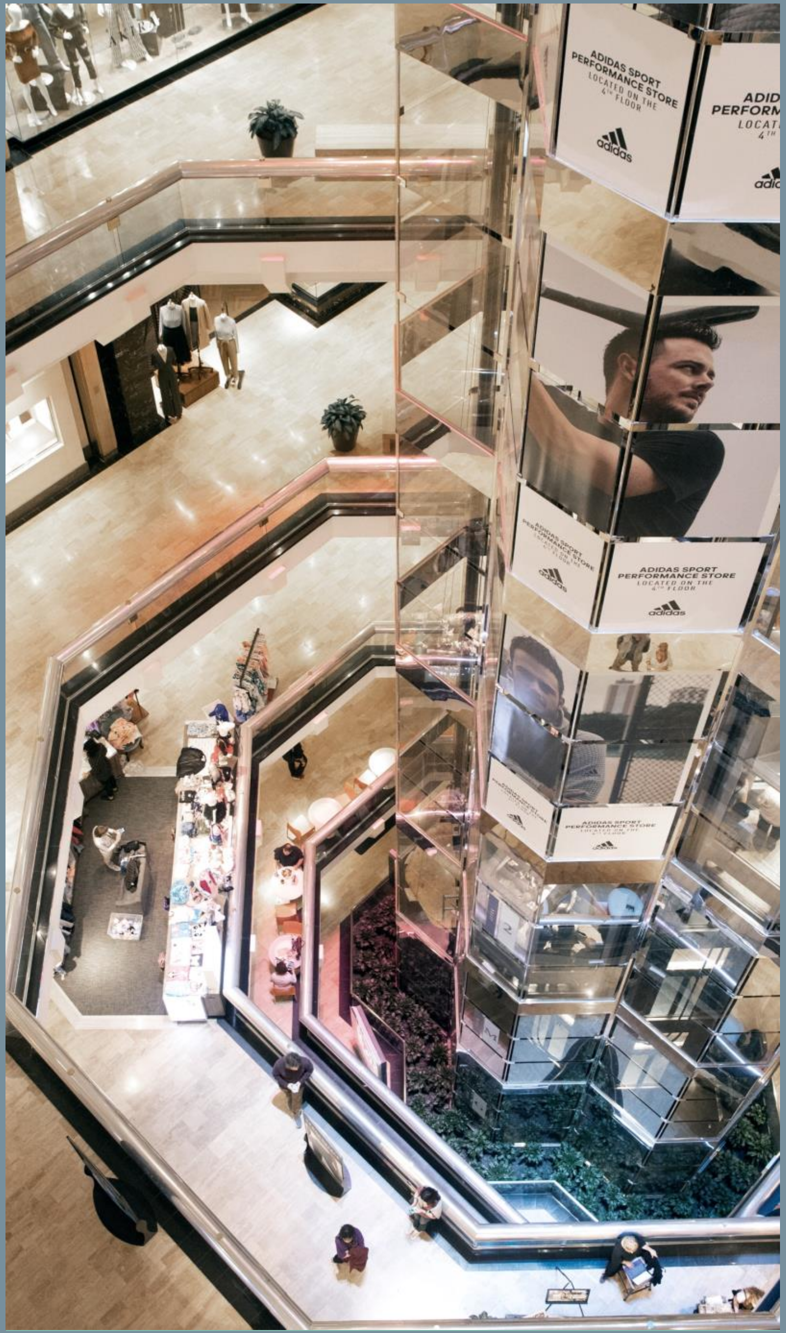
Post-pandemic retail property trends



Trend 1: China is still a top choice for retailer expansion

Retailers' store footprint will exceed pre-pandemic levels within the next three years.

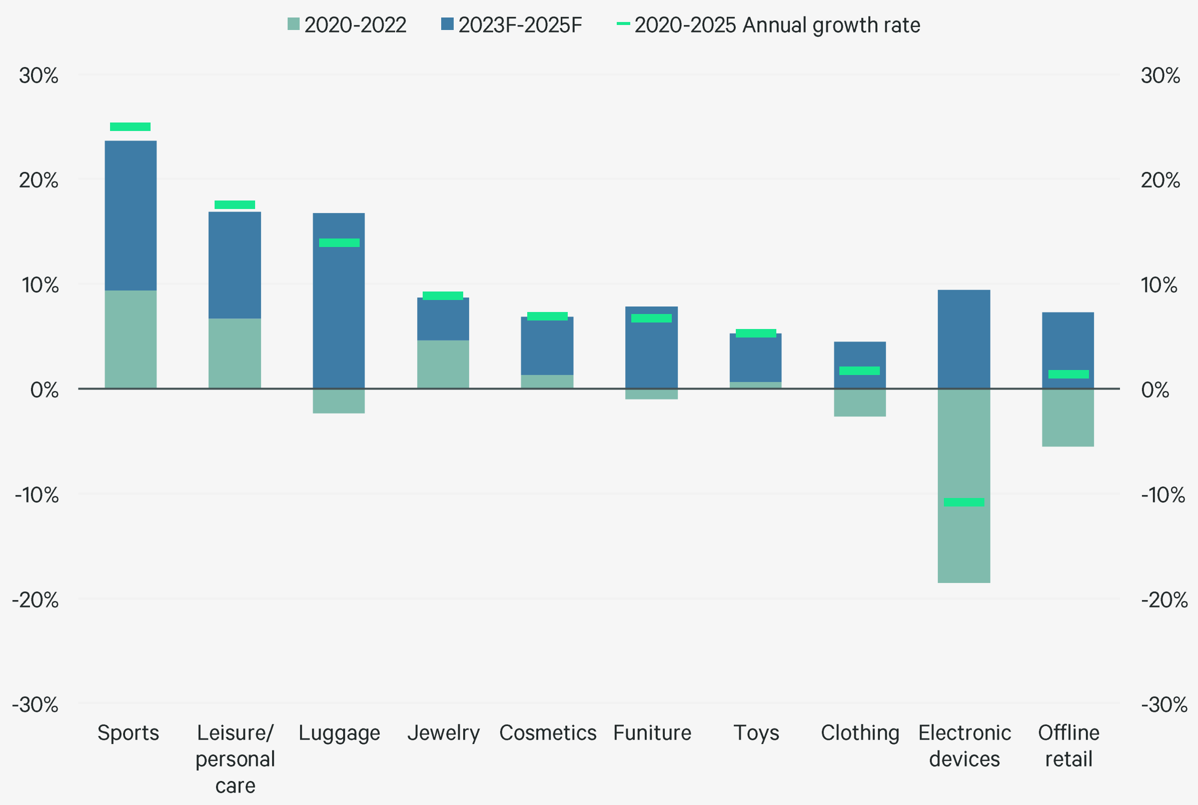
Following three years of disruption, domestic and foreign retailers in China have returned to expansion mode and resumed opening new stores. CBRE's 2023 Asia Pacific Retailer Survey found that 71% of retailers plan to increase the number of stores in China this year, with China's tier I cities retaining their top position as a target for overseas expansion by international brands.

Euromonitor forecasts show that in the next three years (2023-2025), retailers' offline operating area in China will increase by 7.1% to 1.27 billion sq. m., surpassing pre-pandemic levels witnessed in 2019. Retailers in the luggage, sports products, leisure & personal care product categories will witness the fastest expansion, with cumulative growth rates projected to reach 16.7%, 14.3% and 10.2%, respectively, in the next three years.

Along with a retaliatory rebound in demand for tourism and outdoor leisure activity following the lifting of travel restrictions, spending on these categories is being driven by consumers' adoption of healthy and active lifestyles. Retailers benefitting from consumption upgrades, such as cosmetics and jewellery, will also continue to expand their brick-and-mortar stores.

Retailers in the luggage, sports products, leisure & personal care product categories have ranked as the fastest growing retail segments in terms of their real estate footprint since 2019, with the former achieving growth of just under 10% during the pandemic years (2020-2022). McKinsey's "Sporting Goods 2022: The New Normal is here" predicted that China will emerge as the fastest growing major market for sporting goods consumption, with a projected Compound Annual Growth Rate (CAGR) of 13.7% from 2020-2025. The size of China's sporting goods market was estimated to reach around RMB 394 billion (EUR 56 billion) in 2022, around half that of the U.S. With China's per capita consumption of sporting goods only about 12% of that of U.S., there is still significant potential for future growth. CBRE expects the upcoming 2024 Paris Olympic Games to boosts sports consumption and related brand expansion in China in the coming years.

Figure 3: Changes and forecasts to real estate footprint for different retail categories



Source: Euromonitor, CBRE Research, September 2023

Within the sports products segment, professional and outdoor sports brands have been the fastest growing sub-categories. CBRE's field research of shopping malls in major cities has found that over the past three years, more than 30 domestic and overseas professional and outdoor sports brands have entered or expanded to the Chinese market, opening nearly 500 stores in tier I and tier II cities; a trend expected to continue in the coming years. Lululemon's quarterly revenue in China increased by 79% y-o-y in Q1 2023, with the company expecting its number of direct-sale stores to increase to 220 by year's end.

The strong rebound in social activity and gatherings witnessed since the beginning of 2023 has boosted growth in the F&B segment. Qichacha data show that from January to June this year, the cumulative number of newly registered enterprises in the national catering industry reached 1.669 million, a y-o-y increase of 25%. Of the new leasing transactions completed in high-quality shopping centres in major tier I and tier II cities recorded by CBRE in H1 2023, the catering sector accounted for 41%, ranking first among all tenant types. Within the F&B category, local specialties, fast food, and coffee and tea establishments are the most active segments, accounting for 80% of new lease transactions by catering tenants.

The revenue and profit margins of listed catering companies such as Haidilao and Jiumaojiu significantly increased y-o-y in H1 2023, while financing of catering companies has also been robust. This will ensure solid financial support is available for catering tenants to continue to expand their stores in future.

Trend 2: First-store economic support continues to increase

Setting up first stores is an important means to stimulating the commercial vitality of a city and attracting consumers to shopping centres.

Recent years have seen several major domestic tier I and tier II cities introduce first-store subsidy policies. The scope of policy application and volume of subsidies has steadily expanded and improved, creating a fertile environment for domestic and foreign brands to enter new cities. In March 2023, authorities in Beijing upgraded the city's first-store policy, raising the maximum subsidy amount for the first store in Asia from the original RMB 1 million to RMB 5 million. In addition, most cities have extended the scope of application of the first-store policy from the first store in the world, the first store in the country, and the first store in a region/city to flagship stores of existing brands or other new store models.

The resumption of domestic and foreign travel since the beginning of 2023 will compel brand site selection teams to accelerate the identification of potential new locations for new stores. The wider application of the first store incentive policy means that once a new brand establishes a presence in the domestic market, cross-regional first stores and flagship stores are likely to follow, while demand for concept stores will continue to thrive.

Figure 4: Supporting policies for first-store openings in major tier I and tier II cities

City	Applicable level			Store format	Maximum subsidy amount (10,000 yuan)
	Global/ APAC	National	Region/ City		
Beijing	☑	☑	☑	First store, Flagship store, New concept store	500
Shanghai	☑			First store, Flagship store	25
Shenzhen	☑	☑	☑	First store, Flagship store, New format store	100
Guangzhou	☑	☑	☑	First store, Flagship store	500
Chengdu	☑	☑	☑	First store, Flagship store	100
Hangzhou	☑	☑	☑	First store, Flagship store	100
Nanjing	☑	☑	☑	First store, Flagship store	100
Chongqing	☑	☑	☑	First store, Flagship store	100
Wuhan	☑	☑	☑	First store, Flagship store	50
Xi'an	☑	☑	☑	First store, Flagship store	100

Source: Open news, CBRE Research, September 2023

Trend 3: Upgrading the function and layout of physical stores will be needed to facilitate the shift to omnichannel

The return of in-person shopping will put physical stores back at the core of the omnichannel consumption chain.

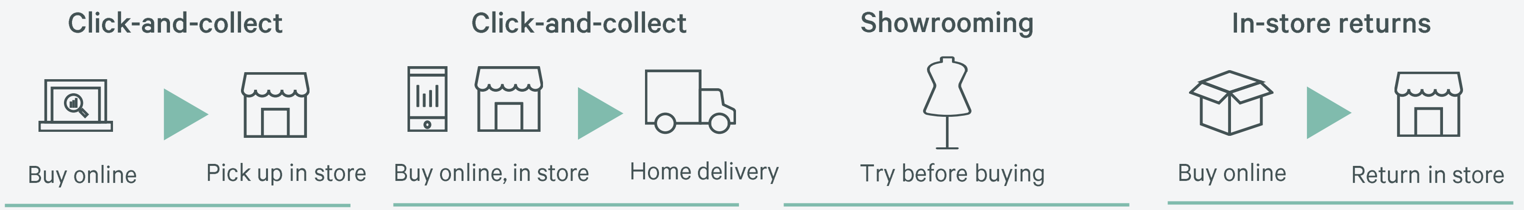
The restoration of face-to-face consumption has seen shopping mall footfall rebound strongly in H1 2023. Data publicly disclosed by listed companies show that growth in footfall at prime shopping malls in the first half of the year exceeded 30% y-o-y, with sales in some shopping malls during the same period exceeding pre-pandemic levels.

Although the surge in consumption at brick-and-mortar stores has partly been driven by 'revenge shopping', it does reflect the ongoing importance of physical shopping malls to consumers. Online penetration rates have gradually slowed in recent years, while the cost of customer acquisition has accelerated. The average customer acquisition cost for domestic mainstream e-commerce companies Alibaba, JD., and 163 yuan increased to RMB 669, RMB 396, and RMB 558[1], respectively, in 2021. With shopping mall rents having fallen due to the impact of the pandemic, expanding offline stores is now more attractive to retailers, particularly in terms of increasing customer attraction and retention and providing greater value to shoppers.

With China's domestic consumer market having entered the omnichannel era, CBRE expects the positioning of physical stores in the consumption chain to evolve from being a simple sales outlet to playing a role as a location to undertake omnichannel sales, customer service, community building, and brand culture experience. CBRE's 2022 Asia Pacific Live-Work-Shop Survey found that consumers named being able to see and try products (50%), the overall in-store experience (41%) and immediate availability of products are immediately available (33%) as the main reasons why they choose to buy in physical stores.

Note 1: Related listed company announcements, Huatai Research

Figure 5: Schematic diagram of physical store functions for omnichannel retailing



Click-and-collect (Buy online → Pick up in store)

- This model has been widely adopted by major offline-based retailers as it encourages consumers to visit stores and potentially spend more.
- Opportunities to considerably reduce last mile delivery costs have prompted a growing number of e-commerce companies to partner with brick-and-mortar retailers for in-store pick-up services.

Click-and-collect (Buy online, in store → Home delivery)

- Electrical and furniture retailers have traditionally led adoption of this model.
- More general retailers are assisting consumers to perform online orders in-store and arrange direct shipments.
- This approach can reduce in-store inventory while enabling consumers to enjoy hands-free shopping.

Showrooming (Try before buying)

- Many retailers now place a small volume of online-only goods in brick-and-mortar stores to let consumers touch and test products before ordering.
- While in-store inventory for such purposes is limited, this model helps to reduce returns of online purchases. The return rate of domestic traditional e-commerce is about 10%-15%, while the return rate of live e-commerce can be as high as 30%-50%[2] .

In-store returns (Buy online → Return in store)

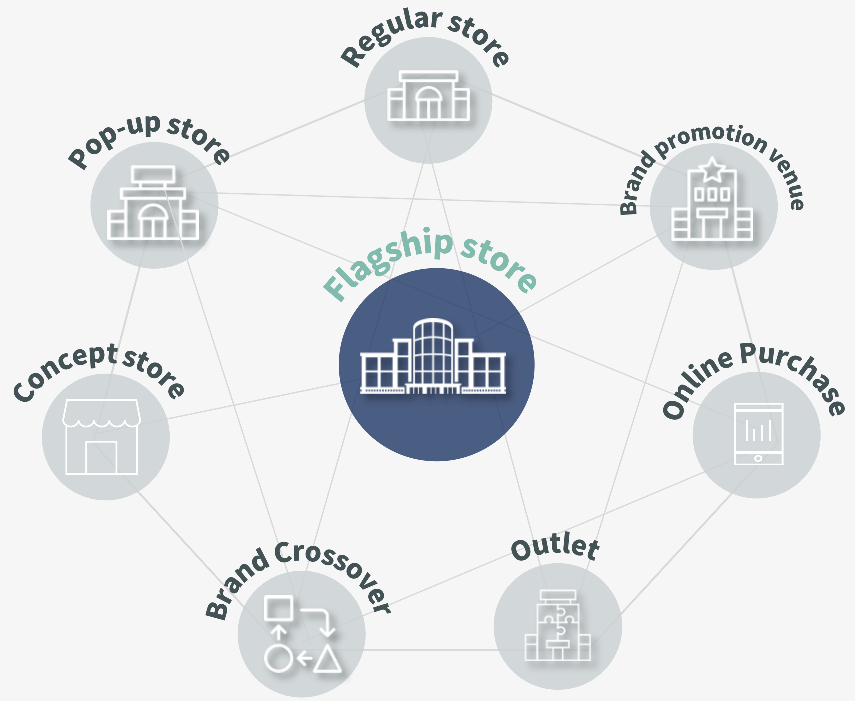
- While many consumers view free returns as essential for online orders, the cost to retailers is considerable.
- Offering in-store returns can entice consumers to spend more in-store while helping to reduce re-stocking periods and lower costs for reverse logistics.

Note 2： 36kr *2020 China Live Streaming E-commerce Industry Research Report*
Source: *Omnichannel Retail and its Impact on APAC Real Estate*, CBRE Research, September 2023

CBRE believes the establishment of brand store networks under omnichannel retailing will need to consider structural changes. Urban store networks, which have historically comprised a large number of standard stores with similar functions, will need to be optimised, which may involve converting under-performing community-oriented stores to service rather than display sales. Retailers are also advised to concentrate resources to create multi-functional flagship stores in core locations, supplemented by a range of innovative store formats such as pop-up stores and concept stores.

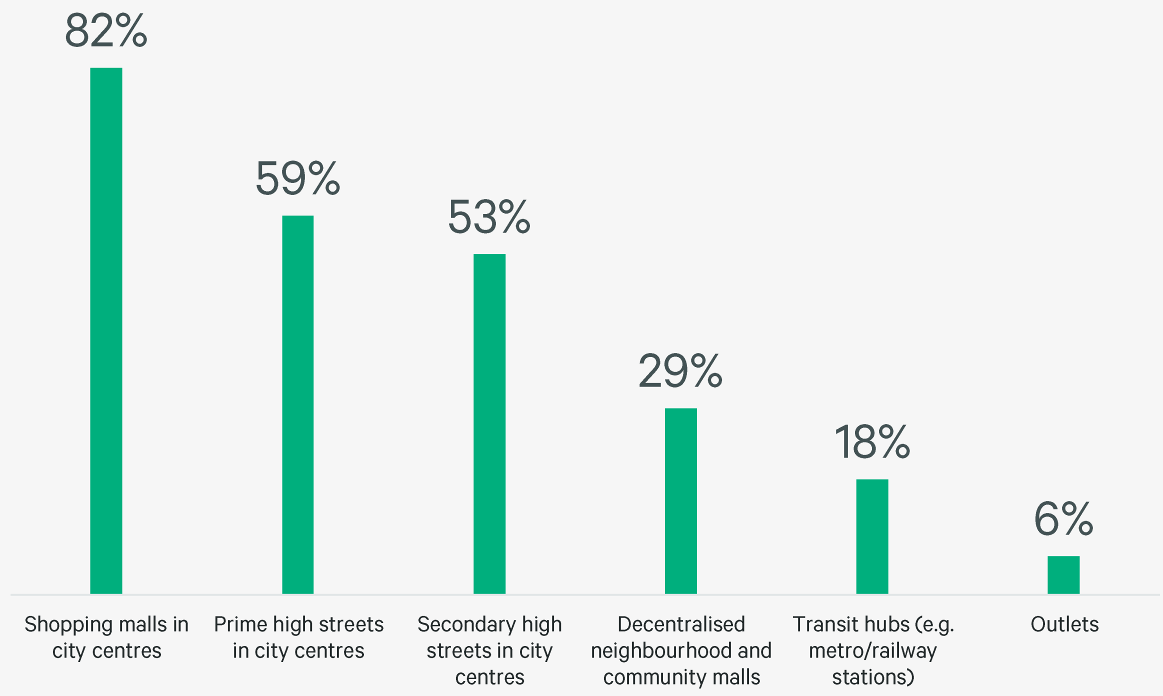
The findings of CBRE's Asia Pacific Retail Survey published earlier this year echoed this trend. Of the retail brands that plan to open new physical stores in mainland China in 2023, 82% stated a preference for locations in downtown shopping malls, followed by high-quality commercial streets in downtown areas.

Figure 6: Composition of omnichannel retail brand store networks



Source: Open news, CBRE Research, September 2023

Figure 7: Retailers' expansion plans for new physical stores in Mainland China in 2023



Source: 2023 Asia Pacific Retail Flash Survey, CBRE Research, September 2023

Trend 4: Adoption of sustainability practices prompts retailers to seek green locations

In November 2021, nearly 200 countries jointly adopted the Glasgow Climate Agreement, which states that by 2030, global carbon dioxide emissions must be reduced by 45% compared with 2010, and net zero emissions should be achieved around the middle of this century. Almost a year previously, in September 2020, China announced its "3060" dual carbon target.

These commitments will accelerate domestic and foreign retailers' adoption of policies and practices to reduce carbon emissions. As an important link in the product value chain, energy savings and emission reductions at brick-and-mortar stores will be key to helping retailers achieve their carbon neutrality goals. 80% of LVMH Group's greenhouse gas emissions come directly from the energy consumption of its 4,700 stores, which occupy an area of 1.5 million sq. m., equivalent to 200 football fields.

Among retail brands, the most commonly adopted sustainability practice is to use renewable energy, LED lighting systems, and environmentally friendly fitout materials in stores. CBRE has also observed that a small number of retail brands have established dedicated sustainability teams to conduct green due diligence on properties during site selection. Projects that do not meet green standards such as energy consumption and environmental protection will not be selected. As more retailers implement sustainability strategies and adopt carbon reduction goals, properties and locations with environmentally-friendly attributes will become more sought-after.

Figure 8: Major enterprises key carbon neutrality targets

Enterprise	Key carbon neutrality target	Target related to brick-and-mortar stores
LVMH	• By 2026, Scope 1 and 2 GHG emissions will be reduced by 50% compared to 2019 • 55% reduction in unit value added of Scope 3 GHG emissions by 2030	• Use renewable or low-carbon energy and LED lighting in all stores by 2026 • By 2026, 100% of the wood used in store fittings will not be sourced from areas at high risk of deforestation and desertification
Kering	• Reduce Scope 1 and 2 GHG emissions by 50% by 2025 • By 2035, reduce Scope 1, Scope 2 and 3 greenhouse gas emissions by 40% compared to 2021	• By 2030, the greenhouse gas emissions of store operating unit products will be reduced by 60% on the basis of 2015, and all stores will use 100% renewable energy electricity
Inditex	• By 2030, reduce scope 1 and scope 2 greenhouse gas emissions by more than 50% compared to 2018 • By 2040, greenhouse gas emissions will be reduced by at least 90% compared to 2018	• 100% of stores to run on renewable energy by the end of 2022
Fast Retailing	• By 2030, Scope 1 and 2 GHG emissions will be reduced by 90% compared to 2019 • Achieve carbon neutrality by 2050	• 100% use of renewable electricity in all stores by 2030
ANTA	• Achieve carbon neutrality by 2050	• Before 2030, achieve zero landfill waste from self-owned production, zero use of virgin plastics and zero carbon emissions in self-owned store operating facilities
L'Oreal	• Reduce Scope 1 and 2 GHG emissions by 50% by 2030 compared to 2016 levels	• By 2025, all store operations will be energy efficient and run on 100% renewable energy
McDonald's	• In 2030, total greenhouse gas emissions will be reduced by 36% compared to 2015 • Achieve carbon neutrality by 2050	• Use of global guidelines for reducing greenhouse gas emissions for all new store openings • Continuous improvement of energy consumption of restaurant kitchen equipment and restaurant lighting system

Source: Open news, CBRE Research, September 2023

Another driver of green stores is consumers' growing recognition of health and sustainability, which has accelerated since the onset of the COVID-19 pandemic. CBRE's 2022 China Live-Work-Shop Survey found that 95% of respondents said they are more concerned about environmental and social issues than before the pandemic, while more than 70% of consumers said they have bought or are willing to buy items at a premium due to environmental factors, or would stop buying related products for the same reasons. Retail stores with sustainable features are therefore becoming an important means for retail brands to communicate their brand values and environmental performance to their target consumers.

According to data from the U.S. Green Building Council, the total area of retail space in China applying for registration of green certification in 2022 reached a record 660,000 sq. m. As of the end of July this year, the total registered area had exceeded 1.77 million sq. m.

The technology and sustainable development service team of CBRE Real Estate Management Department recently assisted an international sports brand to set up a new environmentally friendly store in Shanghai.

Figure 9: Case study: Green store of an international sports brand

Store area	546 sq. m.
Project location	Huaihai Road, Shanghai
Certified	LEED Gold
Achieved green goals	• Saved 53.7% of water in compliance with LEED standards
	• Optimised indoor air quality according to ASHRAE standards
	• Reduced light energy consumption by 17.8%
	• Recycled 92.6% of decoration waste
Cost	The overall cost of the above initiatives was around RMB 100,000

Source: CBRE Research, September 2023

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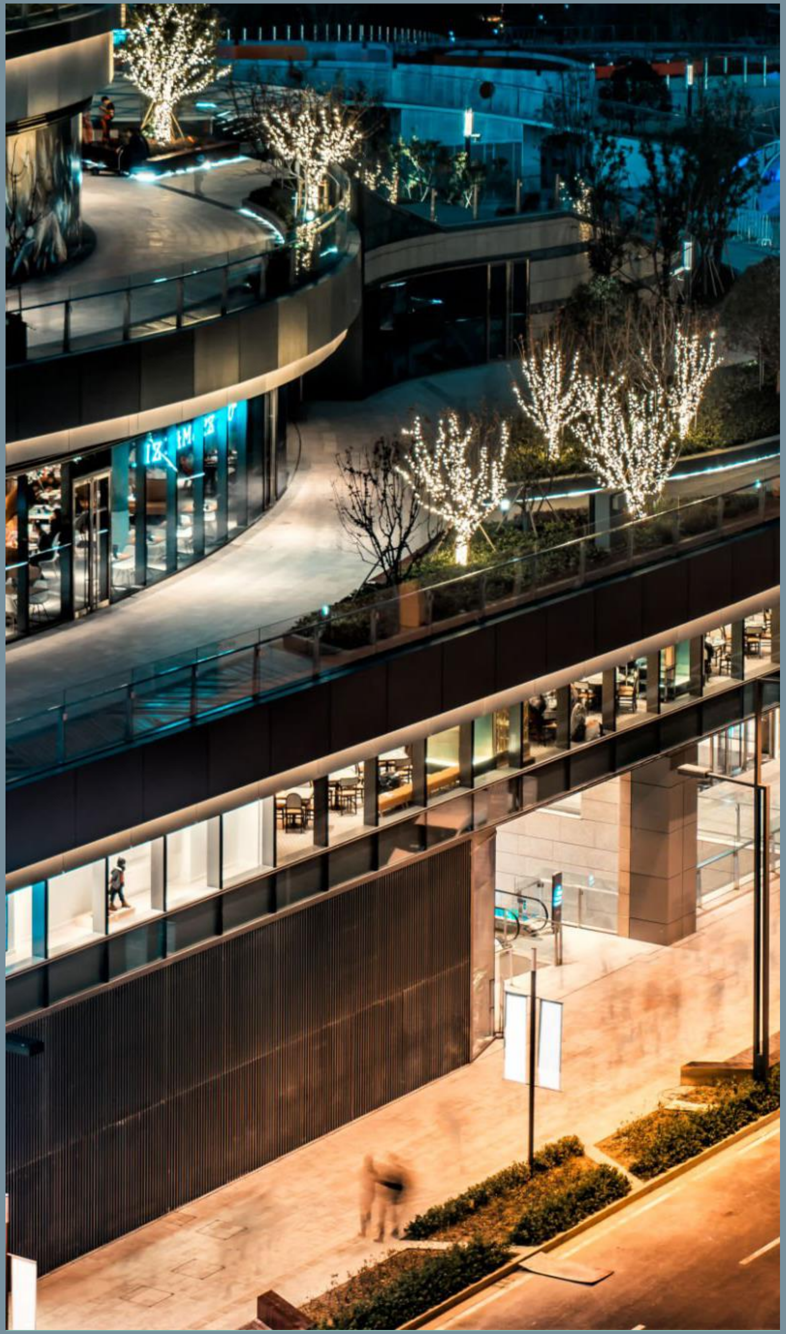
Retail property investment opportunities



Three factors activating retail property investment opportunities

Due to the severe impact of the pandemic on offline consumption, cumulative investment in China retail properties reached just RMB 47 billion during 2020-2022, a drop of 64% compared with the previous three years. Over the same period, retail's proportion of total investment transactions fell by 10.6 pps to 6.7 %.

Despite having a dramatic short-term impact on the retail sector, the pandemic has not altered the medium- to long-term trend of China's consumption upgrading and urbanisation, with consumer demand for high-quality shopping locations and experiences set to continue to grow. The recovery of offline consumption in 2023 will create cyclical opportunities to invest in China retail property.

Retail rents are approaching an inflection point

After experiencing significant disruption during the COVID-19 pandemic, the supply of high-quality retail properties in major cities will accelerate significantly in 2023. However, in the long run, average annual supply during 2020-2025 is forecasted to be 10% below that completed during the five years prior to the pandemic. As leasing demand continues to rebound, CBRE expects the overall vacancy rate to start to decline in 2024, which will see shopping centre rents in most cities bottom out.

The proportion of new supply in core business districts will be 15% of the overall total. Considering that retail brands' store investment will be further tilted towards core business districts to facilitate the implementation of omnichannel strategies, CBRE expects occupancy and rents in core business districts to outperform the overall market.

Asset pricing is more attractive than before the pandemic

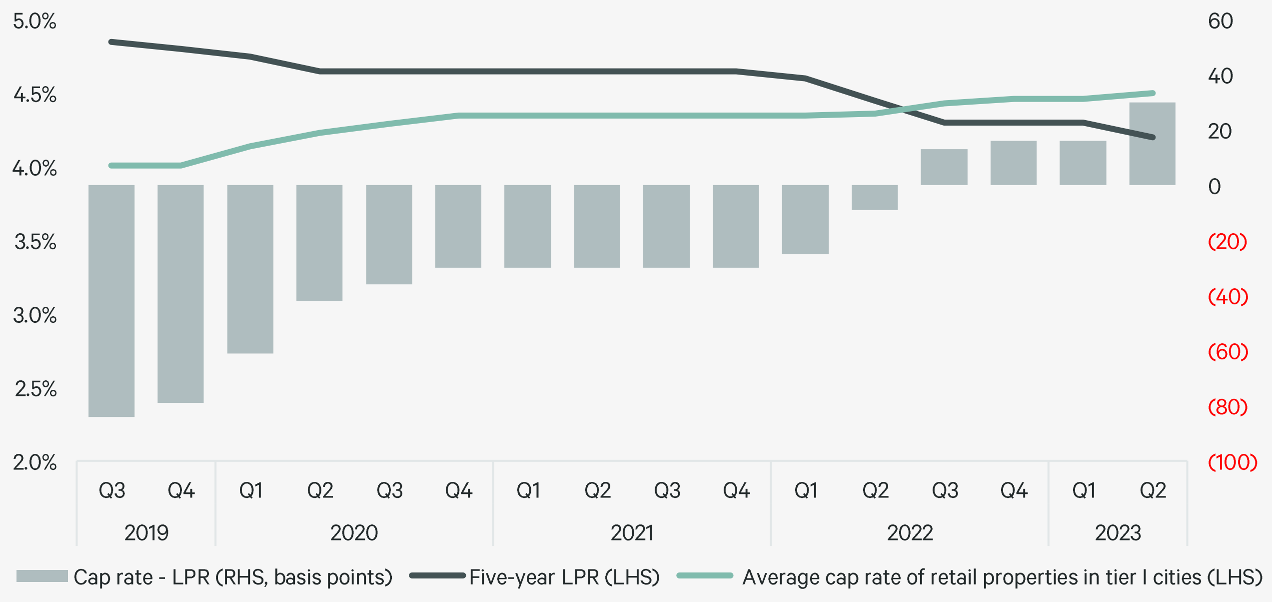
CBRE data for average capital values of high-quality retail properties in tier I cities show a decline of 20% since 2019. Following an improvement in leasing activity since the relaxation of anti-pandemic controls, cap rates stabilised in H1 2023 and asset prices are expected to bottom out in the next six to 12 months. Domestic retail property investment generally enjoys positive leverage as the five-year loan prime rate (LPR) has fallen from 4.8% at the end of 2019 to the current 4.2%.

Publicly offered REITs provide a new path for exiting retail property investments

In March 2023, the National Development and Reform Commission and the China Securities Regulatory Commission issued documents mentioning support for the construction of consumer infrastructure, including department stores and shopping malls. All kinds of retail properties, including shopping malls, community businesses, and farmer's markets, can now be included in the underlying assets of publicly offered REITs. Publicly available information shows that China Resources, Bailian, Jinmao, SCPG, Texhong and many other domestic commercial real estate companies have started to declare an interest in including retail assets in REITs.

CBRE expects the creation of consumer infrastructure REITs to help realise the "closed loop" of investment, financing, construction, management, and withdrawal for retail properties; facilitate the revitalisation of older retail properties; and activate related pre-REIT investment. Retail REITs will also improve the asset liquidity of retail properties in lower tier cities.

Figure 10: Average cap rate and 5-year LPR of high-quality retail properties in tier I cities



Source: PBoC, CBRE Research, September 2023

Three dimensions of operational performance

Retail property is a management-intensive asset class. The rebound in offline consumption following the relaxation of anti-pandemic controls and gradual return to normalcy will be an important window for investors to improve asset performance through enhanced management and operations. Taking evolving consumer trends into account, CBRE advises retail property owners and operators to pursue the following strategies.

Optimise tenant mix and improve efficiency

- Replace the shrinking fast fashion category with outdoor and professional sports brands;
- Reduce large-area and low-percentage supermarkets and formal catering formats, replacing them with coffee and tea, light meal, cosmetics, new energy vehicle, parent-child, entertainment, art and other experiential tenants;
- Capitalise on first store policies and cooperate with retailers to jointly create first stores, flagship stores, and image stores in shops with better displays.

Create experiential destinations and enhance omnichannel capabilities

- Recognise that scene creation and experience are crucial to physical commerce;
- Utilise atrium floating islands, roof space, outdoor squares, flyovers and other spatial design layouts to create retail destinations within shopping centres;
- Cooperate with tenants to create themed shopping areas within projects;
- Build a digital membership system and generate omni-channel private domain traffic.

Embrace ESG practices and principles

- Green shopping malls can not only effectively reduce water, electricity and other costs, but can also provide a healthy and comfortable shopping environment, host green merchants and environmentally-friendly retailers, and avail of green financial support and government green building subsidies.
- As the influence of ESG gradually penetrates into all areas of social and economic activity, ESG-related measures such as installing new energy vehicle charging piles in shopping malls can have a positive impact on project footfall and revenue growth.

Figure 11: Three dimensions of shopping mall operations

Tenant mix

Experience and omnichannel

ESG

Source: CBRE Research, September 2023

Investment recommendations

The years from 2023-2025 will be a critical period for the cyclical recovery of China's retail market and normalisation of domestic consumption. Accelerated expansion by retailers and the emergence of new consumption trends will drive the recovery of the shopping centres leasing demand. Under the omnichannel retail model, brick-and-mortar stores will remain at the core of the consumption chain, and consumer demand for high-quality shopping destinations and experiences will continue to grow.

CBRE urges investors to capitalise on this cyclical window by adopting the following investment strategies:

Focus on major tier I and tier II cities with continuous population inflows:

Investors must conduct detailed research and analysis of the locations of potential purchases and the characteristics of the consumer catchment prior to investing in order to manage the accelerated development of retail properties. The success of destination retailing depends on physical customer flow, which in turn rests on the appeal and specification of project formats. Investors are advised to give priority to regional shopping centres of a certain size and outlets with retail destination characteristics.

Consider the tenant mix and lease profile of the target project, analyse its potential for adjustment and improvement and its projected impact on investment returns:

Thanks to the launch of consumer infrastructure public offering REITs, investors can now avail of pre-REIT opportunities in lower-tier cities where there is a shortage of high-quality retail properties, community-based projects in tier I and II cities, and farmers' markets.

Partner with leading retail property managers:

With China's urbanisation having entered the mid-to-late stage, return on retail property investment in retail properties will depend to a greater extent on alpha, or the excess returns earned on an investment above benchmark returns when adjusted for risk. Institutional investors should therefore consider co-operating with asset-light commercial management companies to maximise returns.

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