

Insufficient high-quality supply in core Central and continued strong expansionary demand from MNCs, especially financial institutions, nudged office rentals to record highs. Two IFC achieved a record renewal of \$160 psf per month while a hedge fund leased 6,000 sf at \$138 psf per month (effective) in Exchange Square, on the verge of the record high registered in the mid-1990s. The supply demand imbalance in core Central is unlikely to

be alleviated in the near future and prime office rents are not expected to face near-term downward pressure. The situation has enabled landlords in second-tier Central buildings to raise asking rents to unprecedented levels, with net effective rents in these Grade A premises increasing by up to 30% over the quarter.

Rental hardening has now spread from Central to CBD-fringe areas such as Admiralty and Wan Chai/Causeway Bay, where average rents surged 8.0% and 7.9% q-o-q, respectively, in the third quarter, outpacing the overall q-o-q prime office average growth of 5.4%.

Hong Kong's close economic ties with China should underpin further expansion from banking and financial institutions as well as professional service consultancies. Currently, MNCs have little choice but to decentralise and/or split their operations to meet cost and space demands, thus providing

extremely strong pre-commitment support to prime office buildings nearing completion. This is especially true of the International Commerce Centre (ICC) above Kowloon Station (Phase I opening in late 2007) and One Island East in Quarry Bay, scheduled to open in early 2008.

Morgan Stanley, for example, has confirmed its relocation from Exchange Square to ICC where they have pre-committed to at least 300,000 sf

by the end of 2008. Aedas, a world-renowned architectural firm, committed to about 53,500 sf in One Island East.

The Kowloon office market is expected to remain stable for the remainder of 2007. By virtue of ICC attracting occupiers from core Central, landlords in Tsim Sha Tsui have not come under any downward rental pressure. Tsim Sha Tsui landlords are reluctant to increase rentals substantially for fear that occupiers might opt for Kowloon East developments in order to reduce costs. With a number of new decentralised developments in Kowloon seeking Occupation Permits in 2008, supply will be plentiful, which may lead to some downward rental pressure in decentralised districts. However, given buoyant demand and strong take-up, particularly in Tsim Sha Tsui where existing occupiers have to compete for space so as to satisfy their expansion requirements, downward pressure on rentals is likely to be very localised.

*Supply demand imbalance in core Central prompted landlords in second-tier Central building to raise asking rents to unprecedented levels and spread rental hardening to CBD-fringe areas.*

**QUICK STATS**

	Change in Q2 07	Change in Q3 07
New Supply	↔	↔
Demand	↑	↑
Vacancy Rate	↓	↓
Prime Rents	↑	↑

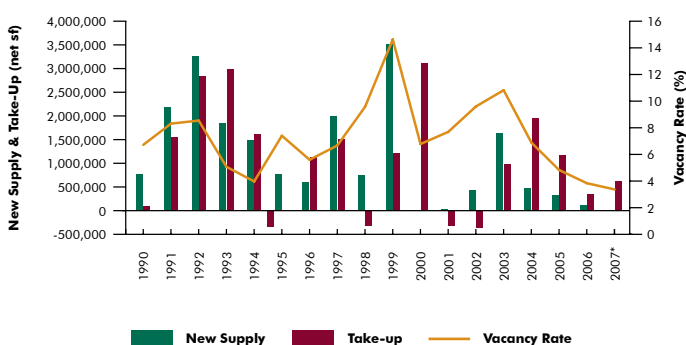
**OFFICE NEW SUPPLY, TAKE-UP AND VACANCY IN JULY - SEPTEMBER 2007**

	New Supply (Net sf)	Total Stock (Net sf)	Vacancy Rate
Core Central	–	13,415,177	1.75%
Admiralty	–	4,037,762	3.85%
Sheung Wan	–	3,231,488	6.29%
Wan Chai	–	6,370,981	2.38%
Causeway Bay	–	3,243,255	3.57%
Tsim Sha Tsui	–	9,711,073	5.03%
<b>Overall Prime</b>	<b>0</b>	<b>40,009,736</b>	<b>3.37%</b>
Decentralised Hong Kong	–	5,812,630	5.96%
Decentralised Kowloon	441,436	10,912,794	12.40%
<b>Overall Decentralised</b>	<b>441,436</b>	<b>16,725,424</b>	<b>10.17%</b>
<b>Overall Total</b>	<b>441,436</b>	<b>56,735,159</b>	<b>5.37%</b>

\* Note: CBRE Research conducted a review on the total stock of office buildings in the third quarter of 2007 and revised the office property database accordingly.

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

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



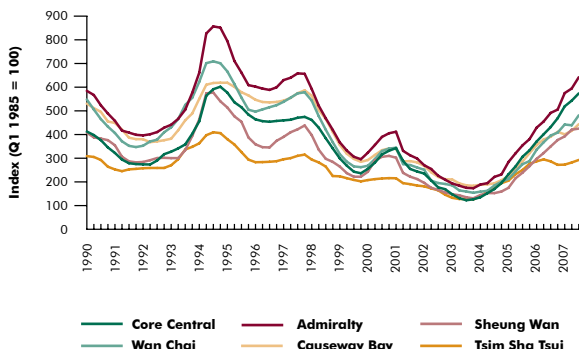
\* As of September 2007

The bullish market for Grade A office properties in prime locations is largely the result of a lack of quality supply along with a low vacancy rate, which indicates strong demand. Current demand is indeed much higher than during the last Grade A office boom in 1994, according to the net year-to-date take-up figure of 620,217 sf, comparing with 123,551 sf in 1994. Rents in Hong Kong’s prime locations are expected to stay firm in the short- to medium-term.

Although the lack of new prime supply will end in the fourth quarter as Phase I of ICC will add some one million sf to the market, the overall office market should not be altered substantially as much of the space in this phase of the project has already been committed. As Hong Kong continues to benefit from favourable Chinese government policies; financial institutions continue to expand to cater to the surging demand for investment and wealth management services, and more Chinese enterprises plan to list in Hong Kong, net take-up is expected to continue to increase, thus providing a lasting uplift in demand for quality office space.

## RENTAL TRENDS IN PRIME AREAS

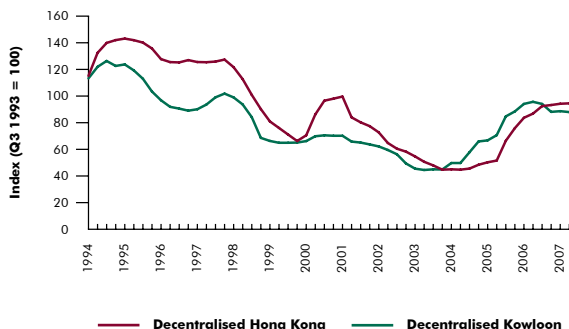
### CB Richard Ellis Grade A Office Rental Indices



The overwhelming market response to the nearly completed projects is no surprise given the rental rally over the last few years. The third quarter saw a pick-up in rental increase over the previous quarter, thanks to outstanding performances in CBD-fringe areas in Wan Chai, Admiralty and Causeway Bay. Quarterly growth in each of these districts, at about 9%, 8% and 6.7%, respectively, outpaced average q-o-q growth in core Central (5.6%) and prime areas overall (5.4%). Since the next major prime office supply in core Central will come from space in Exchange Square to be vacated by Morgan Stanley by the end of 2008, rents in Central are likely to stay firm at least until then.

## RENTAL TRENDS IN DECENTRALISED AREAS

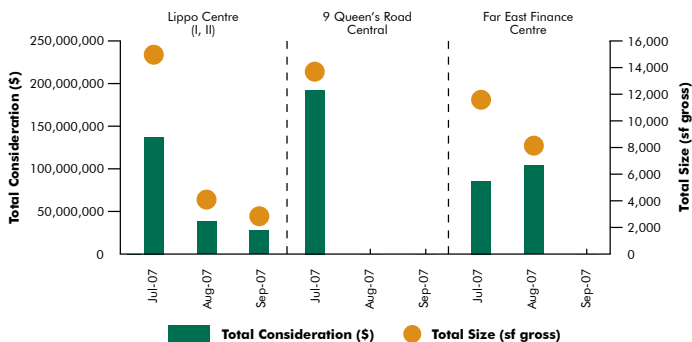
### CB Richard Ellis Grade A Office Rental Indices



As One Island East nears completion and rents in prime areas approach record highs, Hong Kong East's appeal as a location for MNCs requiring significant space is rapidly increasing. The 4.3% q-o-q rental growth in the area in the third quarter, a 12-month high, appears to have been driven by the buoyant sentiment resulting from pre-committments in One Island East. Kowloon East, with four prime developments and the proposed Yue Man Square renewal project in the pipeline, holds the confidence of both landlords and tenants. Sun Hung Kai Properties, for example, opted to hold on to their new Millennium City 6 for long-term leasing, while occupiers such as ICBC, MTRC and Dah Sing Life remain to stay in the area.

## CAPITAL VALUE TRENDS IN PRIME AREAS

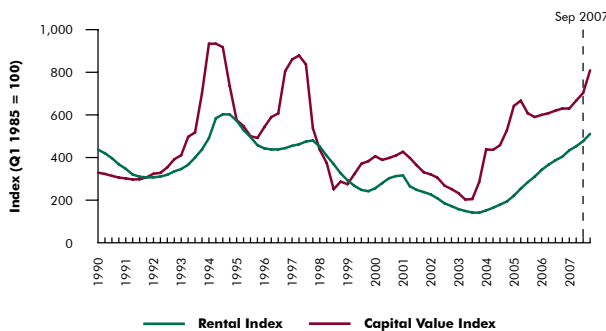
### Major Transactions in Q3 2007



A bullish Grade A office market fuelled investors' interest in strata-title office premises. The average price of available Grade A office space jumped 8.8% q-o-q in the third quarter, following the 6% rise registered in the preceding quarter. A stunning quarterly surge of 26.3% in total floor space transacted was registered in the period under review. The active transactions in CBD-fringe areas coincided with the notable rental rally in these areas. Along with the prevailing supply demand imbalance in prime office locations, it is very likely that landlords' pursuit of investment-worthy yields was one of the major factors driving rental increases.

## PROJECTIONS

### Grade A Office Rental and Capital Value Projection to Q4 2007



Amid extremely limited supply and high rental costs in prime office locations, demand for quality office space will continue to be strong on the back of Hong Kong's unique position as the most sophisticated full-service hub for MNCs to fully harness the advantages of proximity to China. Demand is slated to come from both overseas and Mainland MNCs prompted by various financial market stimuli such as the expanding Qualified Domestic Institutional Investor scheme and more China-related IPOs to be listed on the Hong Kong Stock Exchange. This should keep the Grade A office market buoyant for the foreseeable future.



## 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 13.4 million sf 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 7.0 million sf of Grade A office space or 18 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 6.3 million sf of Grade A office space or 16 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 3.2 million sf of Grade A office space or 8 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 9.8 million sf of Grade A office space or 25 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.