

The polarisation of Hong Kong's Grade A office market became more evident within the third quarter of 2006 as rents for the best quality space in Central continued to increase under still-strong financial-related demand, while the remainder of the market showed signs of easing in its pace of upswing. Financial institutions were very aggressive in their search for the best quality in Core Central with Wealth Management and prime broking demand driving a significant portion of the rise in requirement for

CBD office space in the market. The growth of and optimistic outlook on China-related wealth management services was a notable demand driver for top tier office requirement in Hong Kong within the review period. While a trend of decentralisation has not been witnessed by major finance-related Central tenants, due to their focus on the city's CBD and its immediate periphery, it is seen that some occupiers may have to downgrade their requirements to encompass some of the CBD's lower quality top grade facilities.

On the wider Hong Kong Grade A office market, meanwhile, rental growth was far more moderate than that observed in the Core Central CBD and its immediate environs. While the finance sector continued to be willing to accept higher

rentals in Central, Hong Kong's other prime office markets exhibited a slowing rate of growth. Take-up activity registered at more subdued levels in the wider office market, on the back of the confluence of the level of rental increasing seen earlier in the market and the reduced availability of leasing options. In light of the nearing release of a considerable quantum of

office space to Hong Kong's decentralised markets, a number of landlords are beginning to look towards tying in tenants on longer lease terms.

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Meanwhile, in the Kowloon office market, there has been a recent trend of flight-to-cost savings observed as tenants endeavour to lower the impact of rising rentals. Today, it is evident that landlords across Kowloon are willing to offer leasing packages which are approximately 10% less than the previous quarter. A well known US Investment bank is considering to lease approximately 37,000 sf in The Gateway Towers 1 and 2. The rumoured rental is approximately \$2 psf less than that concluded for Polo Ralph Lauren over the Lunar New Year, which highlights the fact that landlords are already trying to protect their portfolios from the major new supply namely International Commerce Centre and various buildings in Kwun Tong and Kowloon Bay.

### QUICK STATS

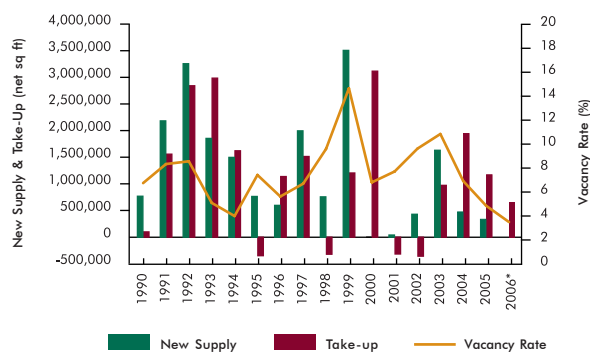
	Change in Q2 06	Change in Q3 06
New Supply	↔	↔
Demand	↑	↑
Vacancy Rate	↓	↓
Prime Rents	↑	↑

**OFFICE NEW SUPPLY, STOCK AND VACANCY IN JULY - SEPTEMBER 2006**

	New Supply (Net sf)	Total Stock (Net sf)	Vacancy Rate
Core Central	-	13,199,794	2.36%
Admiralty	-	4,132,600	2.79%
Sheung Wan	-	3,294,015	5.72%
Wan Chai	-	6,060,460	3.08%
Causeway Bay	-	4,611,255	4.10%
Tsim Sha Tsui	-	7,865,778	4.70%
<b>Overall Prime</b>	<b>0</b>	<b>39,163,902</b>	<b>3.47%</b>
Decentralised Hong Kong	-	9,428,862	4.97%
Decentralised Kowloon	-	10,597,114	5.29%
<b>Overall Decentralised</b>	<b>0</b>	<b>20,025,976</b>	<b>5.14%</b>
<b>Overall Total</b>	<b>0</b>	<b>59,189,877</b>	<b>4.04%</b>

**NEW SUPPLY, TAKE-UP AND VACANCY IN PRIME AREAS**

**Grade A Office Supply, Take-Up and Vacancy**

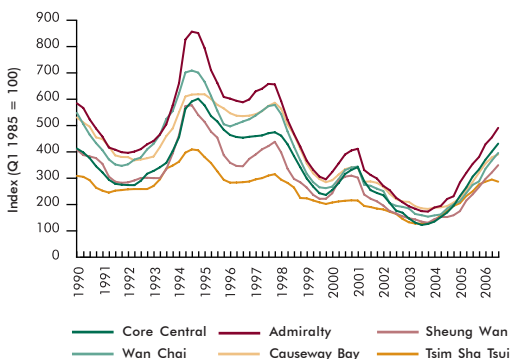


\* As of September 2006

The injection of 106,600 sf of top grade centralised space to the market by Hongkong Land's York House witnessed its first transaction within the period under review with take-up by Legg Mason. The US-based asset management firm's pre-lease of 8,300 sf on the tower's 12/F is forecast as the beginning of a rapid expected rate of take-up in the new prime-located office facility. It is expected to receive its occupation permit in the year's final quarter. Meanwhile, on the back of the strength of demand for space in top grade office space in the CBD, space in premium Grade A buildings is witnessing rapid take-up as in-house banking and finance tenants remain keen on internal expansion. In a CBRE Research occupancy analysis of the top ten Grade A buildings in the CBD within the third quarter, vacancy fell to 1.3%. This further compression, half the rate witnessed three months previous, reflects the considerable gravitational pull of the best space available in the market. On the back of this compression as well as that across prime districts, take-up registered at fairly low levels within the period under review.

## RENTAL TRENDS IN PRIME AREAS

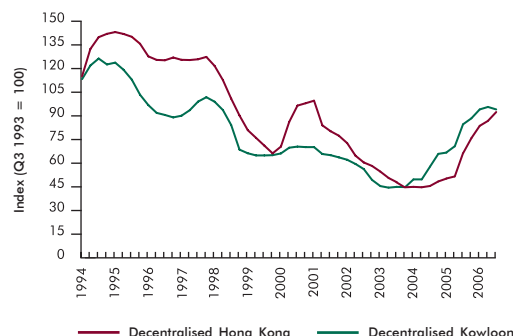
### CB Richard Ellis Grade A Office Rental Index



Overall prime office rentals in the Hong Kong market continued to head north in the third quarter of 2006, however, at a more restrained pace than that seen in previous quarters. The rate of rental increment on a district-by-district basis in Hong Kong's prime office precincts continued to harden, with the exception of Tsim Sha Tsui, which registered a q-o-q downward adjustment of 2.8%. The Central CBD and its immediate periphery in Admiralty and Sheung Wan, meanwhile, registered the most robust q-o-q increment in rentals, with each district witnessing increase of about 8.0%. At the same time, the rate of rise in Wan Chai and Causeway Bay registered its slowest growth in the last two years at 5% q-o-q.

## RENTAL TRENDS IN DECENTRALISED AREAS

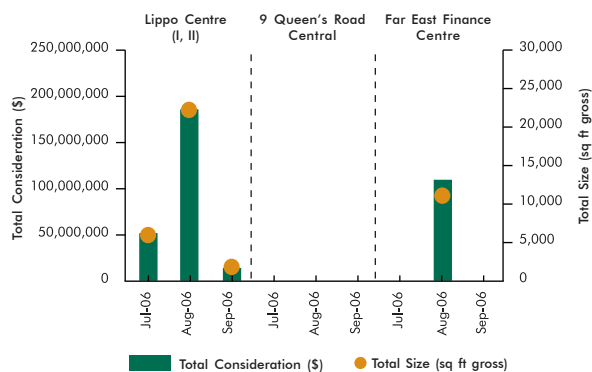
### CB Richard Ellis Grade A Office Rental Index



Decentralised rentals in the Hong Kong office market exhibited varying dynamics within the third quarter of 2006. The hardening of rentals in prime districts coupled with the absence of availability in turn fuelled rental hardening on Hong Kong Island's decentralised office districts. Take-up of decentralised space on Hong Kong Island was registered at in excess of 320,000 sf within the period under review, the highest district take-up witnessed across Hong Kong's office market within the third quarter of 2006. The decentralised market in Kowloon meanwhile exhibited a mild downtrend as landlords competed to secure tenants in view of the significant quantum of supply, which is slated for the market over the near and medium term.

## CAPITAL VALUE TRENDS IN PRIME AREAS

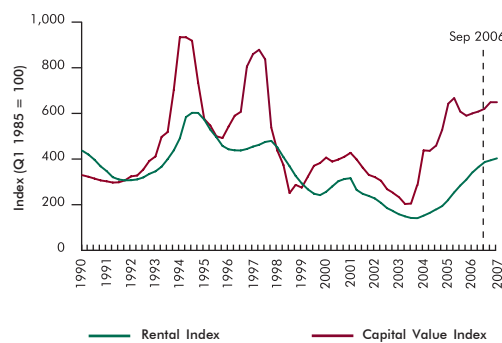
### Major Transactions in Q3 2006



Capital values edged up for the third consecutive quarter within the period under review as investor sentiment remained positive, buoyed by signals from the Fed, which suggested a calming of the US interest rate hike cycle. This boosted wider investor interest and created a clearer picture on the carrying costs of Hong Kong property. The 2% q-o-q increase in prices for office properties in prime areas was the highest on quarter rise since the 4% q-o-q increase observed within the second quarter of 2005. While there were no major en bloc top tier acquisitions of prime office properties as in the last quarter, upbeat strata title activity was observed. One notable transaction saw the entire 20/F of Convention Plaza transact at \$180 million (\$10,897 psf).

## PROJECTIONS

### Grade A Office Rental and Capital Value Projection to Q1 2007



The overall Hong Kong market currently finds itself on the cusp of a major reconfiguration. The tight market conditions for prime offices in Hong Kong is expected to continue in the near and medium term as the release of just 106,600 sf from York House in Central is unlikely to ease the pent up demand in the market. It is forecast that the continued squeeze on the market will lead to the deepening of the trend of flight-to-cost-savings. Thus, as a result of the shortage of new prime-located supply and the resulting firm uptrek of core rentals, which are occurring in conjunction with the upsurge of new non-core supply, the Grade A office market is expected to witness an increasing geographical shift over the medium term.



## PRIME OFFICE DISTRICTS IN HONG KONG

### CORE CENTRAL

This is the banking, legal and financial centre of Hong Kong and the district with the highest office rentals. Core Central consists of 13.2 million sq ft of Grade A office space or 34 per cent of the prime Grade A office stock.

### PERIPHERAL CENTRAL

Peripheral Central is divided into east and west including areas such as Admiralty and Sheung Wan. Over the past decade these areas have grown dramatically, establishing themselves as the extensions of Core Central. Peripheral Central consists of 7.4 million sq ft of Grade A office space or 19 per cent of the prime Grade A office stock.

### WAN CHAI

Gloucester Road divides Wan Chai into two distinct sectors. The reclaimed area to the north has developed as an area for tenants requiring affordable rentals in good quality buildings, close to Central. Beyond the southern side of Gloucester Road are generally older, smaller buildings of lesser quality. Wan Chai consists of 6.1 million sq ft of Grade A office space or 15 per cent of the prime Grade A office stock.

### CAUSEWAY BAY

Causeway Bay has a number of good quality office buildings at rental similar to Wan Chai. The area consists of 4.6 million sq ft of Grade A office space or 12 per cent of the prime Grade A office stock.

### TSIM SHA TSUI

The prime Grade A buildings are mainly concentrated along Canton Road and Nathan Road. The area consists of 7.9 million sq ft of Grade A office space or 20 per cent of the prime Grade A office stock.

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## TERMINOLOGY

### GRADE A:

Modern facility with high quality finishes; flexible layout; large floor plates; spacious lobbies and circulation areas; effective central air-conditioning; good lift services zoned for passengers and goods deliveries; good management and parking facilities are normally available.

### NEW SUPPLY:

The number and/or square footage of buildings completed (including redevelopment) in a period.

### TAKE-UP:

The net absorption of office space let, or sold to the acquirer for occupation.

### VACANCY RATE:

The amount of vacant space divided by the total stock.

### RENT:

Rents are presented in HK\$ on a net basis, unless otherwise specified.

### CAPITAL VALUE:

Capital values are presented in HK\$ on a gross basis, unless otherwise specified.