OFFICE MATTERS UPDATES

HONG KONG OFFICE SERVICES

www.cbre.com.hk | officeservices@cbre.com.hk

CBRE

MARKETVIEW
HONG KONG OFFICE | 3RD QUARTER

• GDP growth may moderate on global uncertainty

Hong Kong's economic growth slowed to a 4.3% y-o-y increase in the third quarter, compared to 5.3% y-o-y growth a quarter earlier. Moderation in economic expansion was largely due to a weakening in trade volumes toward quarter end on the back of falling external demand. On the other hand domestic consumption and tourist spending remained healthy. Full-year economic growth for 2011 is forecast at 5% to 6%, with expectations of milder growth in 2012 on the back of an increasingly fragile global economic outlook.

• Falling occupier demand pulled prime Central rents down 3.8%

Weakened sentiment resulted in some landlords revising down their rental expectations. This was particularly evident in the Central district where factors such as a slowdown in absorption by the banking and finance sectors, coupled with rising secondary space returning to the market, resulted in Central A1 rents falling 3.8% q-o-q to average $148 psf. Beyond Central, rents remained on an uptrend on Hong Kong Island, although the rate of growth slowed considerably compared to earlier quarters. Kowloon rental growth remained on an uptrend on the back of healthy demand, rising 5.3% q-o-q to average $36.5 psf.

• Potential trickle down effect from bank layoffs

Financial institutions such as HSBC, Bank of America and Barclays all announced plans to reduce staff headcount worldwide. The banking and finance sectors are a leading indicator of the broader economy and if global economic growth continues to weaken then more occupiers across various industry sectors will likely look to reduce operating overheads, a large proportion of which will include lowering real estate occupancy costs either by seeking out more cost effective premises or reducing their real estate footprint in Hong Kong. Rents in core districts will likely soften on the back of weaker demand and rising vacancy, while rental growth in decentralized markets may continue to grow as occupiers seek out more cost effective offices.

CONTENTS

CONTRIBUTORS

Edward Farrelly
CBRE Research, Hong Kong, Macau & Taiwan
T: 2820 2886
edward.farrelly@cbre.com.hk

Charles Kelly
Office Services (HK)
T: 2820 2963
charles.kelly@cbre.com.hk

Nick Axford
CBRE Global Research
T: 2820 8198
nick.axford@cbre.com.hk

Oliver Rigg
Office Services (HK)
T: 2820 8193
oliver.rigg@cbre.com.hk

John Davies
Office Services (KLN)
T: 2820 5127
john.davies@cbre.com.hk

Phil Rowland
Global Corporate Services
T: 2820 8122
phil.rowland@cbre.com.hk

David Chang
Global Corporate Services
T: 2820 2872
david.chang@cbre.com.hk

TAILORING THE FUTURE OF HONG KONG

During my 12 years spent in Spain I often came across references to a Spanish tourist board campaign featuring the late, great golfer Steve Ballesteros and the simple slogan, "Spain is different". It would not have been amiss had Seve uttered the words in relation to Hong Kong on one of his visit to these shores.

Edward Farrelly
Director
CBRE Research Hong Kong, Taiwan and Macau

WHERE ELSE IS A 5 MINUTE WALK CONSIDERED EXCESSIVE, AND THEREFORE REFLECTED IN RENTAL DISCOUNTS OF 30% OR MORE? WHERE ELSE WOULD A 35% ANNUAL HIKE IN RENTS BE MET WITH A SHRUG OF THE SHOULDERS?

Hong Kong is an explosion of colour competing with a cacophony of noise. It is an all out assault on the senses. If the buildings don't make your nose bleed the rents will certainly make your eyes water. Hong Kong is also a city of contrasts. Urban areas with twice the number of skyscrapers as Manhattan soon give way to thicket and a blanket of green where long isolated country paths exist oblivious to rents, mortgages and Andy Lau. Temporary respite is also provided by the Star Ferry as the jostle, hustle and bustle of street-life is temporarily suspended. The monotonous chugging and gentle rocking proves almost hypnotic as the evening ebbs its way across the harbour. On the port side, Lantau Island draws in the half-light, while the dying embers of the day reflect their resistance on the smooth exterior of modern Hong Kong. Boats and crafts born of a thousand years of trade weave their patterns through the dusk, then retire, ceding their position.

Given the rich tapestry laid out before it, the waterfront is surprisingly inaccessible in many areas, jealously guarded by assorted constructions along long stretches. The Central Harbour reclamation project plans to address this issue by offering swathes of green, open space. While this is indeed laudable, and action is long overdue, is it the ideal solution, given the perfunctory commercial aspect? This is, after all, the most expensive office market in the world and the taxpayer will therefore be required to foot a very hefty bill in terms of opportunity cost. In a land of extremes, perhaps it is no surprise that an either / or approach is adopted but I maintain that a more substantial commercial development together with integrated quality open, public space would create a better dynamic for the city and its people. I champion the provision of appropriate developments built in harmony with adequate recreational areas, therefore creating destinations.

The planning concept for Hong Kong has been flawed for many years, principally due to the lack of a masterplan approach. Even a cursory glance at other major global cities will show that commercial development and public amenities are not mutually exclusive. Indeed, they can be seen as complementary when planned together. However, hope springs eternal. The recent announcement by central government of plans to create a CBD2 in East Kowloon is a step in the right direction. This envisages the use of vacant, underused or misused land to provide office, retail and residential space together with public amenities and open spaces. While some concerns persist as to the location and dimension of specific elements, initial plans can be moulded to address commercial demands while satisfying social interests. Both facets are not only compatible but mutually dependent as they provide the platform for organizations, and therefore people, to enrich our social fabric.

The Hong Kong Government recently announced plans for the redevelopment of East Kowloon as a major office hub, branding it as CBD2. The 43m sq ft of office developments identified by the government represents a major initiative and we welcome the proposals. This dovetails with a recent CBRE Grade A Office research report, commissioned by Royal Institute of Chartered Surveyor (RICS), which highlights that 70% of future office development activity will be concentrated in Kowloon. The Government's reference to transport, amenities and an anchor tenant suggest a Masterplan approach for the area, something we have long supported. However, we await more detail from the government, specifically in regard to Tai Tak. We see this as a major opportunity to create a destination that has worked extremely successfully in other international cities where commercial, retail, residential and leisure from part of major mixed-use projects.

Edward Farrelly is CBRE Head of Research Hong Kong, Taiwan and Macau and was previously CBRE Head of Research for Spain and Morocco. Contact: edward.farrelly@cbre.com.hk

CENTRAL OFFICE MATTERS CHASING SUPPLY

NO SPACE?

It is a well entrenched fact that Hong Kong, especially Hong Kong Island, is facing a massive shortage of supply.

It is a tough fact to swallow, especially for those in mature markets where vacancy has only increased over the past 36 months, the overall vacancy rate is falling on both sides of the Harbour. With only 1.3 million sq ft of annual average new supply expected to come on line between 2011 and 2014, compared to Hong Kong's average annual absorption over the past 15 years of 2 million sq ft, the trend of falling vacancy is likely to continue.

Up until recently this statistic looked a lot worse for medium-to-large occupiers in Central where the current vacancy rate stands at approximately 4.3% in Grade A Buildings – one of the many reasons why it is pound for pound the world's most expensive office district.

However, just six months ago, Central's vacancy stood at less than 3%. Now the supply situation in Central is changing – in the coming months we will see the vacancy rate in Central increase, while periphery district vacancies will continue to tighten.

A CHANGING CENTRAL LANDSCAPE

In the present market environment, Central Grade A office space offers limited options for medium-to-large occupiers. Fortunately however for occupiers, due to the flight of tenants in search of lower cost alternatives and flexible future growth, a range of choices will begin to come on line.

Opportunities will open in several of Central's A1 buildings that will allow for some breathing room and leverage positions for tenants evaluating their footprints. As large holes are created in some Central's trophy assets, major landlords will begin to compete for key tenants, leading to more favorable terms and lower rental values for occupiers in regards to lease negotiations.

Should the global market uncertainty persist, Hong Kong's commercial property market would not be immune to the effects of an economic slowdown, though the blow would be cushioned by its position within Asia and relationship with China. There is currently approximately 600,000sq ft of available space in Central, with another 450,000 sq ft to be vacated in and around this area over the next six months. Obviously a deterioration in the economic outlook could cause companies to delay or cancel plans to expand, therefore pushing vacancy rates upward. Landlords would then feel increased pressure, providing tenants with a more level playing field, and possibly the upper hand in negotiations.

In order for tenants to take advantage of the cyclical situation that they now face, occupiers can look to two main options: 1) A high risk, high reward approach to wait until the market hits the bottom to strike a deal and potentially risk missing an opportunity; or, 2) be attentive and secure space that would not normally be available in a traditionally tight market at a decent rental and terms.

No matter what track occupiers looks to take they should be prepared to act quickly to capitalize at this point of the cycle. Tenants should try and have decisions surrounding their occupancy confirmed – e.g. future headcount, budget, space versus cost trade off, technical specifications, etc. If we can learn anything from the recent Global Financial Crisis, it's that in Hong Kong the market drops quickly in a downturn, but is even quicker to respond on the rebound.

For more information on this article please contact charles.kelly@cbre.com.hk

Charles Kelly,
Associate Director
Office Services

BUSINESS FOOTPRINTS
GLOBAL OFFICE LOCATIONS 2011

IN A RECENT REPORT WHICH ANALYSES THE GLOBAL LOCATIONS OF 280 OF THE WORLD'S LARGEST COMPANIES ACROSS 101 COUNTRIES AND 232 CITIES, HONG KONG RANKED AS THE NO.1 CITY WITH THE HIGHEST NUMBER OF INTERNATIONAL COMPANIES PRESENT.

The report by CBRE Global Research & Consulting entitled "Business Footprints: Global Office Locations 2011", after examining the locations of companies over Asia Pacific, The America's and Europe Middle East and Africa (EMEA), determined that 68.2% of companies surveyed are present in Hong Kong's office market, with the second ranking city being Singapore at 67.5%. Interestingly, of the following 7 top cities listed, 5 are in Asia Pacific.

The Hong Kong result is not surprising since Hong Kong is regarded as one of the world's pre-eminent business locations, and routinely ranks among the top five global business cities in surveys of international competitiveness. Hong Kong's position as a gateway city for the entire Asia region means it benefits from inward investment from Asia's economies, particularly the rapidly expanding Chinese market. Hong Kong has established itself as a regional hub for a number of reasons relating to its business environment, geography and labour force/ economic structure.

Business environment: Hong Kong has an open economy, with limited restrictions on foreign investment, and a low tax environment. The maximum rates of corporate and personal income tax are 16.5% and 15% respectively, and there is no tax on sales, capital gains or dividends. It has a mature legal system inherited from the United Kingdom.

Geography: Three of Asia's key markets, including mainland China, Singapore and Malaysia, are in the same time zone as Hong Kong and it is possible to reach each of them within four hours. The Hong Kong government has invested heavily in infrastructure, particularly the airport, to improve the city's standing in the eyes of international business. There is a large amount of high quality office space, particularly in Central, which is regarded as the core business district and which accommodates a large number of international financial institutions and other multinationals.

Labour and Economic Structure: There is a highly skilled and very international labour pool in Hong Kong with links to, and an appreciation of, the business culture in the fast growing cities in mainland China and other parts of Asia. Immigration policies are designed to attract qualified professionals worldwide and there is a specific policy to introduce skilled workers from mainland China. For these, and other reasons, the city's economy is increasingly based on Financial and Business Services, and clustering by firms in this sector is likely to be self-reinforcing.

To find out more about our "Business Footprints: Global Office Locations 2011" report, please contact ***Nick Axford****, Head of Research, Asia Pacific and Senior Managing Director, Global Research, CBRE*
nick.axford@cbre.com.hk

OFFICE LEASING *MATTERS* IN HONG KONG

YOU WOULD'T GO ON HOLIDAY WITHOUT FINDING OUT IF YOU NEED A VISA AND YOU WOULDN'T BUY A PROPERTY OVERSEAS WITHOUT UNDERSTANDING LOCAL LAND OWNERSHIP RIGHTS.

Oliver Rigg, Manager Office Services

Why should your decision about your office lease be any less informed? As with any project, the key to getting the most out of it and having the best experience, is understanding local customs and peculiarities.

Leasing office space in Hong Kong is no different, and certainly it does have some unique features. Due to its previous incarnation as a British Territory many of them have been around for a while. However some are just plain homegrown.

The first thing that confuses many new entrants to the market is trying to find out exactly how big the space they are looking at actually is. Unlike many Western markets there is no single standardized system of measurement in Hong Kong. Occupiers are faced with three versions; Gross, Lettable & Net:

NET AREA
The actual usable "carpet" area of the premises and in some cases also include elevator lobbies. Efficiency of net area is typically in the range of 95 - 100% of the quoted area.

LETTABLE AREA
The net area plus structural columns and a percentage of common areas such as elevator lobbies and restrooms. Common areas are apportioned on a pro-rata basis if the floor is subdivided. Efficiency of lettable area depends on the size of the floor plate and usually ranges from 70 - 95% of the quoted area.

GROSS AREA
The total area measured to outside of external walls, including elevator lobbies and wells, restrooms, staircases and all mechanical areas. Similar to lettable area, all elements of the common areas are apportioned on a pro-rata basis if the floor is subdivided. Depending on the size of the floorplate, the efficiency of gross area is in the range of 60 - 80% of the quoted area.

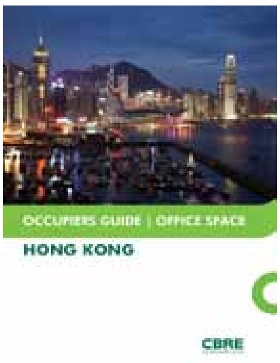
While these are the stated definitions, experience tells us that the honest truth is the space is as big as the landlord says it is and there is very little a tenant can do about it. Exact sizes are, for the most part, not specified in lease documents and even if the technical CAD plans suggests that the space is less than the "83%" a landlord is quoting, the size on which the tenant pays rent stays the same.

When it comes to working out how much a space is going to cost (once you have a handle on roughly how big it is) a tenant should bear in mind that rents are quoted on a per square foot per month basis, exclusive of service charges and government taxes, which are also payable by the tenant, and that leases in Hong Kong are typically three years long, although exceptions are possible.

Many new entrants also have concerns about the deposit amount (3-6 months' rent, service charges and government tax is market practice) and the holding of it. The deposit sum will be given over to the landlord for use as they see fit – blocked or trust accounts are not normal – and 100% interest goes to the landlord.

This all seems rather heavily Landlord biased, and the truth is that it is, but the silver lining to this is that Hong Kong Landlords are, for the most part, in things for the long haul and therefore interested in a good working relationship with their tenant.

The key, as with any project, is to be well prepared and well advised, and that is where an experienced local real estate advisor can really assist and add measurable value. Anyone can find out a quoted rental but really understanding local market practice and nuance is essential to ensuring that your company starts its Hong Kong business venture with the best foot forward.



For more information on this article or to receive a copy of CBRE's "Office Leasing Hong Kong" Guide which goes into more detail on this subject, please email the author at oliver.rigg@cbre.com.hk

KOWLOON EAST
AN INSURANCE POLICY FOR OCCU

THE ORIGINS OF THE CURRENT WAVE OF DECENTRALIZATION CAN BE TRACED BACK TO THE MIDDLE OF 2006 WHEN MAJOR OCCUPIERS SUCH AS HANG SENG BANK CONFIRMED TO LEASE APPROXIMATELY 250,000 SQ FT IN ENTERPRISE SQUARE 5 AND MAERSK BECAME THE FIRST ANCHOR TENANT IN ONE KOWLOON, KOWLOON BAY

Since this period Kowloon East, which includes the districts of Kowloon Bay and Kwun Tong, has firmly become the location of choice for forward thinking occupiers who wish to secure cost effective office accommodation without compromising on quality. Most recently the Life Insurance Sector have taken up a significant amount of space in Kowloon East with some major occupiers completing pioneering relocations in order to accommodate their ever expanding occupancy needs.

Manulife International led the charge with their acquisition of a new flagship hub in Manulife Financial Centre. As of now they occupy in excess of 500,000 sq ft (Gross) in this prominent Kwun Tong building, which offers Grade A specification at cost effective rental levels, while at the same time enjoying prominent signage and naming right exposure. When CBRE worked on this transaction, by far the largest new letting that Hong Kong has experienced in a decentralized area, we shared the same vision as Manulife in what could be achieved in this location.

Today, Manulife have been joined by a number of other major insurance companies which has expedited the transformation of this district.

John Davies
Executive Director
Office Services

Approximately 1,000,000 sq ft gross of Kwun Tong office space is occupied by major insurance companies and CBRE is sure more would follow should there be more quality Grade A space available within this district.

During the current and future projected period of high rental levels in Hong Kong Island, Kowloon East is still proving to be a very attractive location of choice for occupiers, therefore, as long as developers continue to build quality Grade A accommodation quality tenants will find themselves migrating to this ever expanding office hub.

For more information on this article please email the author at john.davies@cbre.com.hk

PANCY COST

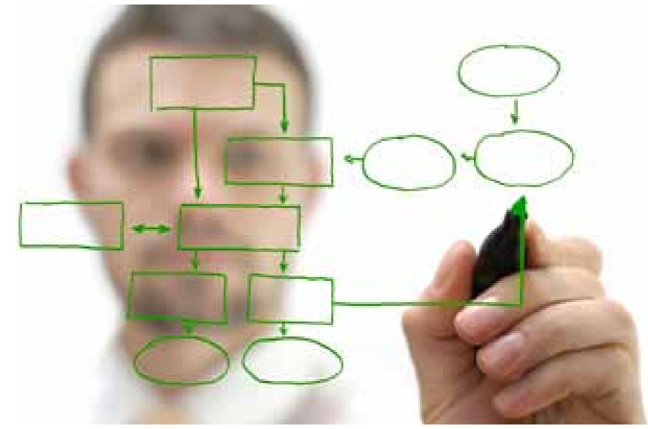
MOVING ORGANISATIONS AHEAD OF THE MATURITY CURVE

From "Evolution of the Corporate Real Estate Organisation in Asia"
By David Chang and Phil Rowland

KEY DRIVERS, INCLUDING THE FINANCIAL CRISIS AND GROWING CLIENT DEMANDS, HAVE PUSHED MANY CORPORATE REAL ESTATE (CRE) ORGANISATIONS TO CONTINUALLY INNOVATE AND EVOLVE.

Traditionally, in-house CRE organisations have been support functions, but increasingly organisational maturity has taken pole position in the minds of senior CRE executives. This trend, which started to gain traction a few years ago, took on greater precedence and urgency during the financial crisis two years ago.

End users' expectations around the delivery, value, quality and expertise of real estate functions have changed and, in response, CRE



managers and organisations are demonstrating growing levels of sophistication in various core competencies, such as strategic leadership and portfolio planning, which have effectively moved their respective organisations from executors to advisors.

It is unsurprising that senior real estate professionals are concerned about organisational maturity. The financial crisis accentuated several significant challenges, one of the clearest being the dichotomy of supporting growth at no cost. Many Asian countries enjoyed buoyant growth after a brief period of slowdown, in stark contrast to the still tepid recovery in most western economies. But while business leaders see Asia as the engine of growth, corporate real estate organisations in Asia are still being asked to contribute to global cost reduction and efficiency targets.

This has been accompanied by a definitive shift in thinking at CRE organisations as they seek to differentiate between "core" and "non-core" activities and are structuring delivery models that reflect this change. For some clients they have defined what is core to their mission, for example customer relationship management and performance measurement, and shifted other secondary responsibilities to service providers.

These are among numerous items undergoing change in organisations and have forced clients to look at their organisations internally, rid themselves of the status quo, and see what they can do better.

As CRE organizations gradually evolve due to the greater demands of the core business and the external environment in Asia, there is a greater need for them to be cognisant and proactive in developing the building blocks for success. CRE organisations must candidly assess their strengths, evaluate areas for improvement and prioritise actions steps for a more streamlined organisation.

To receive a copy of the complete White Paper "Evolution of the Corporate Real Estate Organisation in Asia" or for more information on this article please email *phil.rowland@cbre.com.hk.*

David Chang
Director
Global Corporate Services

Phil Rowland
Managing Director
Global Corporate Services

50
CONNAUGHT ROAD CENTRAL

For information please contact:

Ian Stewart
Associate Director
T: (852) 2820 8109
ian.stewart@cbre.com.hk
Licence: E-265618

Matthew Thompson
Senior Manager
T: (852) 2820 8143
matthew.thompson@cbre.com.hk
Licence: S-282878

www.50CRC.com.hk

CBRE

CBRE

NUMBER ONE REAL ESTATE ADVISOR
AND CONSULTANT IN HONG KONG
EUROMONEY REAL ESTATE AWARDS 2011

For more information please contact:

CBRE Hong Kong Limited
Licence No. C-004065

Hong Kong Island Office
4/F Three Exchange Square
8 Connaught Place
Central, Hong Kong

(852) 2820 2800

Kowloon Office
Suites 1201-03 & 14, 12/F, Tower 6,
The Gateway, 9 Canton Road
Tsimshatsui, Kowloon, Hong Kong

(852) 2820 8100

CBRE