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MarketView
Hong Kong Office

FIRST QUARTER 2008

The market entered 2008 amid continued volatility and uncertainty in global capital markets. With unprecedented losses and the recapitalisation of major banks, multi-billion dollar write-downs look set to continue. The full impact of the situation on Hong Kong's office market is impossible to predict at this stage, though expansion plans by certain banks have been postponed indefinitely and the Bear Stearns sale to JPMorgan Chase might see space released back onto the market, for example. A number of large transactions concluded in 2007 included options on additional space and should the financial turmoil continue, tenants could choose not to exercise these options and the space would re-enter the market.

> *The proven value of strategic focus on the faster growing emerging markets like Asia-Pacific emphasises the importance of Hong Kong as a vital financial hub in driving sustainable business growth in the region.*

Notwithstanding the above, there can be no debate over two essential facts, both of which should prevent a major correction in Hong Kong office rents. Firstly, the almost total lack of pipeline supply on Hong Kong Island for the next three years; and secondly, the increasing importance of Hong Kong and the region to major banks. For example, in HSBC's strong 2007 annual results, Hong Kong and the Asia-Pacific region contributed over 55% of pre-tax profit, up 53.3% y-o-y. Similarly, Standard Chartered Bank ("SCB")'s largest single business, Hong Kong consumer banking, delivered a 22% increase in profits and a 17% increase in income in 2007, the first double-digit income growth in six years. SCB's overall Hong Kong business saw profits increase by 34% to just under US$1.2 billion last year, more than the entire global profit SCB registered in 2001. Recent new commitments by Morgan Stanley, Credit Suisse and JPMorgan have involved expansions of roughly 200,000 sf or more in each case, and have done much to absorb the combined three million sf of new supply from International Commerce Centre ("ICC") and One Island East. Nor should there be cause for immediate concern over the space Morgan Stanley and Credit Suisse will leave behind – Fortis have committed to six of the eight floors Morgan Stanley will vacate in Three Exchange Square at the end of 2008, while the majority of Credit Suisse's space is held on a lease expiring in 2011.

These telling examples demonstrate the corporate focus on driving sustainable growth by concentrating on faster growing emerging markets. Financial institutions cannot overlook the Asia-Pacific market, and particularly China. It is anticipated that Hong Kong's office market will continue to benefit from sustained demand from international users.

This was typified by market performance in the first quarter of 2008, with CBD rents reaching new historic highs on an almost weekly basis. With expansion demand from virtually every business sector, and vacancy in prime office locations at around 2.2%, landlords have not been slow to raise rents, especially in Central, where even 23-year old stock is demanding rents upwards of $150 psf. However, tenant resistance has begun to emerge, with many focusing on cost-efficient initiatives such as re-stacking or hot-desking rather than committing to additional space at current rents.

QUICK STATS

	Change in Q4 07	Change in Q1 08
New Supply	↔	↑
Demand	↑	↑
Vacancy Rate	↓	↓
Prime Rents	↑	↑

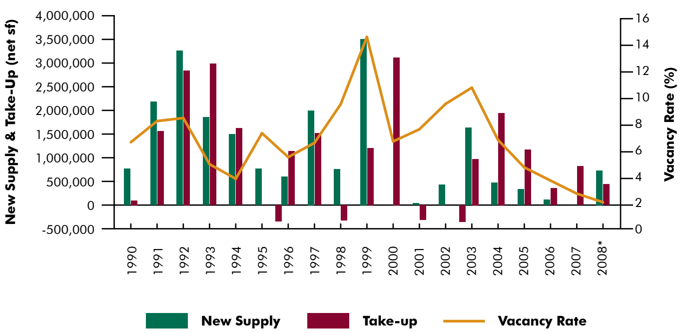
OFFICE NEW SUPPLY, TAKE-UP AND VACANCY IN JANUARY - MARCH 2008

	New Supply* (Net sf)	Total Stock# (Net sf)	Vacancy Rate
Core Central	–	13,415,177	0.91%
Admiralty	–	4,037,762	1.13%
Sheung Wan	–	3,231,488	2.59%
Wan Chai	–	6,370,981	1.92%
Causeway Bay	–	3,243,255	2.99%
Tsim Sha Tsui	732,000	9,895,609	4.23%
Overall Prime	***732,000***	***40,194,272***	***2.21%***
Decentralised Hong Kong	–	5,812,630	1.86%
Decentralised Kowloon	–	10,521,394	6.65%
Overall Decentralised	***–***	***16,334,024***	***4.95%***
Overall Total	***732,000***	***56,528,296***	***3.00%***

*Note: * : New supply as per Occupation Permit issued by Buildings Department and published in Monthly Digest within the quarter, and/or other sources considered appropriate.*
 # : Total stock as per record contained in database of CBRE Research.

NEW SUPPLY, TAKE-UP AND VACANCY IN PRIME AREAS

Grade A Office Supply, Take-Up and Vacancy



** As of March 2008*

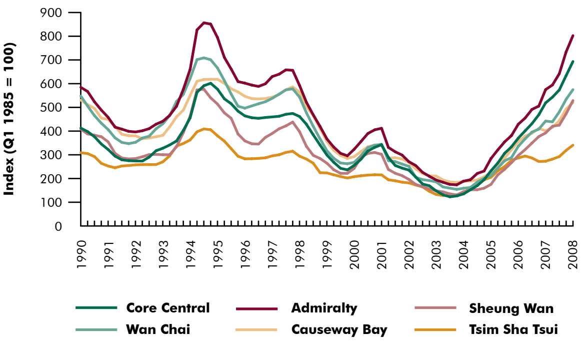
Against a backdrop of turmoil and uncertainty in global financial markets, Hong Kong's Grade A office premises managed to maintain an overall performance somewhat similar to that in 2007. Despite the approximately 732,000 sf of net floor space from the first phase of ICC atop Kowloon Station becoming available in the market, the fully pre-committed new space failed to alleviate the prevailing supply/demand imbalance. In fact, given the market consensus that emerging markets in the Asia-Pacific region, including China, will continue to outperform mature economies albeit posting slower growth than in 2007, many financial institutions are stepping up investment in Asia and China so as to improve margins on the use of their capital in a comparatively less risky environment. Office demand therefore remained at a high level as noted in the first quarter.

Take-up of prime office space remained very encouraging in Hong Kong's prime commercial districts including Central, Admiralty, Sheung Wan, Wan Chai, Causeway Bay and Tsim Sha Tsui, with a total floor space of 440,840 sf involved, an impressive 453.9% y-o-y surge. In the quarter under review, the market saw many tenants from a variety of business sectors actively expanding their presence in Hong Kong. Samsung Electronics let about 38,800 sf (lettable) across two floors in Wan Chai's Central Plaza, while Tiffany expanded into One Island East by taking up some 12,300 sf (lettable) of space. Without any signs of deceleration in office leasing activity, the overall vacancy rate of prime Grade A office districts tightened further, dropping another 65 basis points to 2.21% from the 2.86% registered in the last quarter of 2007, keeping the vacancy rate at the lowest level in over 17 years.

As opportunities in China as well as the Asia-Pacific region are extremely appealing, ironically amplified by the financial strains troubling the US and Euro zone at the moment, while the impacts of this volatility in Asia have thus far been relatively limited, the market should continue to see institutions striving to seize opportunities for growth on this part of the globe, providing firm support for Hong Kong's office leasing market.

RENTAL TRENDS IN PRIME AREAS

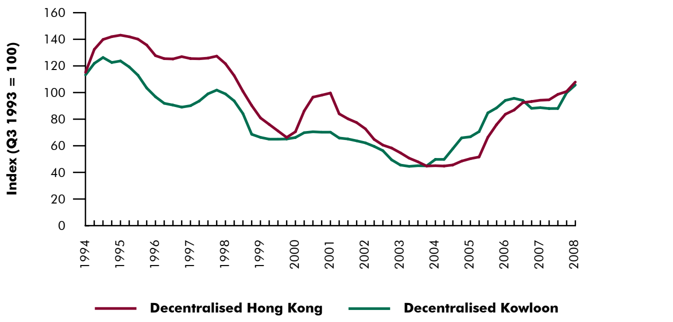
CB Richard Ellis Grade A Office Rental Indices



The persistent expansionary demand continued to support the strong performance of Grade A office leasing in prime commercial locations. Despite a generally slower growth trend, the overall prime office rent still managed to surge 9.1% q-o-q to an average of $71.74 psf (net effective) per month. Central's monthly average unit rental rose 9.4% q-o-q to $124.05 psf (net effective), CBD fringe locations, particularly Sheung Wan, have substantial room to catch up. Being the best performer of the first quarter, Sheung Wan registered an 11.8% quarterly surge to $62.56 psf (net effective) in the period. Despite stronger quarterly growth in these non-CBD locations, the rental gaps with prime core Central continued to widen, especially as Central's Grade A1 buildings, such as One & Two ifc, Chater House, Cheung Kong Centre, AIG Tower and York House, are fast achieving unit rentals beyond $170 psf (net effective), highlighting the esteemed positions these Grade A1 buildings hold for certain capable and uncompromising occupiers.

RENTAL TRENDS IN DECENTRALISED AREAS

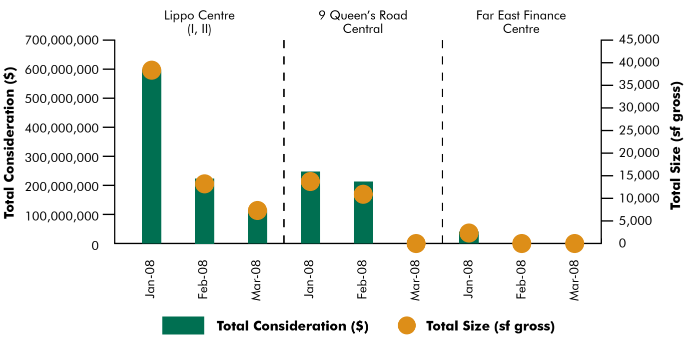
CB Richard Ellis Decentralised Grade A Office Rental Indices



With a considerable number of Grade A office buildings on Hong Kong Island fully occupied, many companies expanding on the Island were forced to compete for limited availability in decentralised locations, thus quickly filling the all-new One Island East in Quarry Bay. A growing number of Hong Kong Island tenants are also considering Kowloon Bay and Kwun Tong as emerging relocation choices, due to their competitive costs and the superior quality of recent projects. There are rumours that PCCW will relocate from the sold PCCW Tower in Quarry Bay to one of the new developments in Kowloon. PricewaterhouseCoopers took 100,000 sf in Henderson's Kwun Tong 223, to be completed in mid-2008. Riding the buoyant demand and the gravitational pull of Kowloon East, the Kowloon office leasing market performed relatively well in the first quarter, with record high rental transactions achieved in the likes of The Gateway ($48 psf) and Millennium City (at $31 psf), and widespread contractions in vacancy.

CAPITAL VALUE TRENDS IN PRIME AREAS

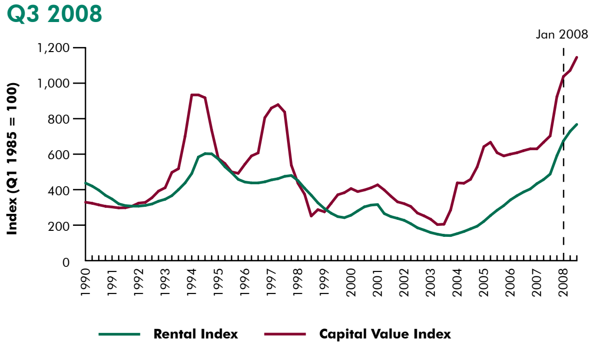
Major Transactions in Q1 2008



Unlike the leasing market, Grade A office sales transactions registered reductions across-the-board in the first quarter. The drop was particularly obvious as the end of the quarter approached with news of macro financial turmoil consistently dominating the headlines. Despite the lower level of market activity, unit prices transacted were consistently above those achieved in the previous quarter, registering a milder average appreciation of 14.1% q-o-q. As robust office demand persists and availability of tradable floors remains limited, while the prevailingly low lending rate continues to keep borrowing costs low, sophisticated investors are not in any hurry to sell. Indeed, the market is expected to grow further backed by sound economic fundamentals. Office rentals will continue to increase given the tight supply situation and, as a result, more investors are likely to be drawn to the market to ride this exceptional property cycle.

PROJECTIONS

Grade A Office Rental and Capital Value Trend Projections to Q3 2008



The outlook for the rest of 2008 is uncertain. The economic slowdown in the US may continue well into 2009. Emerging markets have only partly decoupled from the US. Hence, they will not be entirely immune from the impact of a US slowdown. However, the enhanced domestic momentum exhibited in the comparatively faster growing emerging markets should keep them better positioned than many of the mature economies. In particular, as China continues to reshape herself as a 21st century macro economic powerhouse, Hong Kong is slated to play an active role in the Mainland's continued economic development that no major financial player can afford to overlook. Given Hong Kong's status as an established international financial hub with special access to the world's emerging superpower, and the underlying fundamentals within the prime office market in terms of limited quality supply and rock bottom vacancy rate, the office market should continue to perform well.

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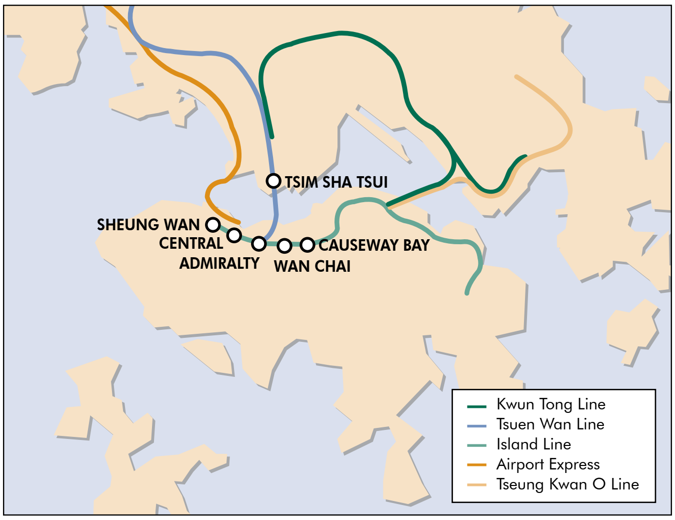

PRIME OFFICE DISTRICTS IN HONG KONG

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.