

Backs to the mall

Sky-high rents are changing the face of the city's retail industry as local stores give way to international chains with deeper pockets

Alex Frew McMillan

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When Italian deli Il Bel Paese saw the lease for its Happy Valley shop come up earlier this year, it was in for a nasty surprise. The landlord, who holds a number of shops in the area, asked for rent of HK\$140,000 per month - nearly twice what it had been.

Founder Massimo Sfriso says the company was lucky to find a space nearby, which meant customers did not get lost in the shuffle of a major move. Still, the company went from a store that was just under 2,000 square feet to less than half that size.

Rent-based relocations such as Il Bel Paese's are routine in Hong Kong, where thriving home-grown shops are commonly dealing with a doubling or trebling of their rent. Local entrepreneurs face - at the least - vastly increased costs, causing serious disruptions to their businesses. Customers often have to deal with the loss of a much-loved local vendor and a constantly shifting retail landscape.

"For our type of business, it was not reasonable at all. It didn't make sense," Sfriso, who founded the deli 10 years ago, says of the rent rise he faced. "They said there were some other people offering as much. For the landlord, of course, it's a game. If you have found someone willing to pay what you ask for, we don't have any grounds to remain."

Price hikes of 100 per cent are the norm when leases are up for renewal in the city's most popular shopping streets, brokers say. Russell Street in Causeway Bay now has the second-most-expensive stores in the world, at rents of US\$125 per square foot per month, according to property agency Knight Frank.

Rents in Queen's Road Central, Russell Street and Canton Road in Tsim Sha Tsui have all doubled in recent years.

Hong Kong risks losing home-grown restaurants and family-run businesses as rents zoom ever higher. Multinationals with deep pockets are keen to tap the tourist demand in Hong Kong, especially from the mainland. They see Hong Kong as the centre of an Asian growth plan as their home markets are struggling.

The big chains are happy to drop large sums on rent because they see those locations as important branding exercises that help them crack the mainland market.

"The international brands are forcing out the local brands," says Helen Mak, the director of retail services at Colliers International. "They are willing to pay a premium, but it is unlikely the local retailers are willing to do it."

With brands such as Apple, Abercrombie & Fitch and Gap all taking up large amounts of space to open their first stores in the city, local chains fight to stay in business in central locations.

"We're seeing huge numbers of tourists coming to Hong Kong, and they're spending big, so all the international brands are doing very well," says Tom Gaffney, the head of retail at Jones Lang LaSalle, another agency. "A lot of these old shops are in key locations with great exposure and these brands are targeting those areas. They have much deeper pockets than local retailers, so they are able to price them out."

The rise has been most pronounced on the high street, where most properties are in the hands of individual owners or small-scale investors. Big brands find high street locations riskier since they can't control the quality of their neighbours or the area. But they view a flagship high-street store as a billboard and valuable marketing tool for the mainland market.

The storefronts are more visible on a high street - with hundreds of thousands of passers-by each day - than in a mall. Malls have seen smaller jumps in rent because they're in the hands of a big landlord that tries to maintain a broad base of tenants in the whole complex rather than maximising rent in each shop.

"It's different if you are a single owner; you are just going to take the highest rent you can get," says David Martin, the head of retail at Hongkong Land. "I've got to keep an eye on the tenant mix, so I can't just take the higher rent. Your tenant mix would just go sideways."

It's hard for a small landlord who owns a couple of shops to see it the same way. "If somebody comes along and tells you they're going to give you 50 per cent more, why wouldn't you?" Martin asks.

Jones Lang LaSalle predicts that shopping centre rents will rise 28 to 32 per cent between now and 2014. Prime street-front rentals are forecast to rise 42 to 48 per cent.

Yields are low, however, on prime retail property, at 2 to 2.5 per cent. Brokers expect rents to keep rising after two years of strong growth in store property values.

Edward Chan - who runs Smart Vantage Investments, a property brokerage - notes that one building on Wellington Street is for sale at HK\$135 million despite generating only HK\$200,000 in monthly rent, for a yield of 1.8 per cent.

"For a really prime location, that's the sort of deal they're doing," Chan says. Landlords may leave the premises empty and wait for a big-money rental. But even stores that have stood empty for months, such as several restaurant spots on Granville Road, have started to fill up.

Chan has a client who is looking to start an Italian restaurant in Tsim Sha Tsui. But a bid to rent space on Hart Avenue at HK\$140,000 per month was rejected in favour of a bigger company offering the same amount. "The landlord prefers to rent to a tenant that has other shops, rather than a new tenant that has a limited budget," Chan says.

The driving force behind these rents is tourism, specifically visitors from the mainland. There has been a boom in individual travel from there after Beijing had eased visa restrictions in 2004, to revitalise a Hong Kong tourist industry devastated by the outbreak of Sars. Mainland visitors now make up 63 per cent of travellers to the city, and they have reshaped Hong Kong's retail landscape.

International brands are keen to use Hong Kong as a springboard. Retail experts say store trends here are quickly picked up by mainland consumers, in much the same way Paris fashion or New York street styles filter through to Hong Kong.

Livian Har, the head of retail at Knight Frank, notes that landlords in core areas say they're getting 30 to 40 per cent of their business from visitors from across the border. And they skew the retail mix to the luxury goods they prefer to buy, with free market Hong Kong adding on none of the hefty luxury goods taxes charged on the mainland.

"You can see how significant they [mainland tourists] are," Har says. "They are buying luxury goods. For food and beverage, their significance is not that great."

Hong Kong retail sales rose 25 per cent this year through the end of July, compared with the same time last year, with HK\$35 billion in sales for the month of July alone. But sales of jewellery and watch stores raced ahead 51 per cent, double the overall rate of increase, with clothing the second-fastest gainer at 29 per cent. Food sales rose just 6 per cent, keeping pace with inflation.

The upshot for local shoppers is a constantly shifting retail environment, with shop openings at prime locations heavily biased towards international luxury brands.

Hong Kong has 10 Cartier stores and seven Louis Vuitton boutiques.

The British fashion firm Burberry plans to open a two-storey flagship store in Pacific Place, Admiralty. The

shop would be Burberry's biggest outlet in Hong Kong and its second largest in the world.

A report from Colliers International says that Wharf is considering remodelling the UA Cinema on the ground floor of Times Square, Causeway Bay, to provide space for global brands in need of flagship stores.

Gap will take 15,000 square feet of space in the redeveloped LHT Tower on Queen's Road Central in November, with Swatch taking a smaller store in the same building. Abercrombie & Fitch is opening a 32,000-square-foot store in the Pedder Building, edging out Shanghai Tang and taking the basement and four upper floors, as well. Apple will also open its first company-owned store in IFC Mall, taking up around 20,000 square feet.

Abercrombie & Fitch is paying HK\$7 million per month in rent, four times the existing rent, according to Colliers. Besides the inroads into the China market, the company may also attract franchise offers from Chinese executives, retail agents say.

"It's the equivalent of five stores, five tenants. They're taking up huge space, and it drives up the rental," Mak says. "The landlord would prefer to deal with one tenant."

Jewellery brands are also driving up rents since they often snap up street-corner locations, the most prized positions, paying double the normal rent to get bigger exposure.

"They contribute nearly half of the rental revenue of a high street," Mak says. "The average check-out [what each customer pays] is something like HK\$100,000. So if you get 20 customers in one day, you can pay the rent for the month."

Shops with high traffic which sell low- to mid-cost items seem to be losing out in this trend. HMV, for example, has relocated its Tsim Sha Shui and Causeway Bay shops to the "fringe" areas of the districts, according to Knight Frank, and it closed its Central store.

Particularly vulnerable are shops such as dai pai dong, stationery vendors and cubbyhole locksmiths, which give Hong Kong its unique street level storefront identity. Now it's in danger of being consumed by the city's vast retail makeover. "I'm afraid of that," Mak says.

Sfriso, who started Il Bel Paese with its first store on Caine Road in 2001, has jiggled through the rent-hike dance before. When the Caine Road store came up for renewal at the end of its first lease, after six years, it was also forced to move.

"We were willing to pay ... It was [the] face of the company," Sfriso says. "The issue was not the rent. The landlord had an offer to rent the store to Maxim's Group and felt more secure with a big company."

At short notice, the company scrambled to find another location nearby on Caine Road so that customers weren't inconvenienced too much. But all the extra rent and moving around keeps cutting into the company's expansion plans.

Retailers normally sign a lease with a two- or three-year fixed period, with an option to extend again for another three years. They say they are rarely able to renegotiate a new lease at current levels and normally have to leave at the end of each lease.

Il Bel Paese, with six outlets in Hong Kong, had earmarked money to open two or three more, which it believes the market can handle. Instead, the cash has gone to find new locations for existing stores.

"Even though you plan to have other openings, you end up having to postpone because you have to use that amount, which should be for a new opening, to relocate," Sfriso says. "In the past two or three years, I see that we are spending as much as before when we were expanding, but the same amount is to keep the positions."

moneypost@scmp.com