

Rental growth for prime office facilities in Hong Kong continued for the second quarter of 2006, albeit at a more moderate pace as leasing options in the market became increasingly scarce on the back of ongoing compression in vacancy levels. The continuation of the market upswing has resulted in growing segmentation in the top-end office market in Hong Kong as borne out by the continued widening of the rental gap between different sub-markets.

*The continuation of the market upswing has resulted in an increasingly clear segmentation of the overall top-end office market in Hong Kong.*

Underscoring the dominance of the financial sector in driving the present upswing in the Hong Kong office market, the CBD remained the focus of market demand within the second quarter of 2006 as banks and hedge funds displayed a willingness to accept high rents in their pursuit of the best quality accommodation available in the market. Continued take-up of space acted to fuel the broadening of the rental gap between Core Central and other prime office districts as well as between top end facilities in the CBD itself. Occupancy continued to rise within the quarter, leading vacancy in Core Central to compress to the level of 3.4%.

At the same time as the best quality office accommodation was the focus of strong demand from both new-market entrants and existing players, the remaining prime office sub-markets in Hong Kong exhibited a trend towards the increasing

convergence in rental levels. This trend acted to dampen relocation demand as the narrowing of the rental differential between markets reduced the incentive for intra-district relocation. Furthermore, as the market anticipates the expected release of a major quantum of decentralised Grade A office stock over the medium-term, which is increasingly being considered by market players as a cost-saving alternative, the upward pressure on wider prime area rentals is expected to decline.

Furthermore, decentralised landlords have been observed offering attractive deals to secure tenants as they begin to act to shore up their leasing portfolios one step ahead of the phased completion of the considerable quantum in upcoming supply, which is scheduled to come on to the market over the next two years. One major deal which represented this kind of move towards decentralisation saw Hang Seng Bank take 200,000 sf in Enterprise Square 5 in Kowloon Bay. It is forecast that this trend will continue to grow as more buildings come on stream in decentralised locations. The trend of flight-to-cost-savings also fuelled upbeat demand in Cyberport, which has recently witnessed an uptick in leasing activity. FedEx vacated Two Pacific Place for 80,200 sf at Cyberport 3, while electronic component distributor, Cytech took 10,450 sf in Cyberport 2.

### QUICK STATS

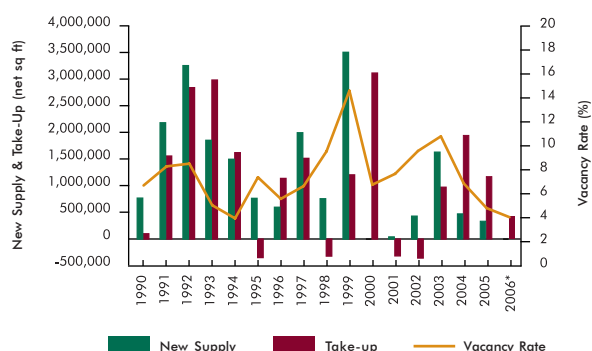
	Change in Q1 06	Change in Q2 06
New Supply	↔	↔
Demand	↑	↑
Vacancy Rate	↔	↓
Prime Rents	↑	↑

### OFFICE NEW SUPPLY, STOCK AND VACANCY IN APRIL - JUNE 2006

	New Supply (Net sf)	Total Stock (Net sf)	Vacancy Rate
Core Central	-	13,199,794	3.38%
Admiralty	-	4,132,600	3.85%
Sheung Wan	-	3,294,015	6.06%
Wan Chai	-	6,060,460	3.57%
Causeway Bay	-	4,611,255	4.06%
Tsim Sha Tsui	-	7,865,778	4.92%
<b>Overall Prime</b>	<b>0</b>	<b>39,163,902</b>	<b>4.07%</b>
Decentralised Hong Kong	-	9,428,862	8.41%
Decentralised Kowloon	-	10,597,114	5.29%
<b>Overall Decentralised</b>	<b>0</b>	<b>20,025,976</b>	<b>6.76%</b>
<b>Overall Total</b>	<b>0</b>	<b>59,189,877</b>	<b>4.98%</b>

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

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

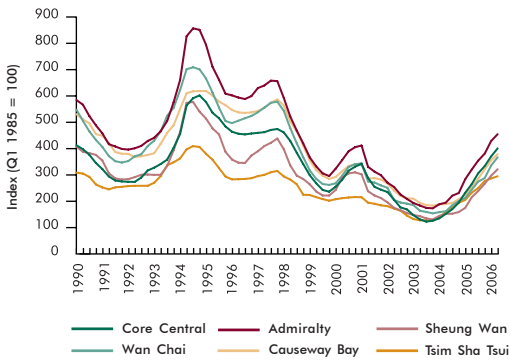


\* As of June 2006

With office demand remaining buoyant and vacancy compressing to record low levels, the position of landlords continues to strengthen in the market. Strong demand continued to fuel positive take-up in prime office space within the period under review, with Central witnessing considerable absorption. Prime office vacancy slid further to 4.1%, the lowest level witnessed in the market since end-1994. As a result of strength of finance sector-related demand, vacancy in Central compressed to 3.4%. Meanwhile, in an analysis of the top ten facilities located in the Central market, vacancy was witnessed as diving to 2.6% from the 4.0% registered at the end of the first quarter, highlighting the clear growth of focus of prestige-conscious end users on securing premium quality facilities in the CBD market. Notwithstanding this fact, the widening of demand across numerous market locations has led to a shortage of large floor plate leasing options across-the-board. The upcoming release of just 119,000 sf net of Grade A space in the second half of 2006 from York House in Central is not expected to ease the level of pent up demand within the sector.

## RENTAL TRENDS IN PRIME AREAS

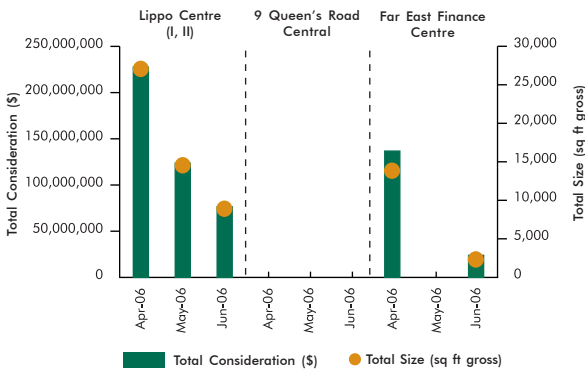
### CB Richard Ellis Grade A Office Rental Index



Prime office rentals in Hong Kong continued their upward trajectory in the second quarter of 2006, however, the rate of climb on a q-o-q basis was the slowest since the market began its present revival at year-end 2003. Prime office rentals in Hong Kong increased by 6.8% in the second quarter of 2006. The pace of rental growth slowed, however, as occupiers were left with declining options in the market, which in turn led to a reduction in activity level. At the same time, some landlords of CBD-located standard Grade A properties were witnessed offering attractive deals to secure tenants with records of good covenant as a means of securing their longer-term commitment.

## CAPITAL VALUE TRENDS IN PRIME AREAS

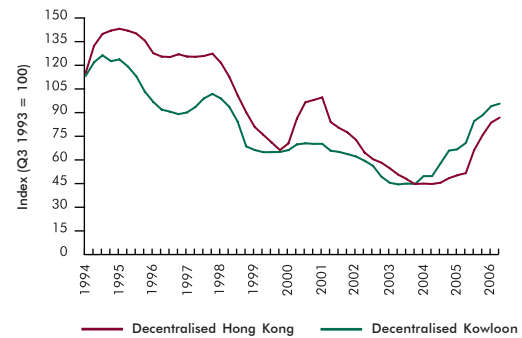
### Major Transactions in Q2 2006



The positive rebound in investment sentiment which became evident at the commencement of 2006, continued into the second quarter. Grade A office capital values sustained their steady upward trajectory with a 1.3% q-o-q rise within the period under review, following the q-o-q uptick of 1.7% recorded in the first quarter. Similar to the first quarter, transaction volume was recorded at a fairly subdued level. However, investors continued to display interest in whole floor, Core Central or peripheral Central-located product, on the back of the forecast sustained growth in rentals of top-tier office space in the CBD. The most notable investment of the quarter saw Macquarie GPA acquire the lower block of Grand Millennium Plaza, for just under \$2.4 billion, the equivalent of approximately \$6,200 psf.

## RENTAL TRENDS IN DECENTRALISED AREAS

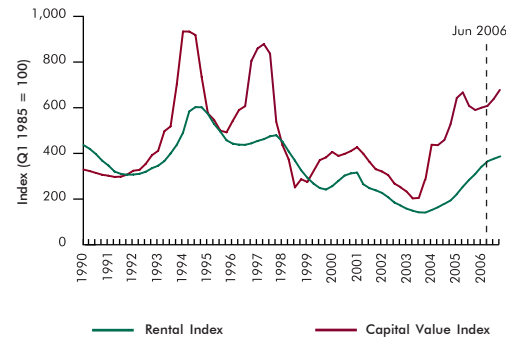
### CB Richard Ellis Grade A Office Rental Index



The ongoing economic upswing in the territory continued to fuel the sustained uptake of office space throughout the SAR in the second quarter of 2006. The broad-based rise in demand has shrunk availability in decentralised areas down to exceptionally tight levels. In the second quarter, overall decentralised vacancy in Hong Kong compressed by approximately 1.5 percentage points q-o-q to be recorded at 6.8%. The rental gap in the market continued to widen in the second quarter as overall decentralised rentals displayed a slightly slower pace of rental appreciation, as compared with prime properties. Overall decentralised rentals increased by 2.7% q-o-q.

## PROJECTIONS

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



Sustained corporate expansion supported by buoyant financial sector demand is forecast to continue placing upward pressure on overall Grade A rentals during the remainder of the year. However, the increment of growth which was witnessed in the first half of 2006 is expected to diminish somewhat as rental options in the market become increasingly scarce. As a result, large-scale restructuring of leased office portfolios is expected to become more prevalent with more decentralising moves expected to be undertaken on a cost-driven basis as well as due to lack of availability of core-located space. The continued upward pressure on rentals is expected to fuel further capital value appreciation as office yields have begun to turn more attractive.



## 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.