

Following the already-robust 7.3% y-o-y GDP growth for the whole of 2005, Hong Kong's economy sustained a strong upturn in the first quarter of 2006, registering a GDP rise of 8.2% in real terms y-o-y. The economy recorded brisk growth on a broad front, driven by thriving external trade on the back of the strong global economy and surging intra-regional trade. The value of total exports in the first half of 2006 (comprising re-exports and domestic exports)

rose by 8.5% over the same period in 2005 to about \$1,122 billion, a manifestation of the continuing key role of the SAR in facilitating trade flows between the Mainland and its trade partners. Meanwhile, a marked y-o-y pick-up in consumer spending of 4.5% in real terms in the first quarter of 2006 was an indicator of the deepening entrenchment of Hong Kong's economic recovery. The near-term economic outlook is expected to fuel further strong domestic demand and positive business and consumer sentiment.

The outlook for the industrial market in Hong Kong is upbeat over the medium-term on the back of strong demand and limited supply, a dynamic that is expected to deepen as it is impacted by an additional two drivers. Firstly, the Public Participation Programme for the proposed Kai Tak development is currently entering

into its third stage. This advances proceedings closer to the finalisation of the Kai Tak Preliminary Outline Development Plan, the proposal for the future development of this 328-hectare site.

Whilst the new Kai Tak development is mandated to contain a substantial quantum of new office development to meet Hong Kong's long-term requirements for quality office accommodation, the existing industrial premises in areas

abutting the former Kai Tak Airport are expected to be phased out as part of the larger development plan. This will result in a further squeezing in the available stock of industrial floor space in the SAR.

Secondly, on 27 June 2006, the Mainland and Hong Kong agreed on a package of further liberalisation measures under CEPA with a view to strengthening the co-operation in trade and investment across a broad range of goods and services. A major aspect under the extension of the arrangement saw the number of products which are eligible for zero tariff under CEPA's regulations on origin increase to 1,407 products starting from 1 July 2006. The zero import tariff preference is expected to increase the attraction of Hong Kong as a place to establish certain kinds of manufacturing operations. It is forecast that this will stimulate an increase in both end-user and investor demand for Hong Kong industrial space.

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QUICK STATS

	Change in Q1 06	Change in Q2 06
WAREHOUSE		
Demand	↑	↑
Supply	↔	↔
Rents	↑	↔
Vacancy Rate	↔	↔
INDUSTRIAL/OFFICE		
Demand	↑	↑
Supply	↔	↔
Rents	↑	↑
Capital Values	↑	↑
FACTORY		
Demand	↑	↑
Supply	↓	↓
Rents	↑	↑
Capital Values	↑	↑

MAJOR LEASING TRANSACTIONS IN 2Q 2006

Property	Floor	Location	Type	Size (sf)	Gross Rental (HK\$ psf per month)
Shatin Industrial Centre	Units 5-8, 2/F	Shatin	Industrial	7,917	7.0
Leader Industrial Centre Block 2	1/F	Tsuen Wan	Industrial	10,423	5.5
Cheung Lee Industrial Building	Unit B, 7/F	Chai Wan	Industrial	3,106	7.6
Metro Centre II	Units 9-12, 22/F	Kowloon Bay	Industrial	2,809	11.5
Nanyang Plaza	Unit 7, 6/F	Kwun Tong	I/O	1,745	12.0
Dragon Centre	Units A-C, 25/F	Cheung Sha Wan	Industrial	3,593	10.0

MAJOR SALES TRANSACTIONS IN 2Q 2006

Property	Floor	Location	Type	Size (sf)	Price (HK\$ Million)	Price (HK\$ psf)
Metro Centre II	Units 1-3, 21/F	Kowloon Bay	Industrial	23,133	40.48	1,750
Kowloon Bay Industrial Centre	Units 1-4, 5/F	Kowloon Bay	Industrial	5,705	7.05	1,235
Nanyang Plaza	Unit 8, 7/F	Kwun Tong	I/O	2,742	7.00	2,553
Eastern Harbour Centre	Unit 3, 5/F	Quarry Bay	Industrial	2,221	5.17	2,328
Elite Industrial Centre	Units 4 & 6, 6/F	Cheung Sha Wan	Industrial	3,414	8.76	2,566
HK Industrial Centre Block B	Units 14 & 15, 9/F	Cheung Sha Wan	Industrial	3,575	6.44	1,800
Wyler Centre II	20/F	Kwai Chung	Industrial	25,618	33.30	1,300
Hong Kong Tobacco Co Ltd	En Bloc	Quarry Bay	Industrial	450,000	718.90	1,598
Jebsen Motor Group Building	En Bloc	Cheung Sha Wan	Industrial	100,000	240.00	2,400

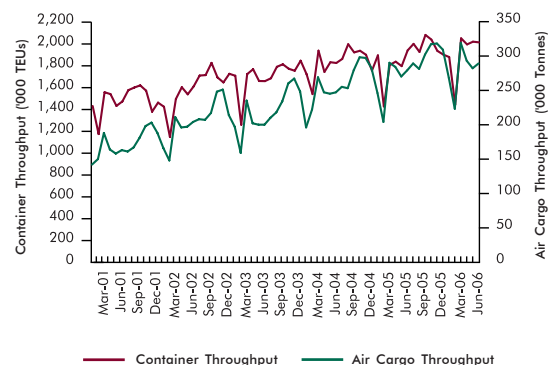
ECONOMIC INDICATORS

Merchandise Trade



Source: Census & Statistics Department

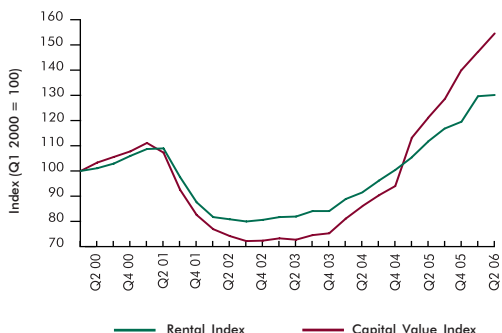
Container and Air Cargo Throughput



Source: Marine Department; Civil Aviation Department

WAREHOUSE

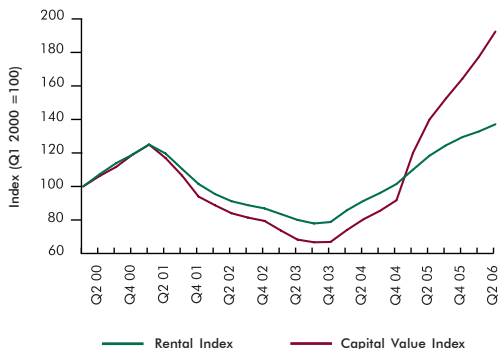
Warehouse Rental and Capital Value Indices



Given the large floor space requirements of end users, warehouse properties continued to attract strong investor demand within the second quarter. However, the upbeat rental appreciation previously observed in the market eased off as end users exhibited growing resistance to further rent escalation, ending the uptrek in rents which has persisted continuously since 2003. Meanwhile, the earlier rental upsurge encouraged investment in warehouse space, which in turn fuelled capital value appreciation. Looking forward, the rental consolidation is expected to be short-lived due to the emergence of near-term supply pressure, as the quantum of upcoming new supply planned for this year and next falls short of the demolition volume. Warehouse yields were recorded at 8.5% in the second quarter.

FACTORY

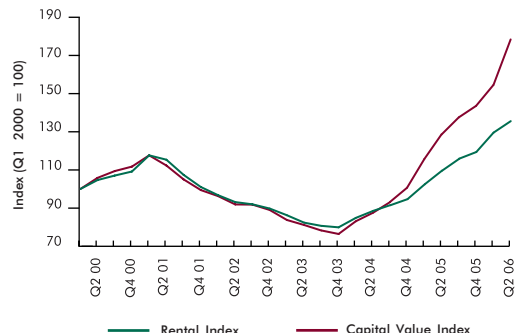
Factory Rental and Capital Value Indices



Rentals and capital values in the factory segment both continued to follow an upward trajectory within the second quarter with q-o-q growth recorded at 3.2% and 8.5%, respectively. Amongst the principal forces driving this strong performance were cost-conscious warehouse users, who saw factory properties as feasible alternatives to warehouse facilities, in the wake of the progressive appreciation of rentals in the latter segment. Suitably specified factory premises located within close proximity of major warehouse districts were particularly sought after in the warehouse market over the past quarter. Meanwhile, local owner-occupiers were active in acquiring strata-title properties to cater for expansion. The robust 28.6% y-o-y increase in value of domestic exports for the first half of 2006 was also a key factor supporting this expansionary requirement.

INDUSTRIAL/OFFICE (I/O)

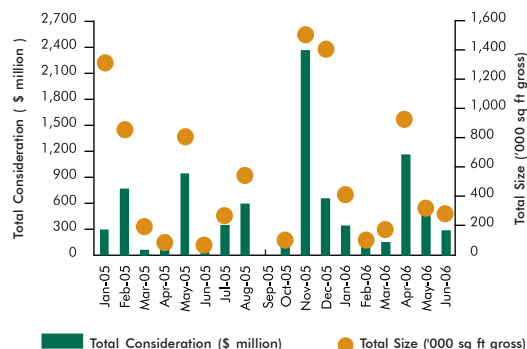
Industrial/Office Rental and Capital Value Indices



I/O facilities continued to benefit from the across-the-board buoyancy of the Hong Kong office market in that they serve as feasible alternatives to Grade A offices in decentralised locations. On the back of flight-to-cost-savings in the office market, I/O properties in the second quarter registered q-o-q rental and capital value growth of 4.6% and 15.5%, respectively. Given the fact that the performance of I/O property market is sensitive to conditions in the decentralised office market rather than the industrial sector, it is expected that an anticipated progressive injection of six million sq ft of decentralised office space in the period between late 2006 and 2008 will begin to exert downward pressure on I/O market segment over the medium term.

EN BLOC & SITE TRANSACTIONS

En bloc and Site Transactions



Despite the shelving of the launch of the Sun Hung Kai Properties-initiated Sun Millennium REIT, which included five industrial premises among others, due to the emergence of unfavourable market conditions for REIT-listings, this temporary set back had no negative implications on the overall prospects of the industrial sector. Industrial properties remained actively sought after by end-users and investors alike, with the levels of total consideration and size of premises sold in the second quarter registering q-o-q surges of 248.6% and 121.6%, respectively. Local investors continued to dominate the en bloc market, with the Hong Kong Tobacco Company Ltd. building in Quarry Bay, acquired by Kerry Properties for \$718.9 million, being the most notable transaction of this type.



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- Western Kowloon
- The New Territories

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INDUSTRIAL PROPERTY DEFINITIONS

WAREHOUSE:

This category comprises premises designed or adapted for use as godowns or cold stores and includes ancillary offices. Also, premises located within container terminals are included. About 80 per cent of the stock is located in the New Territories, with Kwai Tsing alone accounting for 40 per cent.

INDUSTRIAL/OFFICE:

This category comprises floor space in developments with planning permission and lease modification for industrial/office use and certified for occupation as such. The stock was distributed in 10 districts throughout the territory, with predominance in Kwun Tong, Cheung Sha Wan, Sham Shui Po, Kwai Tsing and Shatin, which together accounted for 80 per cent of the total space.

FACTORY:

This category comprises flatted factories and ancillary office accommodation. This includes flatted factory space with planning permission for industrial/office use, but for which Government lease modification has not yet been completed. Also included in this category is strata-title floor space with temporary planning permission for industrial/office use and short-term waivers of Government lease restrictions. It should also be noted that much of the flatted factory space completed in recent years has been built to a good standard with good finishes. Although many factory buildings are occupied as offices, showrooms, or a mix of these and light industrial uses, they should be distinguished from buildings with proper industrial/office status. A majority of the stock was distributed in 4 districts, namely Kwun Tong, Tsuen Wan, Kwai Tsing and Tuen Mun, which accounted for 60 per cent of the total supply.

CBRE
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