

The Grade A office market in Hong Kong continued rising in the first quarter of 2006, following the flattening out of rentals witnessed in November and December 2005. While rental levels crept up by just 1% m-o-m in the year's final two months, the market saw greater upward movement in the opening months of 2006.

The SAR's positive economic performance and its continued employment growth fuelled top tier office demand in the city. Financial

players and law firms with large space requirements were again witnessed to be active in the market. In the expectation of further tightening in Hong Kong's CBD, they took the first quarter as an opportunity to expand their operations. In the period under review, two major financial services providers committed to a combined total of 108,000 sf. Lehman Brothers took two floors in Man Yee Building, while UBS opted for 90,000 sf in Exchange Square and The Landmark. US Legal firms Skadden Arps and Jones Day have leased a combined total of three entire floors in Edinburgh Tower.

*The trend of office relocation for cost-driven reasons has been growing, as the phenomenon of hardened rentals filters through the market.*

The continued strength of Hong Kong's economy, while providing companies with business expansion potential, is at the same time exerting added financial pressure on those operating in Hong Kong. With the rise in employment figures, the market is seeing increased competition between companies for the best talent.

This is expected to result in a rise in wages

in the near to medium-term. This will act in conjunction with the rise in rentals to increase the operating costs of employers in the city. Rising costs are leading companies to

make savings by opting for more creative space use solutions. Adopting more economical office options in decentralised areas is seen as a way to push down the fixed cost impact of rent on their bottom line. As the phenomenon of hardened rentals filters through the market, the trend of relocating for cost-driven reasons has been growing. In one example of such a move, Hallmark Cards relocated from the Gateway in Tsim Sha Tsui to Harbourfront Landmark in Hung Hom. Indeed the market is witnessing a strong wave of interest with respect to Decentralised Kowloon. This is a trend not only being observed amongst occupiers in Kowloon, but also tenants in business precincts on Hong Kong Island, such as Wan Chai and Causeway Bay.

### QUICK STATS

	Change in Q4 05	Change in Q1 06
New Supply	↔	↔
Demand	↓	↑
Vacancy Rate	↑	↔
Prime Rents	↑	↑

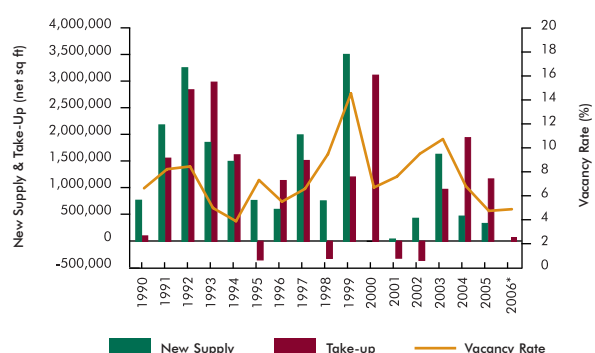
### OFFICE NEW SUPPLY, STOCK AND VACANCY IN JANUARY - MARCH 2006

	New Supply (Net sf)	Total Stock (Net sf)	Vacancy Rate
Core Central	-	13,199,794	4.79%
Admiralty	-	4,132,600	4.48%
Sheung Wan	-	3,294,015	7.74%
Wan Chai	-	6,060,460	4.89%
Causeway Bay	-	4,611,255	4.69%
Tsim Sha Tsui	-	7,865,778	4.62%
<b>Overall Prime</b>	<b>0</b>	<b>39,163,902</b>	<b>4.97%</b>
Decentralised Hong Kong	-	9,428,862	10.71%
Decentralised Kowloon	-	10,597,114	6.19%
<b>Overall Decentralised</b>	<b>0</b>	<b>20,025,976</b>	<b>8.32%</b>
<b>Overall Total</b>	<b>0</b>	<b>59,189,877</b>	<b>6.11%</b>

Note: The CB Richard Ellis office database has been adjusted to reflect the current Grade A office market conditions.

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

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



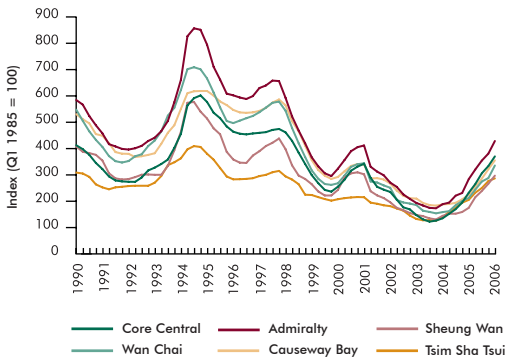
\* As of March 2006

No new prime-located space came on stream in the first quarter of 2006. With Hong Kong's prime office market undergoing considerable compression, the upcoming release of just 119,000 sf in 2006 from York House in Central is not expected to ease the level of pent up demand witnessed in the sector. Vacancy in the overall prime market was meanwhile registered at 4.9% at the end of the first quarter of 2006.

Yet despite the squeeze on the market and the impact this has been having on rents, particularly in the CBD, the importance of the factor of location continued to rule over rentals for a number of tenants. As was previously highlighted, this has especially been the case with a number of major financial players. Having said this, however, some occupiers sought to lessen the impact of a centrally-located office by relocating to more cost effective facilities within the CBD. For instance Stephenson, Harwood & Lo left Edinburgh Tower for one and a half floors in Bank of China Tower, while Taiwan Securities relocated from Lippo Centre to United Centre.

## RENTAL TRENDS IN PRIME AREAS

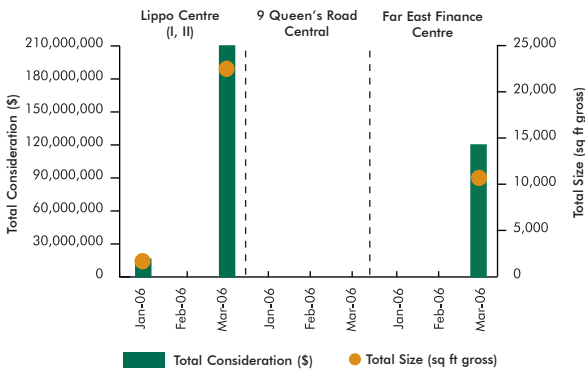
### CB Richard Ellis Grade A Office Rental Index



Prime office rentals in the first quarter of 2006 broke through the highs witnessed during the last market peak, which was set at the time of the IT bubble at year-end 2000. Leasing levels picked up quickly in January as landlords continued to push up asking rentals on the back of the high level of compression in the market and upbeat demand. Prime office rentals saw an increase of 10.5% q-o-q within the first quarter. As was the case in the market at year-end 2005, the continued upswing in the market attracted smaller financial players as well as incremental expansion by larger players where opportunities become available.

## CAPITAL VALUE TRENDS IN PRIME AREAS

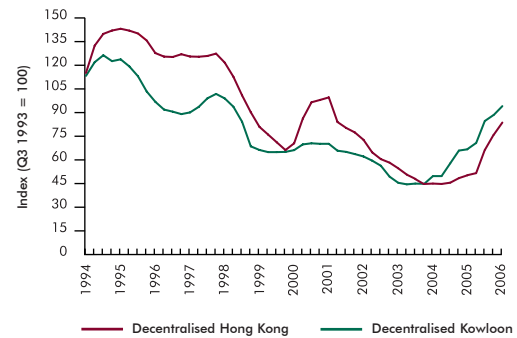
### Major Transactions in Q1 2006



Following the decline in capital value of 12%, which top tier office properties registered in July to December 2005, the first quarter of 2006 saw prices commence flattening out. Capital values increased by 1.7% q-o-q within the period's under review, with all of the gains registered achieved in January over December. While prices rose marginally, sales market activity continued to consolidate, in a trend which was led by the reduction of transactions for smaller spaces. However, bigger players were observed as still active in the Grade A investment market in search of quantum bargains, in the expectation that the uptrend in rents would feed through to capital values over a medium-term horizon. The major transaction of the quarter saw Macquarie GPA acquire Vicwood Plaza en bloc for approximately \$2.6 billion (i.e. \$6,558 psf).

## RENTAL TRENDS IN DECENTRALISED AREAS

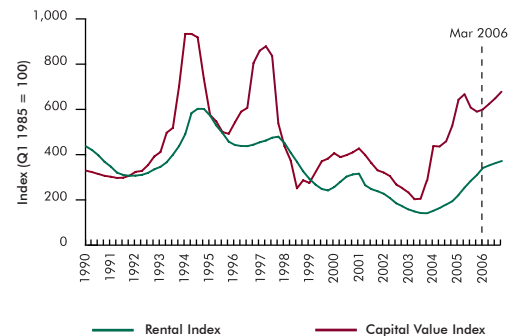
### CB Richard Ellis Grade A Office Rental Index



Vacancy in decentralised areas has followed a downward trend in the last 12 months on the back of the expansion of businesses in the city and also due to the flight-from-cost factor. The growth of interest in decentralised office facilities has seen current market occupiers as well as new market entrants turn their attention to more economical business hubs. Cyberport, for instance, has been observed as drawing its occupation from a variety of sources with a number of major transactions concluded by Hong Kong start-ups, while international players, seeking to establish operations in Asia, are also increasingly being drawn to this precinct.

## PROJECTIONS

### Grade A Office Rental and Capital Value Projection to Q4 2006



On the back of the continued robust level of expansion in financial market operations coupled with the dearth of new supply, Grade A office market rents are expected to continue to follow an upward trajectory in 2006. With boosted levels of demand and the compression of availability in top tier office space, particularly in Core Central, it is expected that the market will increasingly exhibit a decentralising trend. The rise in occupational demand is expected to continue to swell, fuelling further upward pressure in rentals and yields. As a result, the capital value curve is expected to come off its plateau and begin to head north again in the next nine months as investors are drawn to re-enter the market.



## 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.