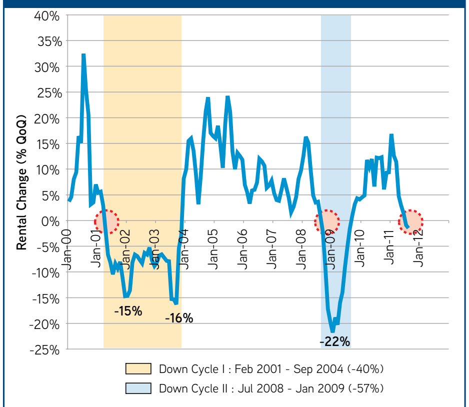
RESEARCH & FORECAST REPORT

# HONG KONG REAL ESTATE MARKET

| MARKET INDICATORS | (12 MONTH FORECAST) |
|---|---|
| OFFICE | ↓ |
| LUXURY RESIDENTIAL | ↓ |
| INDUSTRIAL | ↓ |
| RETAIL | ↑ |

CENTRAL OFFICE RENTALS




*Source: Colliers*

## A Change in Market Course

There is no doubt that the exceptional price volatility of various asset markets around the globe was the key event dampening the local real estate market sentiment during 3Q 2011. However, fundamentally, the worry is always the uncertainty of global economic growth. Sovereign debt issues continued to dampen the growth prospects in a number of western economies. Economic growth in China is relatively strong but is likely to taper off in 2012 after a series of interest rate hikes during the past quarters. Against the current economic backdrop, the local real estate sector displayed more signs of peaking in 3Q 2011 and it is our prediction that the market is heading towards a cyclical downturn over the next 12 months.

First of all, the strength of occupational demand weakened. In the local office sector, rentals in Central started to fall in 3Q 2011 after having a continued rally for eight quarters. Although other sub-markets were largely resilient, the overall growth pace on a quarterly basis tapered off to virtually zero during 3Q 2011. Generally, demand growth remained uncertain. Our base-case scenario suggests the market will change its course with rentals coming down by 8% in the next 12 months. Although the level of new supply in the next couple of years is going to stay significantly below its long-term average, supply might help in slowing the pace of the downturn.

In the residential sector, buying momentum showed no signs of revival, particularly after an increase of effective mortgage rates by about 75 basis points during the period. Transacted rentals were flat but more landlords were willing to revise downward their asking rentals and provide additional lease incentives. Given a scenario of slackening leasing demand, residential prices are predicted to fall by 13% in the next 12 months after seeing their peak in 3Q 2011.

Likewise, the uncertain economic growth in the key export markets will continue to impair the Hong Kong external trade performance. Demand for industrial premises is anticipated to soften over the next 12 months in the midst of slower growth in local private consumption and exports of goods and services despite the fact that achievable rentals continued to edge up in 3Q 2011. Over the next 12 months, industrial rentals are expected to see downward adjustments of 2 to 5%.

The only exceptional bright spot in the market is the retail sector. Thanks largely to the continued influx of Mainland visitors, street-level retail rentals in the traditional shopping districts will see a further growth of 11% in the next 12 months. However, the key point to note is the sustainability of the current consumption pattern of inbound visitors. It is uncertain whether local consumption can take up the slack if there is any slowdown in visitor spending going forward.

# Economic Update

## OVERVIEW

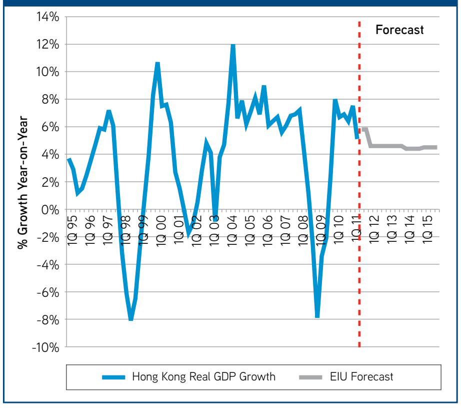
During 3Q 2011, the fragile US economic recovery and the lingering European debt crisis shattered investor sentiment, which had weighted on the stock markets. On 5th August 2011 (Friday), investors were spooked by the downgrade of US credit rating from AAA to AA+ and the Hong Kong Hang Seng Index (HSI) plunged 4% after the local market opened on 8th August (Monday). The HSI dropped by 21% to 17,592 points in 3Q 2011.

The deteriorating global economic outlook and the unresolved debt crisis in the western part of the world will continue to erode market's confidence and pose further downside risks to the Hong Kong real estate market. Since the Hong Kong luxury residential prices are highly and positively correlated to the performance of the local stock market, the stock market plunge in 3Q 2011 suggests the overall luxury residential prices will experience a cyclical downturn, down by 13% over the next 12 months. The average luxury residential rents are predicted to undergo a mild downward adjustment of 3% over the same period. The drag down in rents will give rise to a further drop in prices as the sales market is no longer supported by a sustainable rental growth.

## GDP

The impact of the challenging external environment is yet to be reflected in the Hong Kong economy. The local economy expanded at a solid pace with real GDP expanded by 5.1% YoY in 2Q 2011, underpinned by a solid domestic demand, with private consumption expenditure grew by 9.2% YoY.

HONG KONG REAL GDP GROWTH




*Source: Census & Statistics Department, HKSAR Government; The EIU (2011-2015)*

The increasing turbulence in global economic growth will pose greater downside to Hong Kong exports and economic growth. Surging inflation remains the key challenge to the economy. Overall consumer prices increased by 5.7% in August 2011. The Economist Intelligence Unit (EIU) predicts the local GDP to grow at a slower impetus from 5.5% YoY in 2011 to 4.7% YoY in 2012. Meanwhile, inflation will increase by 5.1% YoY in 2011 and begin to taper off to 3.4% YoY in 2012.

## INTEREST RATES

Banks in Hong Kong raised their mortgage rates in 3Q 2011. In general, HIBOR-based mortgage rates increased from HIBOR plus 150 – 200 basis points (bps) to a range of HIBOR plus 200 - 285 bps, while the maximum mortgage interest rate was revised upwards from Prime (P) minus 255 – 280 bps to P minus 200 – 250 bps. The effective residential mortgage rate increased from HIBOR plus 150 – 200 bps to HIBOR plus 230 – 275 bps.

Banks in Hong Kong remained conservative to lending and continued to adopt stringent stress test to gauge borrowers' ability. According to the Hong Kong Monetary Authority, the volume of new loans approved in August dropped to a 30-month low of HK$15.8 billion, down 10.3% compared to July 2011.

## HOUSING SUPPLY

The government has engaged in political pressure to maintain a constant supply of land to improve the current limited supply situation in the residential market. Chief Executive Donald Tsang emphasised an annual target of 20,000 new private flats over the next ten years to meet demand, according to the 2010 - 11 Policy Address delivered in October 2010. As of the end of September 2011, a total of 17 residential sites were sold via public land auctions and tenders in the 2011-12 Land Sale Programme, providing about 5,700 flats to the market. Together with the three above railway station projects by MTR Corporation, providing another 6,639 units, this would bring a total of 12,339 units to the marketplace. The total supply was still 38% below the government's annual target of 20,000 new private flats as of 3Q 2011.

# Grade A Office Sector

# Employment Trends

The latest HSBC Hong Kong Purchasing Managers' Index, job vacancies and hiring expectations statistics suggest further slowing in office leasing demand in the near term.

## HONG KONG GRIPPED BY PMI CONTRACTION

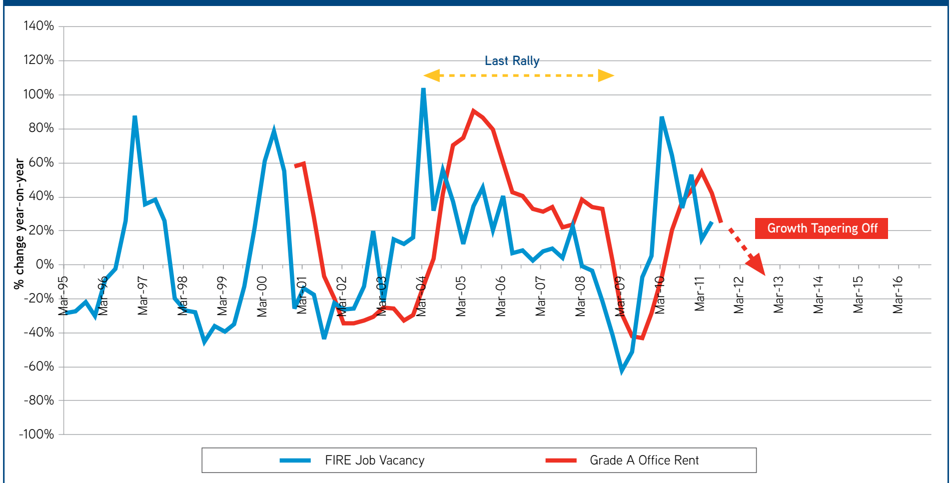
Hong Kong's private sector was hit by its first contraction in two years, indicating a sharp deterioration in business conditions. The HSBC Hong Kong Purchasing Managers' Index dropped 3.6 points from 51.4 in July 2011 to 47.8 in August 2011. With a reading under 50 indicating contraction, this signalled the worst deterioration in 26 months. As demand contracted markedly in the wake of a worsening economic environment, the fall in the headline index was led by a decrease in output of private sector firms. Output shrank at its fastest rate since May 2009. New orders slipped and employment also decreased – the first decrease since December 2010 – as a drop in new orders and output discouraged hiring.

## DIP IN HIRING EXPECTATIONS

Hiring expectations were lower in 3Q 2011 than the preceding quarter but remain at a healthy level. A quarterly survey conducted by Hudson, a global recruitment firm, found hiring expectations across key business sectors experienced a slight dip: 61% of the 600 executives interviewed in the poll planned to increase their headcounts in 3Q 2011, versus 69% in 2Q 2011. This is the first quarter in which expectations have fallen since 2Q 2009 and a levelling off was anticipated after a long period of strong growth. However, many employers tend to take a more conservative approach in 3Q 2011.

Across key business sectors, the Legal, Consumer and Banking & Financial industries outperformed other sectors, such as I.T, Media / PR / Advertising. The Legal sector again recorded the highest expectations (90%); while the largest increment in expectations was reported by the Consumer sector (68%), mainly underpinned by the buoyant retail business. In the Banking & Financial sector, 62% of the respondents would expand their headcount in 3Q 2011, down from 73% in 2Q 2011. Despite the slowdown, there was still a high level of activity in a number of areas, including product sales for corporate banking, IPOs and private banking.

**GRADE A OFFICE RENT vs JOB VACANCY IN "FIRE" SECTOR**




*Note: FIRE = Financing, Insurance and Real Estate*

*Source: Census & Statistics Department, HKSAR Government; Colliers*

In Central, a slowdown in office leasing enquiries was observed in 3Q 2011. Despite the deterioration in business sentiment, tenants in private equity and the legal sector were comparatively active in office leasing enquiries and typically had office requirements from 3,000 to 5,000 sq ft. This helped to push net take-up levels in Central from negative 105,000 sq ft in 2Q 2011 to 125,000 sq ft in 3Q 2011.

### FIRE SECTOR'S JOB VACANCIES TAPER OFF

Hong Kong's economic growth continues to be highly dependent on the Finance, Insurance and Real Estate (FIRE) industries. The FIRE sector, which is a primary office space user group in Hong Kong, continues to enjoy growth albeit at a slowing rate. The latest figures from the Census and Statistics Department indicated that growth momentum in the FIRE sector's job vacancies tapered off significantly from 53% YoY in 1Q 2010 to 25% YoY in 2Q 2011. Correspondingly, the overall Grade A office rents experienced an easing, with growth slowing down from 46% YoY in 1Q 2011 to 27% YoY in 3Q 2011. Meanwhile, the rental gap between Central and other districts, such as Wanchai / Causeway Bay, Island East and Kowloon East was close to historical highs, therefore the Central district would be the most vulnerable to such easing.

## Tenant Demand

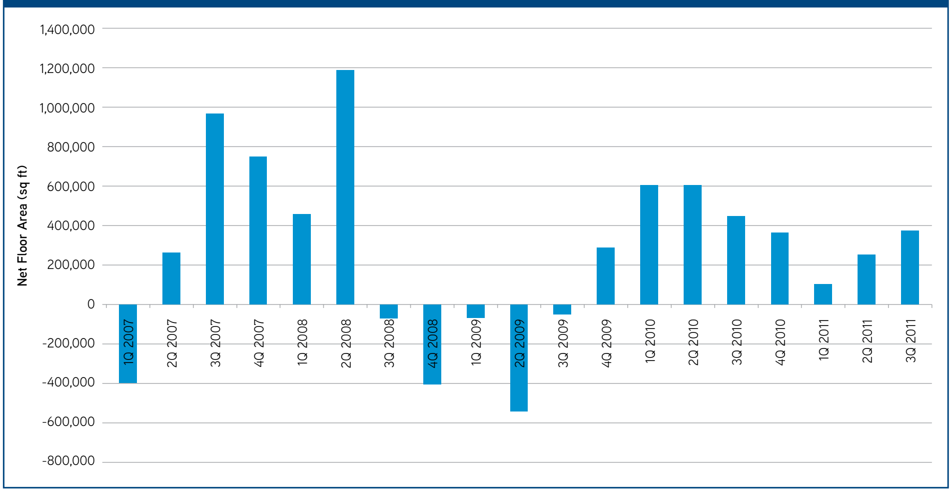
### INCREASING NET TAKE-UP

The strong sell-off in global and local stock markets amid larger downside risks on global growth prospects resulted in a noticeable deterioration in business sentiment and a slowdown in Hong Kong's Grade A office leasing demand during 3Q 2011. However, the slowdown in leasing activities has yet to be fully reflected in the market. The overall net take up increased by 48% QoQ to 374,000 sq ft in 3Q 2011. Activities during the quarter were largely underpinned by the relocation of some tenants away from Central as well as expansion demand by tenants into office locations other than Central.

### SUB-MARKET PERFORMANCE – SLOWING ENQUIRIES

In Central, a slowdown in office leasing enquiries was observed in 3Q 2011. Despite the deterioration in business sentiment, tenants in private equity and the legal sector were comparatively active in office leasing enquiries and typically had office requirements from 3,000 to 5,000 sq ft. This helped to push net take-up levels in Central from negative 105,000 sq ft in 2Q 2011 to 125,000 sq ft in 3Q 2011. Meanwhile, Wanchai / Causeway Bay continued to enjoy tenant relocations as rents in Central were close to the historic peak level and the rental discount in Central was about 50%. As a result, net take-up in Wanchai / Causeway Bay edged up by 28% QoQ to 53,000 sq ft

GRADE A OFFICE NET TAKE-UP




*Source: Colliers*

Some of the smaller or cost-sensitive tenants were forced to relocate after receiving landlord's expensive rental proposal, and looked for alternate office accommodations either away from Central or into lower-cost options in lower-quality offices in fringe Central.

in 3Q 2011. The sub-district of Kowloon East was responsible for the bulk of net take-up during the quarter, as a new round of in-house expansions pushed net take-up in Kowloon East by 129% QoQ to 165,000 sq ft in 3Q 2011 despite higher rents and lower vacancy.

## SOURCES OF DEMAND

Prominent leasing transactions in Central were highlighted by the lease of six floors in Cheung Kong Centre in Central by the Securities and Futures Commission (SFC) for a monthly rental of HK$15.03 million or an average rent of HK$125 per sq ft per month. The space is currently occupied by Pricewaterhouse Coopers. The six floors of SFC will be located on 21/F, 30 - 33/F and 35/F, in which the lease commencement date for the 21/F is November 2011 and the leases for the remaining five floors will start from September 2012.

## TENANTS RELOCATION: AFFORDABILITY ISSUE

Some of the smaller or cost-sensitive tenants were forced to relocate after receiving landlord's expensive rental proposal, and looked for alternate office accommodations either away from Central or into lower-cost options in lower-quality offices in fringe Central. Due to tenants' affordability issues, this pattern of relocation flowed down through the market. The relocating tenants from core Central pushed out tenants from fringe Central who in turn pushed tenants out to the other districts such as Wanchai / Causeway, etc., which created demand in the marketplace. For example, Aon Corporation will relocate from Aon China Building in Central to Times Square, Tower 1 in Causeway Bay, as they had pre-committed to lease all of 27/F and 28/F and a portion of the units on 39/F, involving a total floor area of 50,000 sq ft in Times Square for a monthly rental of about HK$2.25 million or an average rent of HK$45 per sq ft per month.

## TENANTS IN KOWLOON EAST SAW IN-HOUSE EXPANSIONS

The district of Kowloon East experienced rising expansionary demand by the banking sector as well as the non-banking and finance industry sector tenants in 3Q 2011. In relation to the banking and finance sector, Bank of China committed to lease a whole office floor on 25/F Millennium City Phase 5, Kwun Tong, for a unit rental of about HK$30 per sq ft per month, to meet their business expansion needs. This involved a total floor area of 25,000 sq ft. Meanwhile, Hong Kong Interbank Clearing Limited committed to lease the whole of 5/F and some spaces on 23/F and 25/F, taking up a total floor area of 53,000 sq ft, in MG Tower, Kwun Tong. As regards the non-banking industry, Citizen Watch Co. Ltd took 20,000 sq ft of space in Landmark East, paying an effective unit rent of HK$29 per sq ft per month. Moreover, Donna Karan - a US fashion brand leased the whole of 25/F (about 20,000 sq ft) in Two Landmark East for an average rental of HK$27 per sq ft per month.

# Supply Conditions

## NEW OFFICE DEVELOPMENTS IN 2011

No new Grade A office development was completed in 3Q 2011. Under the final stages of construction, LHT Tower in Central with a net floor area of over 100,000 sq ft is targeted for completion in 4Q 2011. In addition, the new office development in Kowloon East at 414 Kwun Tong Road involves a total floor area of 203,000 sq ft net and is scheduled for completion in 4Q 2011. For 2011 as a whole, an estimated total of 1.2 million sq ft of new Grade A office supply in the marketplace is 45% below the long-term average annual supply of 2.2 million sq ft.

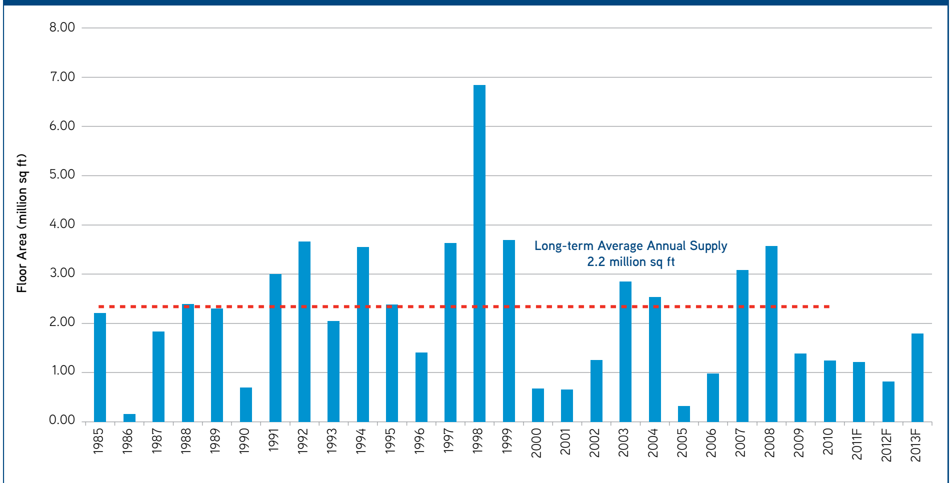
## SUPPLY REMAINS TIGHT IN 2012

There will be no significant easing on the current tight supply situation, with only four new office developments in our covered markets due for completion in 2012. This includes the redevelopment of the Hotel Ritz-Carlton in Central (191,000 sq ft net), Hysan Place in Causeway Bay (237,000 sq ft net), Elite Centre (176,300 sq ft net) and 55 King Yip Street (210,900 sq ft net), bringing a total of 815,000 sq ft to the market.

## KOWLOON EAST WILL BE THE KEY SOURCE OF SUPPLY IN 2013

For 2013, the sub-district of Kowloon East will be the key source of supply, providing a total of 1.5 million sq ft gross of new Grade A office space. This involves five developments, considering those buildings with a total gross floor area of 200,000 sq ft and above.

GRADE A OFFICE SUPPLY TREND




*Source: Rating and Valuation Department (1985-2010); Colliers (2011-2013)*

## GRADE A OFFICE SUPPLY (2011 – 2014 AND BEYOND)

| BUILDING | DISTRICT | NFA (sq ft) | DEVELOPER | STATUS |
|---|---|---|---|---|
| **2011 NEW SUPPLY** | | | | |
| 18 Kowloon East | Kowloon Bay | 307,847 | Sino Land | Completed |
| 50 Connaught Road Central | Central | 122,648 | National Electronics / Citi Property Investors | Completed |
| MG Tower | Kwun Tong | 478,846 | Billion Development | Completed |
| LHT Tower | Central | 105,891 | The Luk Hoi Tong Co Ltd | Under Construction |
| 414 Kwun Tong Road | Kwun Tong | 203,570 | Chiefast Investment Ltd | Under Construction |
| | **2011 Total** | **1,218,802** | | |
| **2012 NEW SUPPLY** | | | | |
| Hotel Ritz Carlton redevelopment | Central | 191,250 | Lai Sun/China Construction Bank | Under construction |
| Hysan Place | Causeway Bay | 237,344 | Hysan Development | Under construction |
| 55 King Yip Street & 24 Hing Yip Street | Kwun Tong | 210,846 | Billion Development | Under construction |
| Elite Centre (20-24 Hung To Road) | Kwun Tong | 176,252 | Sun Hung Kai Properties | Under construction |
| | **2012 Total** | **815,692** | | |
| **2013 NEW SUPPLY** | | | | |
| Kowloon Commerce Centre (Phase II) | Kwai Chung | 442,000 | Sun Hung Kai Properties | Under construction |
| 52-56 Tsun Yip Street | Kwun Tong | 305,989 | Billion Development | Under construction |
| 181 Hoi Bun Road | Kwun Tong | 262,650 | Sun Hung Kai Properties / Wong's | Under construction |
| 135-137 Hoi Bun Road | Kwun Tong | 175,650 | Sundart | Under construction |
| 10 Shing Yip Street | Kwun Tong | 209,368 | Billion Development | Under construction |
| 6 Wang Kwong Road | Kowloon Bay | 224,645 | Billion Development | Under construction |
| 10 Cheung Yue Street | Cheung Sha Wan | 176,545 | Billion Development | Under construction |
| | **2013 Total** | **1,796,848** | | |
| **2014 & BEYOND NEW SUPPLY** | | | | |
| 10 Harcourt Road | Central | 419,468 | Hutchison | Under planning (Existing Hutchison House) |
| 70 Queen's Road Central | Central | 156,641 | Wheelock | Under planning (Existing Crawford House) |
| 38-52 Queen's Road Central | Central | 167,292 | New World Development | Under planning (Existing Manning House and Loke Yew Building) |
| 10 Chater Road | Central | 514,342 | Hongkong Land | Under planning (Existing Prince's Building) |
| 979 King's Road, Taikoo Place | Taikoo Place | 1,712,743 | Swire Properties | Under planning (Existing Warwick House, Somerset House, Cornwall House) |
| 9 Cheung Yee Street | Cheung Sha Wan | 275,482 | Nisilk Ltd | Under planning (Existing Kin Yip Plaza) |
| 15-17 Chong Yip Street | Kwun Tong | 226,480 | Right Union Development Ltd | Under planning (Existing Nan Fung Industrial Building) |
| 180 Wai Yip Street | Kwun Tong | 407,324 | Sun Hung Kai Properties / Wong's International | Under planning (Existing Wong's Industrial Centre) |
| 98 How Ming Street | Kwun Tong | 972,243 | Transport International Holdings / SHKP | Under planning (Existing Bus Depot) |
| 2 Ng Fong Street | San Po Kong | 267,082 | Billion Development | Under planning (Existing Unimix Industrial Centre) |
| | **2014 & Beyond Total** | **5,119,097** | | |

*Note:*
*Demolition: Demolition work is actively undergoing*
*Under construction: Construction activity, including either foundation or superstructure, are undergoing on site*
*Under planning (Existing Building): Building plan for a site, currently occupied by a tenanted building, is approved by the Government*
*Under planning (Vacant Building): Building plan for a site, currently occupied by an empty building, is approved by the Government*
*Under planning (Bare Site): Building plan for a bare site is approved by the Government*
*Completed: Construction is completed and an occupation permit is issued by the Government*

*Source: Colliers*

For 2013, the sub-district of Kowloon East will be the key source of supply, providing a total of 1.9 million sq ft gross of new Grade A office space. This involves five developments, considering those buildings with a total gross floor area of 200,000 sq ft and above.

In Kwun Tong, the project at 181 Hoi Bun Road, developed by Sun Hung Kai Properties / Wong's, is expected to have a total gross floor area of 301,000 sq ft, with an average floor plate size of 12,000 sq ft. Billion Development's office project at 52 - 56 Tsun Yip Street was still in the process of demolishing the existing buildings. The development is expected to provide a total gross floor area of 375,000 sq ft with an average floor plate size of about 13,000 sq ft. Another project by Billion Development at 10 Shing Yip Street was under construction, with a total gross floor area of 300,000 sq ft and a typical floor plate size of 12,000 sq ft. Meanwhile, the project at 135 - 137 Hoi Bun Road by Sundart was under construction, expecting to deliver a total gross floor area of 227,000 sq ft. Other than Kwun Tong, Billion Development's project at 6 Wang Kwong Road in Kowloon Bay was under construction. The project will provide a total floor area of 330,000 sq ft, with a typical floor plate area of 12,000 sq ft.

### POTENTIAL SUPPLY IN 2014 AND BEYOND

In Central, potential new supply in 2014 and beyond will focus on the redevelopment of the existing Hutchison House, Crawford Houses, Prince's Building as well as Manning House and Loke Yew Building, amounting to a total floor area of 1.3 million sq ft net. In Island East, the redevelopment of Techno Centre in Taikoo Place, comprising 1.7 million sq ft of office space, will provide tenants more decentralised alternatives on Hong Kong Island. Across the harbour, a couple of redevelopment buildings in Kowloon East will provide a total of 1.6 million sq ft to the marketplace.

## Vacancy

GRADE A OFFICE VACANCY RATES (BY SUB-MARKETS)

| DISTRICT | TOTAL STOCK (million sq ft) | 3Q 10 | 4Q 10 | 1Q 11 | 2Q 11 | 3Q 2011 |
|---|---|---|---|---|---|---|
| Central / Admiralty | 21.4 | 3.3% | 3.0% | 3.0% | 4.0% | 3.5% |
| Wan Chai / Causeway Bay | 11.1 | 3.8% | 3.5% | 3.3% | 2.9% | 2.4% |
| Island East | 10.9 | 3.2% | 5.8% | 4.7% | 3.9% | 4.5% |
| Sheung Wan | 1.6 | 3.5% | 5.3% | 3.8% | 4.5% | 3.9% |
| Tsim Sha Tsui | 6.4 | 6.1% | 4.8% | 6.6% | 3.9% | 2.6% |
| Kowloon East | 8.2 | 7.3% | 5.5% | 7.2% | 9.8% | 12.9% |
| **Overall** | **59.5** | **4.2%** | **4.2%** | **4.3%** | **4.6%** | **4.7%** |

*Note: Floor area on net basis* *Source: Colliers*

### SIGNS OF RISING VACANCY

The overall vacancy trended upwards by 14 basis points, from 4.6% in 2Q 2011 to 4.7% in 3Q 2011. The surprisingly stronger-than-expected levels of demand from various sector tenants and the ongoing relocation of cost-sensitive tenants saw vacancy levels in Central, Wanchai / Causeway Bay and Tsim Sha Tsui, with the exception of Kowloon East and Island East, trending downwards in 3Q 2011.

Despite stronger in-house expansion demand from both banking and non-banking sector tenants in Kowloon East, the vacancy rate in the sub-market ended the quarter higher than the previous, subject to the completion of MG Tower, which contributed to pushing vacancy levels up from 9.8% in 2Q 2011 to 12.9% in 3Q 2011. Island East also experienced a lift in vacancy rates, up 56 points from 3.9% in 2Q 2011 to 4.5% in 3Q 2011. Expiring leases of relocated tenants and vacant spaces yet to be absorbed by new demand led to a general rise in vacancy in Island East.

The average Grade A office rents stalled across the five sub-markets, with the exception of Central, which experienced a minor lowering in rents through 3Q 2011.

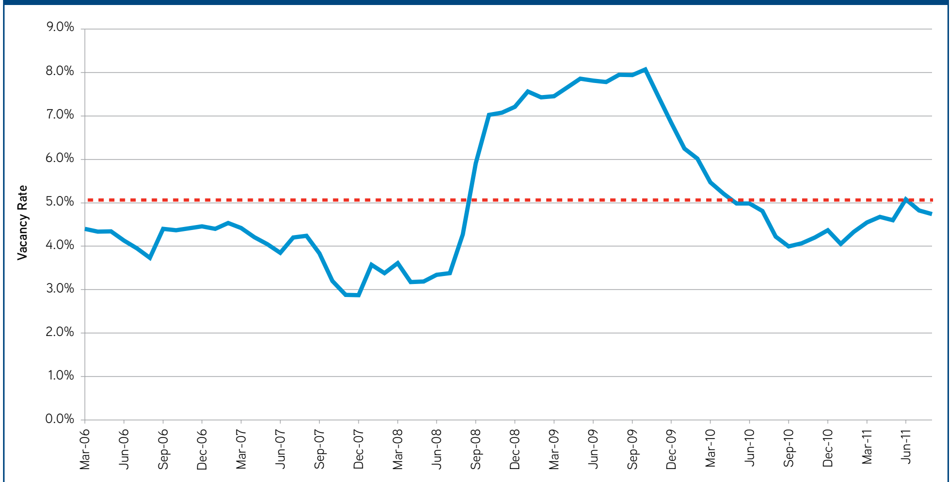
The lowering of vacancy levels in Central, driven by a relative increase in leasing demand from private equity and legal sector tenants, pushed vacancy levels lower by 59 basis point from 4.0% in 2Q 2011 to 3.5% in 3Q 2011. The increase in tenant relocations from Central resulted in falling vacancy levels in Wanchai / Causeway Bay by 47 basis points from 2.9% in 2Q 2011 to 2.4% in 3Q 2011. The strength of demand prompted leasing options in the sub-market to remain limited, given that the availability of vacant space in higher-quality buildings such as Times Square and The Lee Gardens was extremely tight. Due to increasing difficulties to secure larger office spaces, the majority of tenants chose to renew their leases unless there would be a significant change in company size, in terms of either expansion or consolidation.

## FORECAST VACANCY

Due to the anticipated completion of two office developments in the remainder of 2011 and pending higher vacancy due to increasing lease expiry or surrendered spaces in 4Q 2011, the average vacancy level of the whole market is expected to reach its historical average of 5.0%, potentially during the first half of 2012.

The lease expiry of major tenants in Central relocating to other districts, will exert pressure on vacancy levels in Central. For example, the existing leases of Credit Suisse in Exchange Square will expire by the end of 2011 and approximately 72,000 sq ft of office space will be released back into the market. The 120,000 sq ft of vacated space in Cheung Kong Centre previously taken up by Deutsche Bank was still available for lease as of 3Q 2011. Credit Suisse and Deutsche Bank are two of the anchor tenants in International Commerce Centre (ICC) in West Kowloon. Meanwhile, the existing lease of Ernst and Young in Two International Finance Centre (ifc), involving a total of 69,000 sq ft, will expire in 1Q 2012. The group is relocating to Citic Tower in Admiralty.

GRADE A OFFICE VACANCY RATE TREND




*Source: Colliers*

The overall Grade A office rents are set to slow and undergo a downward correction by 8% over the next 12 months.

# Rentals

GRADE A OFFICE RENTALS (BY SUB-MARKETS)

| DISTRICT | 3Q 10 | 4Q 10 | 1Q 11 | 2Q 11 | 3Q 11 | 3Q 2011 (% QoQ) |
|---|---|---|---|---|---|---|
| Central / Admiralty | $89.6 | $97.9 | $110.2 | $113.5 | $111.8 | -1.5% |
| Wan Chai / Causeway Bay | $42.8 | $47.2 | $55.2 | $58.1 | $59.3 | 2.2% |
| Island East | $29.8 | $32.6 | $38.0 | $39.2 | $40.6 | 3.7% |
| Sheung Wan | $45.8 | $48.6 | $50.4 | $54.7 | $54.7 | 0.0% |
| Tsim Sha Tsui | $34.7 | $36.3 | $39.8 | $42.7 | $44.8 | 4.8% |
| Kowloon East | $22.9 | $24.5 | $27.0 | $28.8 | $29.8 | 3.5% |
| **Overall** | **$53.3** | **$57.9** | **$65.2** | **$67.9** | **$67.9** | **0.0%** |

*Source: Colliers*

## STAGNANT RENTAL GROWTH

A sharp deterioration in business conditions, the lowered hiring expectations and the slower growth momentum in the FIRE sector's job vacancy suggested softening office leasing demand. The average Grade A office rents stalled across the five sub-markets, with the exception of Central, which experienced a minor lowering in rents through 3Q 2011.

## CENTRAL SAW FALLING RENTS

In Central, landlords kept rents broadly stable albeit with a marginal downtrend, especially those buildings with higher and pending vacancy. After posting a 2.9% QoQ increase in 2Q 2011, rental growth in the sub-district recorded a mild decline of 1.5% QoQ in 3Q 2011, due to the relatively weaker demand from the banking and finance sector tenants. The Central district would be the most vulnerable to easing, given the rental gap between Central and other districts, such as Wanchai / Causeway Bay, Island East and Kowloon East which stayed close to historical highs as of 3Q 2011. Top-tier buildings in Central will experience higher pressure on easing given its pending vacancy due to increasing surrender stocks, where rents have already got into a headwind since July 2011.

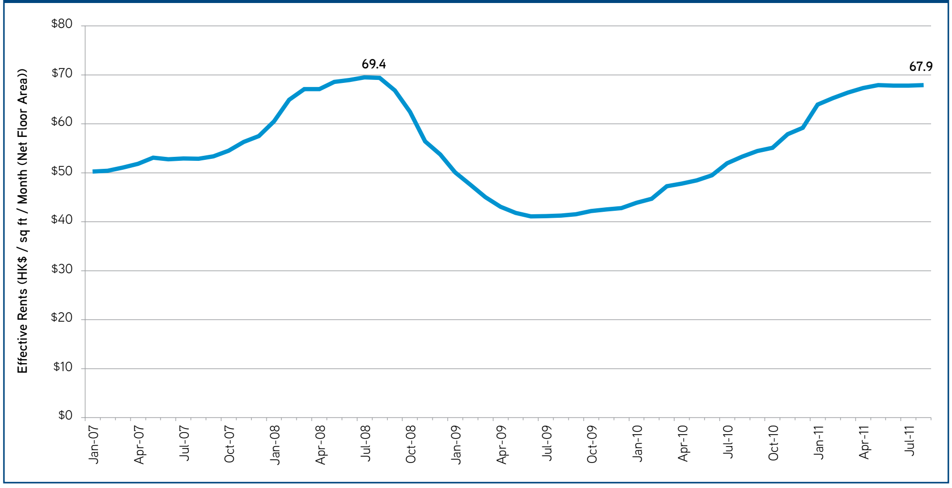
## GROWTH IN OTHER SUB-MARKETS TAPERS OFF

Other than Central, all sub-districts experienced rental growth amid a slower growth pace. The rise in rents was due to expansionary demand from various sector tenants, as well as relocations of smaller or cost-sensitive tenants. In Wanchai / Causeway Bay, the pick-up in demand, largely from tenant relocations, coupled with falling vacancy prompted landlords to adopt a stronger stance in rental negotiations, thereby lifting overall rental growth in the sub-district by 2.2% QoQ in 3Q 2011. In Island East, the aggressive position taken by landlords in leasing negotiations had driven rents to increase by 3.7% QoQ despite vacancy climbing to 4.5%. Across the harbour in Kowloon, Tsim Sha Tsui recorded the strongest rental growth during 3Q 2011, which contributed to a 4.8% QoQ increase in average rents, due to a very low vacancy at 2.6%. In Kowloon East, expansionary and upgrading demand from both banking and non-banking sector tenants continued to support rent increases by 3.5% QoQ in 3Q 2011.

## LANDLORDS WERE LESS FIRM IN RENTAL NEGOTIATIONS

Clouded by the fragile economic recovery of the US and the lingering sovereign debt crisis in the Eurozone, several multinational corporations put their expansion plans on hold, while a number of landlords became less firm in rental negotiations, particularly those office buildings in Central with high and pending vacancy.

GRADE A OFFICE RENTAL TREND




*Source: Colliers*

## RENTAL FORECAST

The market is heading towards a downturn on the back of falling rents in Central since July 2011. Grade A office rents had fallen by 15 - 20% per year during the previous two downward cycles. Looking ahead, a relatively higher rental environment, especially in Central, will result in a steady stream of relocations as tenants seek more cost-effective office accommodation. A sharp deterioration in business conditions affecting business expansion plans and an increasing number of companies turning cautious in hiring will progressively weaken office leasing demand. Coupled with rising vacancy due to increasing surrender stocks and lease expiry, the office market is expected to come under pressure. In view of the current poor market conditions, it will be increasingly difficult to find tenants, especially in the banking industry, to secure large office spaces paying expensive rents, especially in Central. The overall Grade A office rents are set to slow and undergo a downward correction by 8% over the next 12 months.

# Investment Market

## MARKET VOLUME

Investment demand for property softened in 3Q 2011. The total value of investment sales transactions, with a total consideration in excess of HK$30 million, was 68% lower than in 2Q 2011, totalling HK$3 billion in 3Q 2011. Investors remained cautious and adopted a wait-and-see attitude. The total consideration of investment sales transactions continued to stay below its historic average of HK$5.6 billion per quarter. Office prices were still holding firm as there were no signs of investors selling their office premises at significantly discounted prices.

## INVESTMENT RATIONALE

Due to the limited availability of en bloc office investment stock, the bulk of sales transactions, where the total consideration was in excess of HK$30 million, remained focus on the traditional strata-titled office properties in decentralised locations in Kowloon East.

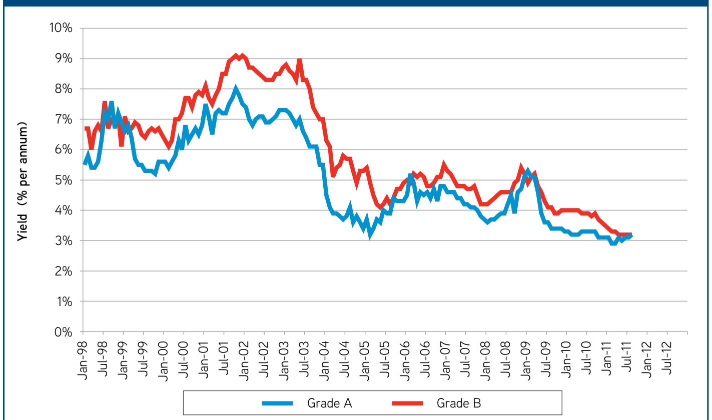
## OUTPERFORMANCE IN KOWLOON EAST

The continual influx of owner-occupiers buying into the Kowloon East sales market pushed capital values slightly higher through 3Q 2011. Sales activity in Kowloon East remained focussed on the pre-sale of Elite Centre developed by Sun Hung Kai Properties and the office development at 55 King Yip Street, both located in Kwun Tong, due for completion in 2012. Sales response at the two projects was well received, in which only two floors were left for sale in Elite Centre, while 60 - 70% of the units at 55 King Yip Street were sold. This helped to boost investment activities in the Kowloon East district.

## COMMERCIAL SITE SOLD THROUGH GOVERNMENT TENDERS

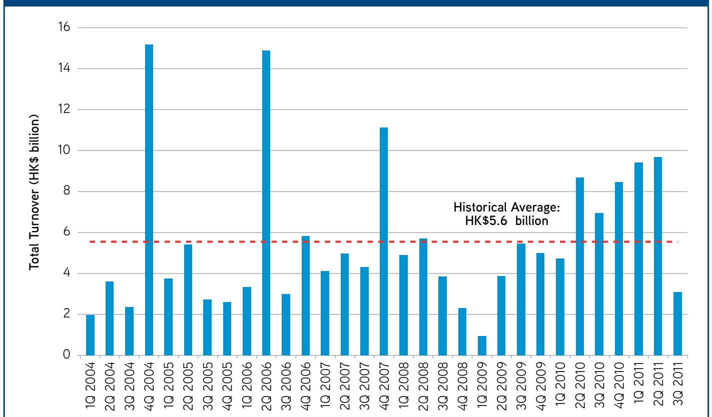
The limited opportunities to purchase en bloc office assets had prompted some developers to remain keen to replenish their land banks. Wheelock Properties purchased two commercial sites through government tenders in 3Q 2011, where the Kwun Tong commercial site located at the junction of Wai Yip Street, Shun Yip Street and Hoi Bun Road (NKIL No. 6269) was acquired for HK$3.528 billion (accommodation value of HK$3,856 per sq ft). The developer plans to build two 20-storey Grade A office buildings with a total gross floor area of 914,897 sq ft. The acquisition of a commercial site at the junction of Hung Luen Road and Kin Wan Street, Hung Hom Bay Reclamation, (KIL No. 11111) by Wheelock Properties fetched HK$4.028 billion (an AV of HK$6,827 per sq ft). In addition, Smart Edge Limited won the tender for a site at the junction of Kai Cheung Road and Wang Kwong Road in Kowloon Bay for HK$3.432 billion(an AV of HK$4,026 per sq ft).

### HONG KONG OFFICE INVESTMENT YIELDS




*Source: Rating and Valuation Department, HKSAR Government; Colliers*

### HONG KONG OFFICE INVESTMENT SALES TRANSACTIONS




*Note:*
*Investment sales transactions with lump sums of HK$30 million or above*

*Source: EPRC*

# Market Outlook

| DOWNWARD RENTAL CYCLE | GRADE A OFFICE RENTAL RATE | AVERAGE GRADE A OFFICE SUPPLY |
|---|---|---|
| 2001 - 2003 | -40% | 1.6 million sq ft |
| 2008 - 2009 | -57% | 2.5 million sq ft |
| 2011 - 2012* | -8% | 1.0 million sq ft |

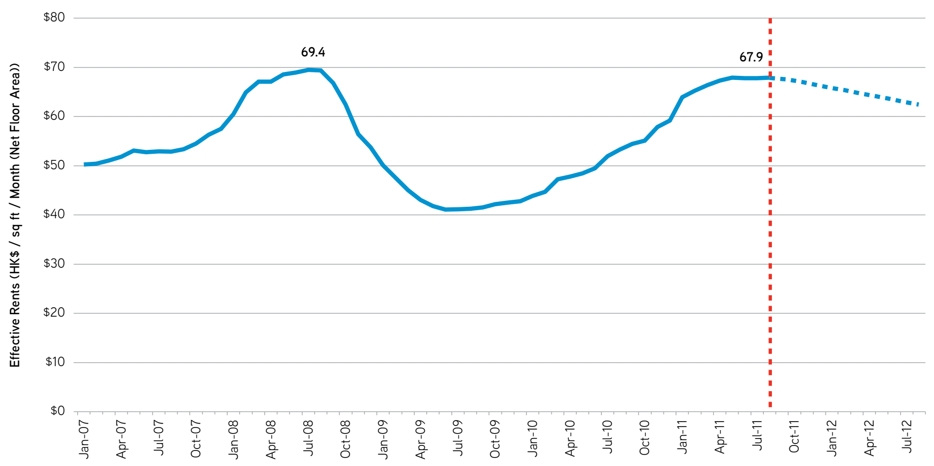
**Colliers Forecast* *Source: Colliers, Rating & Valuation Department of HKSAR*

The market is heading towards a downturn in view of falling rents in Central since July 2011. Rents fell by 15 - 20% per year during the previous two downward cycles. Considering a general deterioration in business conditions affecting business expansion plans, increasing numbers of companies have turning cautious in hiring will progressively weaken office leasing demand in Hong Kong. The office market expects to come under pressure in anticipation of rising vacancy due to increasing surrender stocks and lease expiry. It will be increasingly difficult to find tenants, in the banking industry in particular, to secure large office spaces paying expensive rents, especially in Central, subject to a weak business environment. The overall Grade A office rents are set to slow and undergo a downward correction by 8% over the next 12 months.

Due to the anticipated tighter supply situation of 1.0 million sq ft of supply in 2011 - 2012, the rate of rental decline is expected to be of a smaller magnitude than the previous two downward cycles.

The level of Grade A office supply was relatively higher in the previous two downward cycles in 2008 - 2009 and 2001 - 2003, with the average supply brought to about 2.5 million sq ft and 1.6 million sq ft, respectively. Due to the anticipated tighter supply situation of 1.0 million sq ft of supply in 2011 - 2012, the rate of rental decline is expected to be of a smaller magnitude than the previous two downward cycles.

GRADE A OFFICE RENTAL TREND




*Source: Colliers*

# Luxury Residential Sector

## Sales Market

### SALES ACTIVITY SLOWED SIGNIFICANTLY

During 3Q 2011, the weaker-than-expected US economic activity and the lingering European debt crisis shattered investor sentiment, which had already weighted on the stock markets. Since the market was still subject to policy risks, financing difficulties and interest rate hikes, sales activity in the Hong Kong residential market slowed significantly, with the total number of sales and purchases of residential units falling by 28.9% QoQ during the three-month period ending August 2011.

In the luxury segment, sales activity experienced a deeper deceleration across the board, with the number of luxury residential sales transactions in the three traditional luxury districts of The Peak, Mid-levels and South Side, that sold for over HK$20 million, decreasing by 48% QoQ during the three-month period ending August 2011. Similarly, the number of sales transactions in the top-end market (i.e. sales transactions of properties above HK$100 million) declined by 47% QoQ over the same period. As far as wealthy mainland Chinese buyers are concerned, the market showed signs of broader investor caution over tighter credit conditions in mainland China given a greater downside risk on global growth prospects. The dampened market sentiment resulted in softening demand from mainland Chinese buyers for properties in Hong Kong. The proportion of mainland Chinese buyers in Hong Kong decreased from 30 - 40% in 2Q 2011 to less than 20% in 3Q 2011.

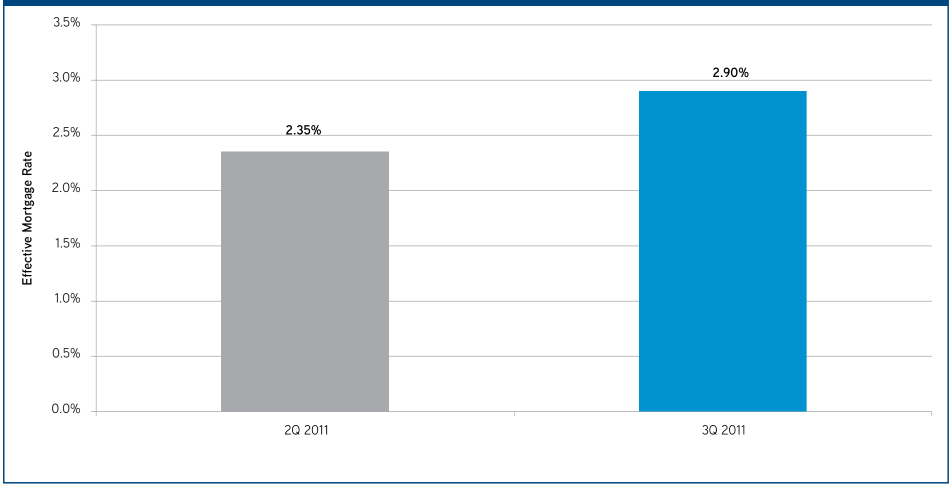
Therefore, unavoidable bargaining occurred in the residential market, while buyers continued to face difficulties in mortgage financing subject to policy risks and interest rate hikes. Local banks raised their interest rates and maintained their conservative approach to property valuations. Some individual homeowners were willing to negotiate the selling prices of their flats and slash asking prices by 10% - 15% to facilitate a transaction. On the other hand, vendors with greater holding power were in no rush to sell flats at substantial discounts, possible due to the relatively low interest rate environment still prevalent.

### INTEREST RATE HIKES

In terms of financing, major local banks raised their mortgage rates during 3Q 2011 and mortgage rates just started to return to a normal level – averaging 3% to 4% over the past decade. For example, HSBC announced that it raised its HIBOR-based mortgage interest rate (H) from H plus 1.8 - 2.3% to H plus 2.3 - 2.7% in August 2011. With the 1-month HIBOR rate at 0.2%, the new HIBOR-based rate would range from 2.5 to 2.9%. In terms of Prime rate-based mortgage rates, HSBC also raised it from P minus 2.7% to P minus 2.1 - 2.4%.

The new round of mortgage rate hikes initiated by HSBC further dampened market sentiment and prompted potential buyers to maintain their wait-and-see attitude. It is not just the interest rate increase that eroded buyer confidence but also a general concern about global economic growth ahead.

HSBC'S PRIME-RATE BASED MORTGAGE RATES




*Source: HSBC*

## LUXURY PRICES PEAKED OUT

LUXURY RESIDENTIAL PRICES (BY SUB-MARKETS)

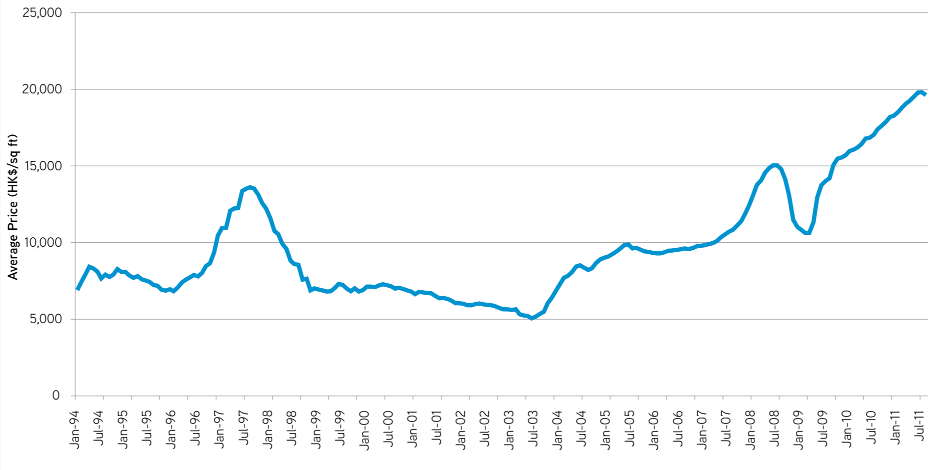
| DISTRICT | 1Q 10 | 2Q 10 | 3Q 10 | 4Q 10 | 1Q 11 | 2Q 11 | 3Q 11 | 3Q 2011 (% QoQ) |
|---|---|---|---|---|---|---|---|---|
| The Peak | $25,063 | $26,875 | $28,050 | $29,313 | $30,938 | $32,413 | $33,063 | 2.0% |
| Mid-levels | $11,443 | $11,803 | $12,000 | $12,725 | $13,188 | $13,663 | $13,838 | 1.3% |
| South Side | $17,338 | $17,713 | $18,613 | $19,288 | $19,538 | $19,925 | $19,725 | -1.0% |
| **Overall** | **$16,058** | **$16,783** | **$17,391** | **$18,189** | **$18,806** | **$19,520** | **$19,629** | **0.6%** |

*Source: Colliers*

During 3Q 2011, the growth of luxury residential prices tapered off significantly, with a mild growth of 0.6% QoQ to HK$19,629 per sq ft as of August 2011, following the 3.8% QoQ increase in May 2011. The average price had surpassed the previous high in mid-2008 by 30%, in which residential properties on The Peak displayed strongest growth of 52%. The average luxury residential prices had already peaked out.

During 3Q 2011, the growth of luxury residential prices tapered off significantly, with a mild growth of 0.6% QoQ to HK$19,629 per sq ft as of August 2011.

HONG KONG LUXURY RESIDENTIAL PRICE TREND




*Source: Colliers*

## SELLING AT DISCOUNTS

To allow room for bargaining, the market had been filled with stories of homeowners cutting prices during 3Q 2011. For example, a house owner chopped HK$5 million or 6.25% off the asking price (from HK$80 million to HK$78 million) before selling the 4,212 sq ft house at Regalia Bay in Stanley for HK$68.3 million (HK$16,216 per sq ft). The deal indicates a 15% drop in prices between the asking price of HK$80 million and actual transaction of HK$63.8 million. In fact, the original owner bought the flat in October 2007 for HK$58 million, meaning this purchaser gained 10% from the deal.

There were a few cases of individual mainland Chinese homeowners selling their properties at discounts on the back of tighter credit conditions in mainland China. During the quarter, a mainland Chinese owner sold a 5,368 sq ft house in The Giverny, Sai Kung, at a loss, for HK$58 million (HK$10,805 per sq ft). The deal represents a 26% or HK$20 million loss in transacted price, as the property was purchased for HK$78 million in June 2008. In Regalia Bay, a 4,902 sq ft house was also sold at a discount for HK$96 million, although it was originally purchased in January 2008 for HK$110 million, demonstrating a 13% or HK$14 million loss.

However, up until 3Q 2011, price slashing had not yet been fully reflected in the overall luxury residential market.

## MAJOR RESIDENTIAL SALES TRANSACTIONS

| MONTH | PROPERTY | GFA (sq ft) | PRICE (HK$ m) | UNIT PRICE (HK$ / sq ft) |
|---|---|---|---|---|
| **SOUTH SIDE** | | | | |
| Jun-11 | Regalia Bay, Phase 2, House B55 | 4,104 | $78.00 | $19,006 |
| Jun-11 | Regalia Bay, Phase 2, House B32 | 4,094 | $68.38 | $16,702 |
| Jun-11 | Grand Garden, Block 1, 19/F, Flat A | 3,054 | $74.20 | $24,296 |
| Jun-11 | Grand Garden, Block 1, 15/F, Flat A | 3,054 | $70.80 | $23,183 |
| Jun-11 | Shouson Peak, House 17E | 4,392 | $205.00 | $46,676 |
| Jun-11 | Shouson Peak, House 17B | 4,045 | $187.80 | $46,428 |
| Jun-11 | Repulse Bay Heights, House 1 | 4,018 | $101.50 | $25,261 |
| Jun-11 | Fortuna Court, 12/F, Flat B | 2,857 | $96.42 | $33,749 |
| Jun-11 | Fortuna Court, 9/F, Flat A | 2,857 | $88.00 | $30,802 |
| Jun-11 | Carrianna Repulse Bay, 11/F, Flat A | 2,161 | $64.40 | $29,801 |
| Jun-11 | Belgravia, 26/F, Flat A | 2,390 | $84.30 | $35,272 |
| Jul-11 | Belgravia, 17/F, Flat B | 2,790 | $78.00 | $27,957 |
| Aug-11 | Carrianna Repulse Bay, 19/F, Flat A | 2,161 | $55.32 | $25,600 |
| Aug-11 | Redhill Peninsula - Palm Drive, House 72 | 3,119 | $58.50 | $18,756 |
| Aug-11 | Regalia Bay, Phase 1, House D16 | 4,902 | $118.50 | $24,174 |
| **MID-LEVELS** | | | | |
| Jun-11 | Azura, 46/F, Flat B | 2,078 | $62.76 | $30,200 |
| Jun-11 | Azura, 49/F, Flat B | 2,078 | $67.12 | $32,300 |
| Jun-11 | Harbourview, 17/F, Flat B | 2,346 | $70.38 | $30,000 |
| Jun-11 | Garden Terrace No 2, 23/F, Flat A | 3,002 | $66.00 | $21,985 |
| Jun-11 | Grenville House, Block G, H, 7/F, Flat H | 3,700 | $93.88 | $25,373 |
| Jun-11 | Estoril Court Block 1, 11/F, Flat A | 3,347 | $60.00 | $17,927 |
| Jul-11 | Regence Royale, Tower 2, 11/F, Flat B | 2,522 | $58.01 | $23,000 |
| Aug-11 | Harbourview, 19/F, Flat A | 2,350 | $72.85 | $31,000 |
| Aug-11 | Century Tower I, 16/F, Flat A | 2,330 | $42.80 | $18,369 |
| Aug-11 | Century Tower I, 25/F, Flat A | 2,330 | $47.20 | $20,258 |

*Source: Colliers*

# Leasing Demand

## LARGER PROPORTION OF EXPATRIATE ARRIVALS FROM NON-FINANCE COMPANIES

Despite the global economic turbulence, no significant impact was seen in the leasing market during 3Q 2011. Without an increasing number of stocks for lease on the back of slowing sales, the market continued to experience sustainable occupation demand, with a larger proportion of expatriate arrivals from non-finance companies, such as insurance, IT and manufacturing enterprises. Meanwhile, the banking and finance sectors remained the largest contributors to total expatriate arrivals. A majority of the leasing deals were recorded at monthly rents of HK$30,000 to HK$80,000, contributing 42% of the total in 3Q 2011. Due to the seasonal factor, there were less expatriate family arrivals compared to the previous quarter subsequent to the opening of the school year.

Without an increasing number of stocks for lease on the back of slowing sales, the market continued to experience sustainable occupation demand, with a larger proportion of expatriate arrivals from non-finance companies, such as insurance, IT and manufacturing enterprises.

As of the end of 3Q 2011, budgets for staff at junior levels ranged from HK$20,000 to HK$60,000 per month, middle management levels from HK$60,000 to HK$150,000 per month, and senior executives from HK$150,000 and above per month.

## RENTS SURPASS MID-2008 PEAK BY 4.5%

Housing continues to become less affordable for expatriates in Hong Kong, as luxury residential rents continued to ride on an upward trend during 3Q 2011, thanks to the relentless demand from expatriates for large-sized apartments or houses. The average luxury residential rents surpassed the previous peak in mid-2008 by 4.5%, while rents on The Peak showed remarkable growth of 18%, with rents averaging HK$68.56 per sq ft in August 2011.

## THE LACK OF INTERNATIONAL SCHOOLS WITHOUT A NEAR-TERM SOLUTION

Without a near-term solution, the problem about the lack of access to quality international schools and limited school places exists. Coupled with inflated housing rentals, this continued to deter senior employees of multinational firms from relocating to Hong Kong and these expats had been considering opportunities in other financial centres in Asia, such as Singapore.

But so far, the delay in confirmation to rent standard homes from this batch of expatriates did not slow overall demand for housing, as demand had still been outstripping supply. Hong Kong offers bright prospects for growth of businesses due to its geographical proximity to inland mainland cities. The continual inflow of expatriates coupled with limited luxury residential properties available for lease gave support to underpin the luxury residential leasing market.

# Rental Trend

**LUXURY RESIDENTIAL RENTALS (BY SUB-MARKETS)**

| DISTRICT | 1Q 10 | 2Q 10 | 3Q 10 | 4Q 10 | 1Q 11 | 2Q 11 | 3Q 11 | 3Q 2011 (% QoQ) |
|---|---|---|---|---|---|---|---|---|
| The Peak | $50.13 | $52.15 | $54.31 | $56.96 | $60.88 | $66.55 | $68.56 | 3.0% |
| Mid-levels | $37.54 | $39.97 | $41.90 | $43.20 | $44.97 | $45.79 | $46.88 | 2.4% |
| South Side | $40.81 | $42.29 | $44.18 | $45.32 | $46.55 | $48.48 | $49.31 | 1.7% |
| **Overall** | **$39.08** | **$40.93** | **$42.60** | **$43.83** | **$45.42** | **$47.30** | **$48.37** | **2.3%** |

*Source: Colliers*

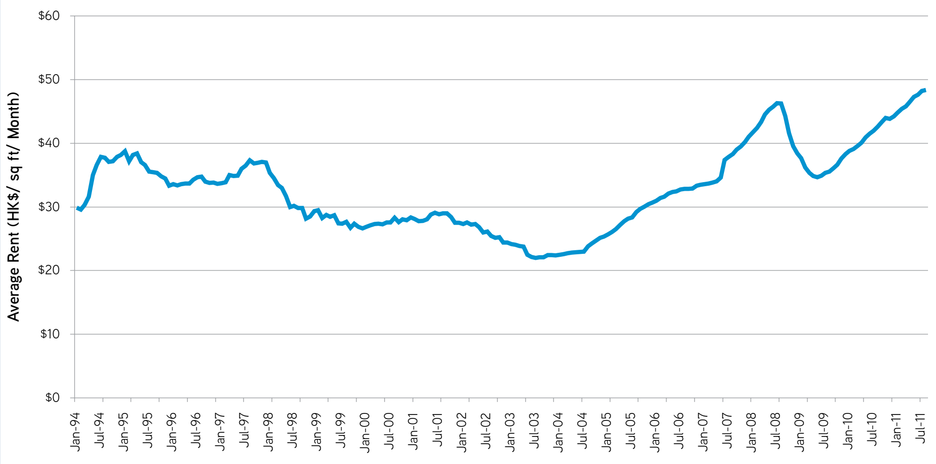
Several corporate landlords became more negotiable on rents in the wake of increasing downside risks in the global economic environment. Yet there was still a mismatch between corporate housing budgets and landlords' asking rents. Tenants who could not justify the widening gap between budgets and rents turned to downgrading flat sizes, or moving away from the traditional luxury residential areas to other districts, such as West Kowloon, Olympic Station or Tung Chung.

**MAJOR RESIDENTIAL LEASE TRANSACTIONS**

| MONTH | PROPERTY | DISTRICT | GFA (sq ft) | RENTAL (HK$ / MONTH) | UNIT RENTAL (HK$ / sq ft / MONTH) |
|---|---|---|---|---|---|
| Jun-11 | Bamboo Grove | Mid-levels | 2,600 | 110,000 | 42.31 |
| Jun-11 | Branksome Grande | Mid-levels | 3,030 | 113,000 | 37.29 |
| Jun-11 | The Harbourview | Mid-levels | 2,350 | 143,000 | 60.85 |
| Jul-11 | The Summit | Mid-levels | 3,254 | 188,000 | 57.78 |
| Aug-11 | Queen's Garden (Renewal) | Mid-levels | 2,830 | 196,000 | 69.26 |
| Aug-11 | Garden Terrace (Renwal) | Mid-levels | 3,726 | 130,000 | 34.89 |
| | | | | | |
| Jun-11 | Hong Kong Parkview | South Side | 2,714 | 120,000 | 44.22 |
| Jul-11 | Borrett Mansion | South Side | 2,800 | 130,000 | 46.43 |
| Jul-11 | Carmina Place | South Side | 2,628 | 116,000 | 44.14 |
| Jul-11 | Regalia Bay | South Side | 4,218 | 178,000 | 42.20 |
| Aug-11 | Cedar Drive, Redhill Peninsula | South Side | 3,000 | 118,000 | 39.33 |
| Aug-11 | Residence Bel-Air | South Side | 3,200 | 140,000 | 43.75 |
| Aug-11 | The Lily | South Side | 3,700 | 196,000 | 52.97 |

*Source: Colliers*

**HONG KONG LUXURY RESIDENTIAL RENTAL TREND**

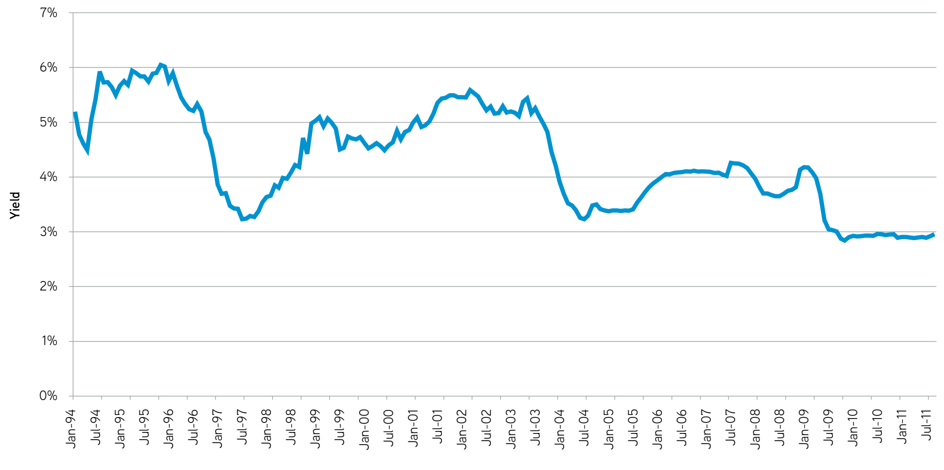



*Source: Colliers*

The demand-supply imbalance coupled with inflationary pressure continued to drive rents upwards, with the average luxury residential rents edging up further by 2.3% QoQ, to HK$48.37 per sq ft per month as of August 2011, after rising by 4.2% QoQ in the previous quarter.

# Investment Market

## HONG KONG LUXURY RESIDENTIAL YIELD TREND




*Source: Colliers*

Overall luxury residential yield in the three traditional luxury residential districts edged up from 2.72% in May 2011 to 2.77% at the end of August 2011, indicating that the growth rate of luxury residential rents had outpaced prices during the quarter.

Regarding land sales, a total of 11 sites were sold in the government's public land auction or via tender during 3Q 2011, in which six sites were designated for residential use and none of the sites were located in the traditional luxury residential districts of The Peak, Mid-levels and South Side.

**GOVERNMENT LAND SALE RESULTS 3Q 2011 – RESIDENTIAL SITES**

| DATE | LOT NO. | LOCATION | MAXIMUM GFA (sq ft) | LUMP SUM (HK$ MILLIONS) | ACCOMMODATION VALUE (HK$/sq ft) | PURCHASER | AUCTION OR TENDER |
|---|---|---|---|---|---|---|---|
| 28-Jul-11 | TCTL 36 | Area 55A, Tung Chung, Lantau Island | 1,394,369 | $3,770 | $2,704 | Sun Hung Kai Properties | Tender |
| 9-Aug-11 | STTL 525 | Area 56A, Kau To, Shatin, New Territories | 1,031,461 | $5,500 | $5,332 | Sino Land (40%)/ Kerry Properties (40%/ Manhattan (20%) | Auction |
| 25-Aug-11 | IL 8920 | Oil Street, North Point, Hong Kong | 755,647 | $6,267 | $8,294 | Cheung Kong | Tender |
| 6-Sep-11 | TKOTL 113 | Area 66A, Tseung Kwan O, New Territories | 792,898 | $3,120 | $3,935 | Sun Hung Kai Properties | Auction |
| 6-Sep-11 | Lot No. 1282 in DD No. 253 | Pak Shek Wo, Sai Kung | 12,107 | $121.50 | $10,036 | International Group | Auction |
| 6-Sep-11 | Lot No. 4309 in DD No. 124 | Tan Kwai Tsuen Road, Yuen Long, New Territories | 120,471 | $361 | $2,997 | Paliburg (50%)/ Regal (50%) | Auction |
| **Total:** | **About** | **4.1 million sq ft** | **$19,139.5 M** | | | | |

*Source: Lands Department, HKSAR Government*

## POOR LAND AUCTION RESULTS REFLECT DEVELOPERS' CAUTION

In early August, the strong sell-off in both the Hong Kong and global stock markets amid growing economic gloom resulted in a noticeable deterioration in business confidence and the worse-than-expected land auction results during 3Q 2011. The poor land auction results of Kau To Shan (drew only one bid) and Oil Street (sold at a lower-than-expected price) reflected local developers' caution on Hong Kong's medium-to-long-term property market outlook. The land of the Tseung Kwan O site was sold by auction to Sun Hung Kai Properties at below market expectations, while the Tan Kwai Tsuen site in Yuen Long and the Pak Shek Wo San Tsuen site in Sai Kung were sold at the middle range of market consensus. The increasing downside risks in the external environment and more parcels of land being put up for sale by the government in coming months have prompted developers to remain cautious.

## RESIDENTIAL SITES OFFER FOR SALE

Despite the unenthusiastic atmosphere in land auctions during 3Q 2011, the Hong Kong government will offer seven sites in the Application List for tender sale in 4Q 2011 with an attempt to increase land supply, where the five residential sites are estimated to provide 1,770 units. The remaining two sites are designated for business and hotel purposes, which could provide a gross floor area of 351,980 sq ft and an estimated 750 rooms, respectively.

**FIVE RESIDENTIAL SITES TO BE OFFERED FOR GOVERNMENT TENDERS IN 4Q 2011**

| SITE | LOT NO. | GFA (sq ft) | ESTIMATED MARKET VALUE (HK$ m) | ESTIMATED ACCOMMODATION VALUE (HK$/sq ft) | TENDER INVITATION DATE | TENDER CLOSES |
|---|---|---|---|---|---|---|
| Cheung Sha Site 406, Lantau | Lot 724 in DD 332 | 31,904 | $191 | $6,000 | 28-Oct-11 | 25-Nov-11 |
| Cheung Sha Site 407, Lantau | Lot 726 in DD 332 | 32,507 | $195 | $6,000 | 28-Oct-11 | 25-Nov-11 |
| Mui Mo Lantau | Lot 726 in DD 4 | 49,407 | $98.80 | $2,000 | Nov-11 | - |
| Tseung Kwan O Area 66B2 | TKOTL 119 | 489,011 | $1,956 | $4,000 | Dec-11 | - |
| Ex-Perowne Barracks North site, Area 48, Castle Peak Road, Tuen Mun | TMTL 423 | 937,125 | $5,623 | $6,000 | Dec-11 | - |
| **Total: About 1.5 million sq ft (1,770 units) $8,063.8 Million** | | | | | | |

*Source: Lands Department, HKSAR Government*

| UPCOMING TENDERS BY MTRC | | | | | |
|---|---|---|---|---|---|
| SITE | GFA (sq ft) | ESTIMATED MARKET VALUE (HK$ m) | ESTIMATED ACCOMMODATION VALUE (HK$/sq ft) | TENDER INVITATION DATE | TENDER CLOSES |
| Nam Cheong MTR Station | 2,608,763 | $13,200 - $15,650 | $5,000 - $6,000 | 20-Sep-11 | 17-Oct-11 |
| Tsuen Wan 5 (Bayside) project at West Rail's Tsuen Wan West Station | 2,240,527 | $15,684 - $17,924 | $7,000 - $8,000 | 4Q 2011 or Early 2012 | To be confirmed |
| Tsuen Wan 5 (Cityside) project at West Rail's Tsuen Wan West Station | 891,518 | $5,346-$6,686 | $6,000-$7,000 | 4Q 2011 or Early 2012 | To be confirmed |
| **Total: About 5.7 million sqft (6,639 units)** | | | | | |

*Source: : MTRC*

MTRC has also planned to tender the property development projects in 4Q 2011. In addition to the Nam Cheong site (estimated to provide a total of 3,313 units),the railway property development projects in Tsuen Wan 5 (Bayside) and the Tsuen Wan 5 (Cityside) projects at the West Rail's Tsuen Wan West Station are estimated to bring a total of 3,326 flats, about 55% of which (1,832 units) will be small- and medium-sized flats.

## SUPPLY IS 38% BELOW GOVERNMENT'S ANNUAL TARGET

The government has engaged in political pressure to maintain a constant supply of land to improve the current limited supply situation in the residential market. Chief Executive Donald Tsang emphasised an annual target of 20,000 new private flats over the next ten years to meet demand, according to the 2010 - 11 Policy Address delivered in October 2010.

As of the end of September 2011, a total of 17 residential sites were sold via public land auctions and tenders since the announcement of the 2011 - 12 Land Sale Programme in February 2011. This could provide about 5,700 flats to the market. Together with the three above railway station projects by MTR Corporation, providing another 6,639 units, this would bring a total of 12,339 units to the marketplace. The total supply was still 38% below the government's annual target of 20,000 new private flats as of 3Q 2011.

# Supply

However, there was no significant improvement in the prevailing tight supply situation in the luxury sector in 3Q 2011. As of August 2011, the overall luxury residential supply between 2011 and 2013 was 54% below its long-term average of 549 units.

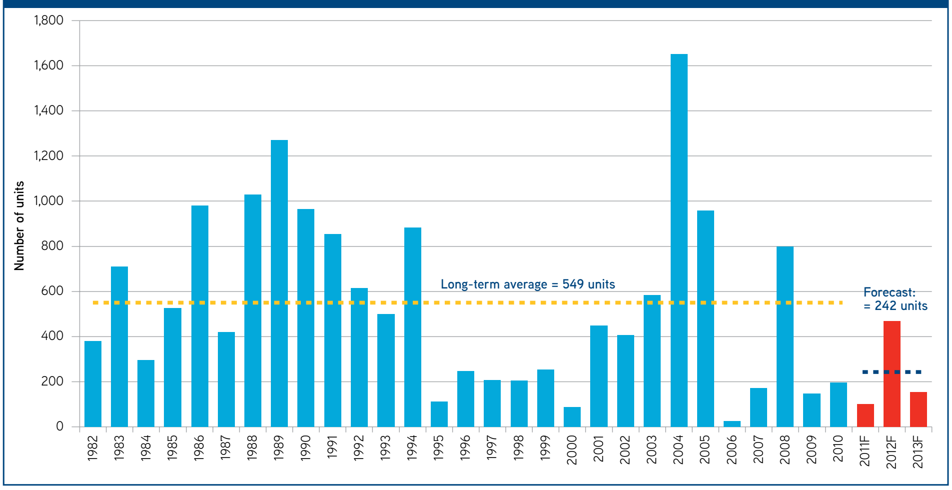
**PROJECTED NEW SUPPLY OF LUXURY RESIDENTIAL UNITS IN 2011**

| DEVELOPMENT | HOUSE* | APARTMENT* | DEVELOPER / OWNER | NO. OF UNITS | STATUS |
|---|---|---|---|---|---|
| **THE PEAK** | | | | | |
| 54 Mount Kellett Road | 3@2-s | - | Manhattan Group | 3 | Completed in May 2011 |
| 3 Black's Link | 2 @ 3-s | - | Fortune Link Development Ltd | 2 | Completed in June 2011 |
| 59 Mount Kellett Road | 1 @ 2-s | - | Wincord Investment Ltd | 1 | Under Construction |
| 37 Severn Road | 3 @ 3-s, 4 @ 3-s | - | SHKP | 7 | Under Construction |
| **SOUTH SIDE** | | | | | |
| 43 Beach Road | - | 2 @ 3-s | Silver Mark Ltd | 4 | Completed in Feb 2011 |
| 216 Victoria Road (Tower II) | | 1 @ 4-s | Lo & Son Land Invest Co Ltd | 32 | Completed in May 2011 |
| 4A South Bay Road | 1 @ 3-s | - | Infinitive Ltd | 1 | Under Construction |
| 2 Belleview Drive | 1 @ 4-s | - | Emperor Group | 1 | Under Construction |
| 18 Carmel Road | 1 @ 4-s | - | Horizon East Investment Ltd | 1 | Under Construction |
| **MID-LEVELS** | | | | | |
| 9A-H Seymour Road, 5, 6, 6A, 7 & 7A Ying Fai Terrace | - | 1 @ 48-s | Wing Tai Asia | 82 | Under Construction |

** No. of block @ No. of storey*

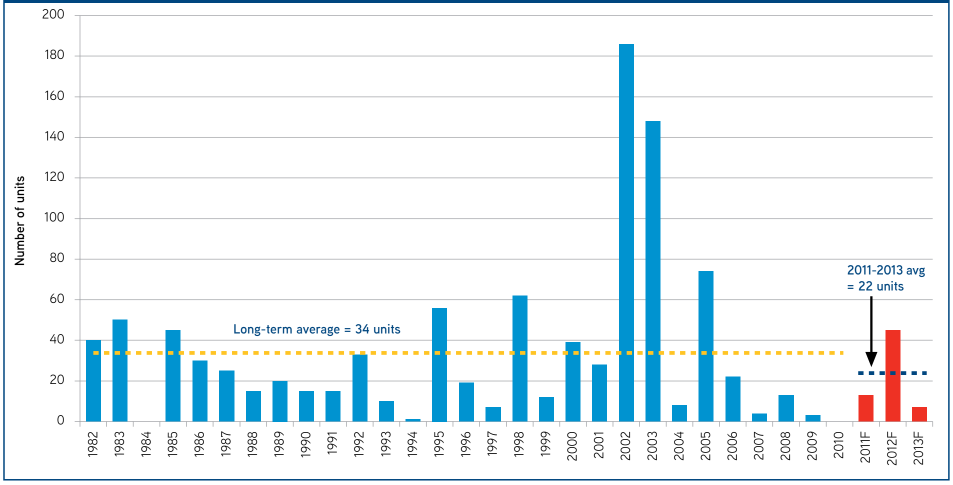
*Source: Colliers*

**OVERALL LUXURY RESIDENTIAL NEW SUPPLY**



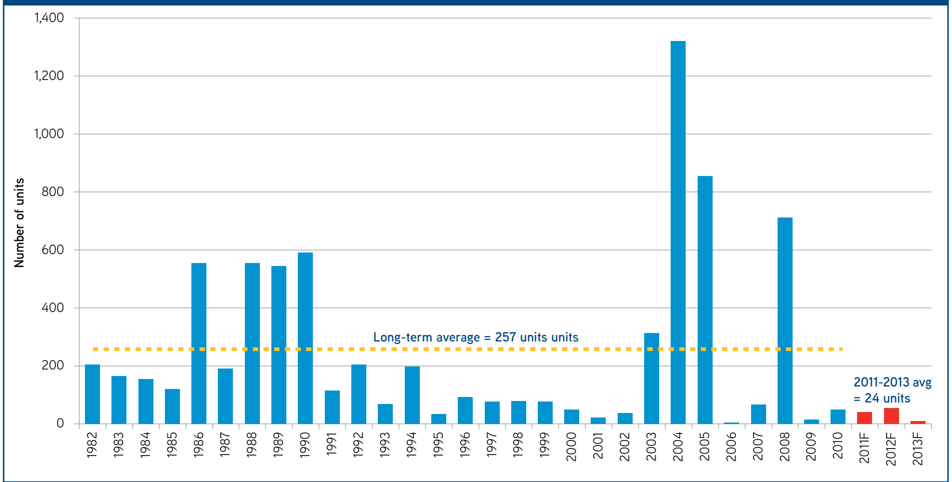

*Source: Colliers*

## LUXURY RESIDENTIAL NEW SUPPLY ON THE PEAK



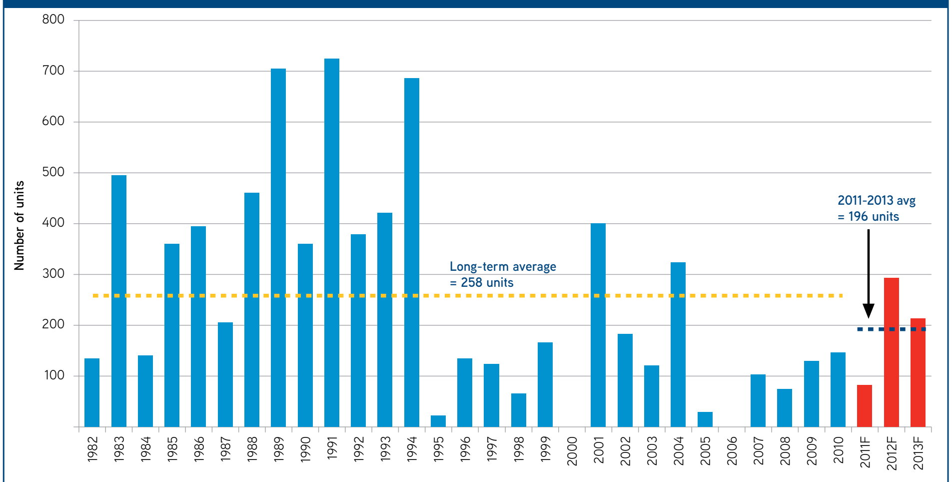

*Source: Colliers*

## LUXURY RESIDENTIAL NEW SUPPLY ON SOUTH SIDE




*Source: Colliers*

## LUXURY RESIDENTIAL NEW SUPPLY ON MID-LEVELS




*Source: Colliers*

# Market Outlook

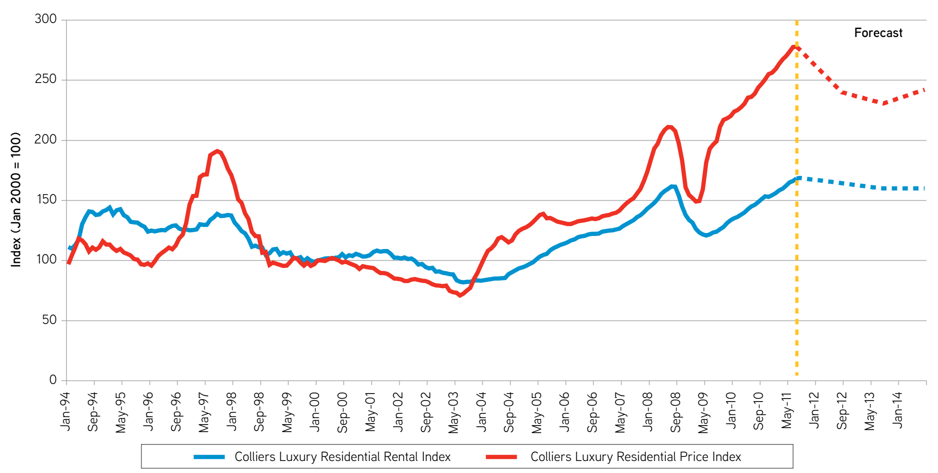
Looking ahead, the deteriorating global economic outlook, tightening credit conditions in mainland China and mortgage rate hikes in Hong Kong will erode the market's confidence and pose further downside risks to the Hong Kong luxury residential market, leading to a slowdown in both sales volume and prices. The enduring stringent stress tests adopted by local banks and the persistent low loan-to-value ratio will continue to affect residential sales activity, especially from end-user demand.

The cyclical downturn will lead to an 13% correction in overall luxury residential prices over the next 12 months, considering an average cyclical downtrend of about 6.5 quarters. The average luxury residential rent is expected to undergo a downward adjustment of 3% over the next 12 months.

The current credit crunch in mainland China coupled with a subdued sentiment will prompt mainland Chinese buyers to retreat from the Hong Kong residential market. Although the US has vowed to maintain ultra-low interest rates until 2013, this is unlikely to help boost home buyer sentiment as the market remains vulnerable to credit risks. However, the Hong Kong property market is still relatively well-placed as economic growth in the territory is not expected to weaken like developed western economies. Supported by a tight residential supply situation in the high-end sector, residential prices are not expected to dramatically decline. The cyclical downturn will lead to an 13% correction in overall luxury residential prices over the next 12 months, considering an average cyclical downtrend of about 6.5 quarters.

In the leasing market, the average luxury residential rent is expected to undergo a mild downward adjustment of 3% over the next 12 months. The slowdown in global economic growth will lead to slowing residential leasing demand in Hong Kong, subject to a hold back in the inflow of expatriates from various industries, such as the banking and finance sector. The drag down in rents will give rise to a further drop in prices as the sales market will no longer be supported by a sustainable rental growth.

HONG KONG LUXURY RESIDENTIAL TREND




*Source: Colliers*

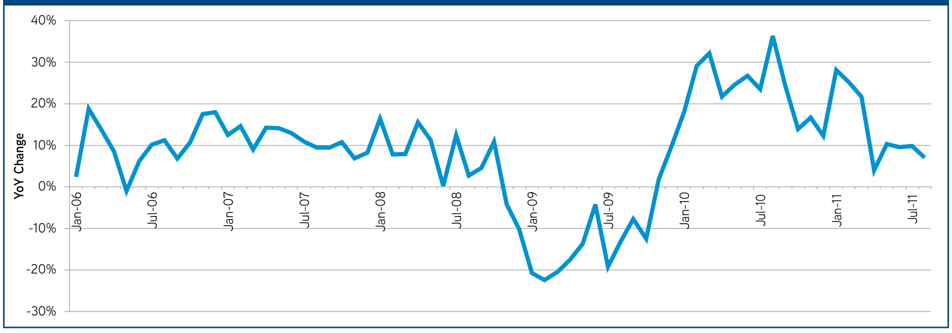
# Industrial Sector

## External Trade Losing Steam

Hong Kong external trade continued to grow in 3Q 2011 but the pace of growth slowed. The external environment has become increasingly challenging, due to the stalling recovery in the advanced economies and deepening sovereign debt crisis in the Eurozone. During the period from June to August 2011, the total value of re-exports increased 8.8% year-on-year (YoY) to HK$872 billion, compared with the growth rate of 11.8% YoY in the preceding three-month period.

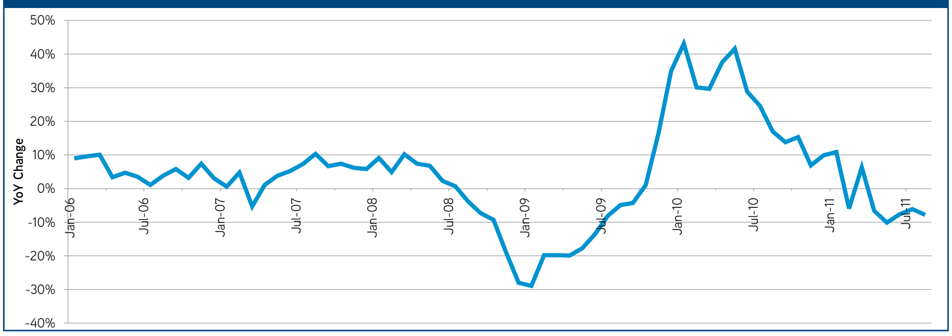
The slowdown of external trade growth has affected the growth of air cargo and container throughput during the period from June to August 2011. In view of the economic uncertainties, individual cargo owners requested their shippers to ship the cargo by sea freight instead of airfreight in order to lower the shipping cost. Consequently, container throughput recorded mild growth while the air cargo throughput showed decline. During the three-month period ending in August 2011, container throughput increased 2.2% YoY to 6.4 TEUs, compared with 5.8% YoY in the preceding three-month period. Meanwhile, the air cargo throughput decreased 7.2% YoY to 980,935 tonnes, compared with a negative growth of 3.6% YoY in the preceding three-month period.

**RE-EXPORT TRADES**
Year-on-Year Change



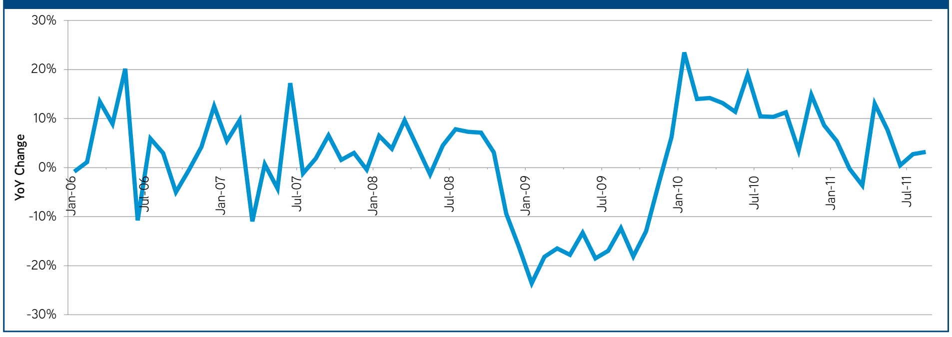

*Source: Census and Statistics Department, HKSAR Government*

**AIR CARGO THROUGHPUT**
Year-on-Year Change




*Source: Civil Aviation Department, HKSAR Government*

**CONTAINER THROUGHPUT**
Year-on-Year Change




*Source: Marine Department, HKSAR Government*

*13 Ping Tong Street South, Yuen Long* *Source: Colliers*

# Leasing Demand

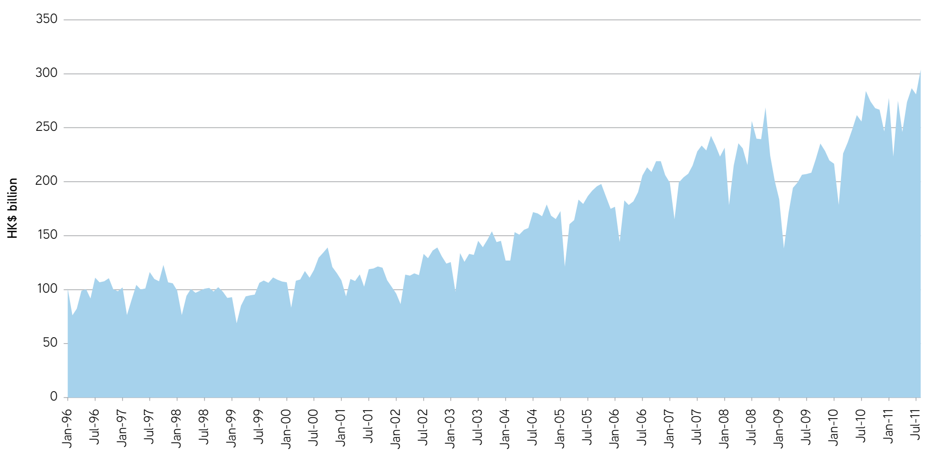
## SUSTAINED DEMAND FOR WAREHOUSES

The demand from third-party logistics companies for warehouse premises was sustained in 3Q 2011. Some major corporations are looking to outsource their logistics functions. A group of third-party logistics companies are searching for quality warehousing premises in order to capture the demand growth for logistics services from the outsourcing activity. According to our research, the third-party logistics companies engaged in local distribution and export of fashion and electronics products are the most active group of tenants seeking additional spaces.

Benefitting from the sustained demand for warehouse premises, major owners of quality warehouse facilities recorded high occupancy in their portfolios. For example, the occupancy rates in ATL Logistics Centre in Kwai Chung and Goodman's Hong Kong portfolios were about 99% in 3Q 2011.

Apart from the demand for space from the existing third-party logistics companies, there is new demand for warehousing facilities from individual multinational fashion companies and overseas third-party logistics operators including mainland Chinese operators. According to our research, these companies are seeking to establish their regional hubs in Hong Kong for serving their business needs in Southeast Asia and the South China region. These tenants are seeking warehouse premises of 100,000 sq ft or above. However, in view of the current high occupancy levels, there are no existing warehouse premises available in the marketplace matching their size requirements.

HONG KONG RE-EXPORTS VOLUME




*Source: Census and Statistics Department, HKSAR Government*

# Supply

## FOUR INDUSTRIAL DEVELOPMENTS COMPLETED

Four new industrial developments were completed during the review period. A warehouse development with a total floor area of 118,157 sq ft at 13 Ping Tong Street South in Yuen Long was completed in August 2011.

**COMPLETED NEW BUILDINGS FOR WHICH OCCUPATION PERMITS HAVE BEEN ISSUED**

| DISTRICT | ADDRESS | GROSS FLOOR AREA (sq ft) | BUILDING TYPE | APPLICANT |
|---|---|---|---|---|
| Tseung Kwan O | Tseung Kwan O Industrial Estate | 35,522 | Industrial | Hong Kong Trade Development Council |
| Tai Po | 2 Dai Li Street | 64,576 | Factory extension | Luk Yeung Restaurant Ltd |
| Yuen Long | 13 Ping Tong Street South | 118,157 | Warehouse | Crest Bright Enterprises Ltd |
| Fanling | Lok Yip Road, On Lok Tsuen (FSSTL 114) | 144,527 | Industrial | Muchtime Ltd |

*Source: Buildings Department, HKSAR Government*

## CONSTRUCTION OF THREE DEVELOPMENTS STARTED

During the period from June to August 2011, construction work on five industrial developments was started. All five projects are located in industrial estates. The corresponding applicants will occupy the five developments for their business use.

**NEW BUILDINGS FOR WHICH CONSENT TO COMMENCE WORK HAS BEEN GIVEN**

| DISTRICT | ADDRESS | GROSS FLOOR AREA (sq ft) | BUILDING TYPE | APPLICANT | APPLICANT'S INDUSTRY |
|---|---|---|---|---|---|
| Tai Po | 18 - 20 Dai Fat Street, Tai Po Industrial Estate | 50,314 | Industrial | Skyland Investment Ltd | Food and beverages |
| Tseung Kwan O | Chun Kwong Street, Tseung Kwan O Industrial Estate | 52,713 | Industrial | Sun Right (Hong Kong) Ltd | Service and support |
| Tseung Kwan O | Junction of Chun Ying Street and Chun Kwong Street, Tseung Kwan O Industrial Estate | 298,895 | Data Centre | HKEx Property Ltd | Finance |
| Yuen Long | 25 Wang Lok Street, Yuen Long Industrial Estate | 12,064 | Workshop | ClearWaterBay Technology Ltd | Chemical |
| Yuen Long | 42 Wang Lee Street, Yuen Long Industrial Estate | 46,396 | Industrial Extension | Chau Leong Enterprise (Group) Ltd | Electronics and electrical appliances |

*Source: Buildings Department, HKSAR Government; Hong Kong Science & Technology Parks Corporation; HKTDC*

# Rental Trend

| INDUSTRIAL RENTALS (BY SUB-MARKETS) | | | | | | |
|---|---|---|---|---|---|---|
| SUB-MARKET | 3Q 10 | 4Q 10 | 1Q 11 (HK$ / sq ft / MONTH) | 2Q 11 | 3Q 11 | 3Q 2011 (% QoQ) |
| Factory | 7.03 | 7.31 | 7.76 | 8.17 | 8.56 | 4.9% |
| Cargo Lift Access Warehouse | 5.60 | 5.83 | 6.16 | 6.49 | 6.82 | 5.1% |
| Ramp Access Warehouse | 8.07 | 8.32 | 8.80 | 9.28 | 9.81 | 5.7% |
| I-O Building | 11.09 | 11.39 | 11.96 | 12.44 | 12.93 | 3.9% |

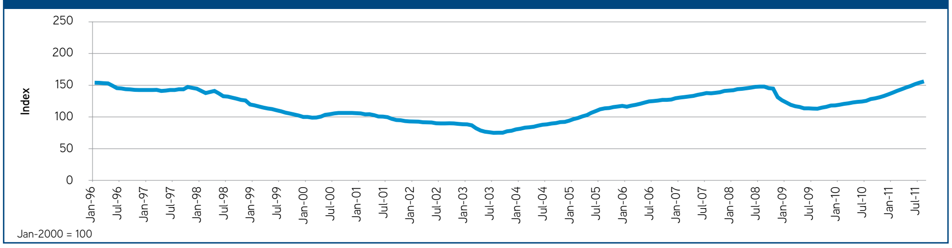
*Source: Colliers*

## SUSTAINED RENTAL GROWTH

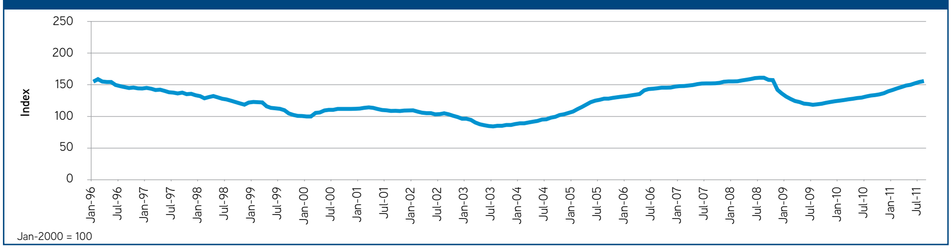
The overall industrial market continued to enjoy positive spill-over from the traditional office sector as a result of the sustained increase in rentals in the office market. In view of sustained demand from tenants, industrial rentals increased further in 3Q 2011. Meanwhile, in view of limited availability and growing demand from logistics operators, the rentals of ramp access warehouse premises have outperformed other sub-sectors during the quarter.

As of the end of August 2011, the average rent of ramp access warehouses increased 5.7% QoQ to HK$9.81 per sq ft per month, compared with 5.5% QoQ recorded during the period from February to May 2011. The average rent of cargo lift access warehouses increased 5.1% QoQ to HK$6.82 per sq ft per month, compared with 5.4% growth recorded in the preceding three-month period. The average rent in the factory sector increased 4.9% quarter-on-quarter (QoQ) to HK$8.56 per sq ft per month, compared with the growth of 5.3% QoQ recorded in the preceding three-month period. The average rent in the industrial-office (I-O) sector increased 3.9% QoQ to HK$12.93 per sq ft per month, compared with 4.0% growth recorded during the period from March to May 2011.

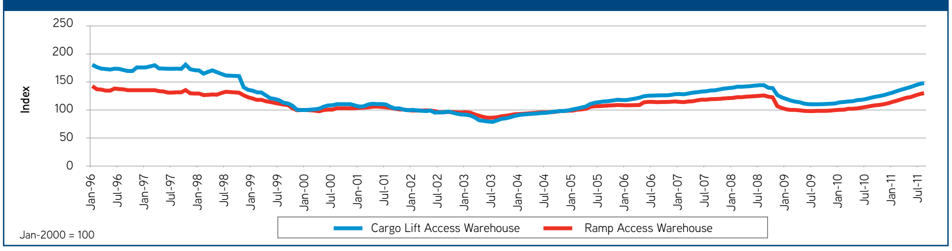
### FACTORY RENTAL INDEX




### I-O BUILDING RENTAL INDEX




### WAREHOUSE RENTAL INDEX




*Source: Colliers*

# Sales Market

INDUSTRIAL PRICES (BY SUB-MARKETS)

| SUB-MARKET | 3Q 10 | 4Q 10 | 1Q 11 (HK$ / sq ft) | 2Q 11 | 3Q 11 | 3Q 2011 (% QoQ) |
|---|---|---|---|---|---|---|
| Factory | 1,673 | 1,786 | 1,960 | 2,174 | 2,278 | 4.8% |
| Cargo Lift Access Warehouse | 1,838 | 1,963 | 2,138 | 2,375 | 2,488 | 4.7% |
| Ramp Access Warehouse | 1,950 | 2,050 | 2,255 | 2,480 | 2,600 | 4.8% |
| I-O Building | 2,566 | 2,767 | 3,002 | 3,214 | 3,332 | 3.7% |

*Source: Colliers*

## PRICE GROWTH TAPERING OFF

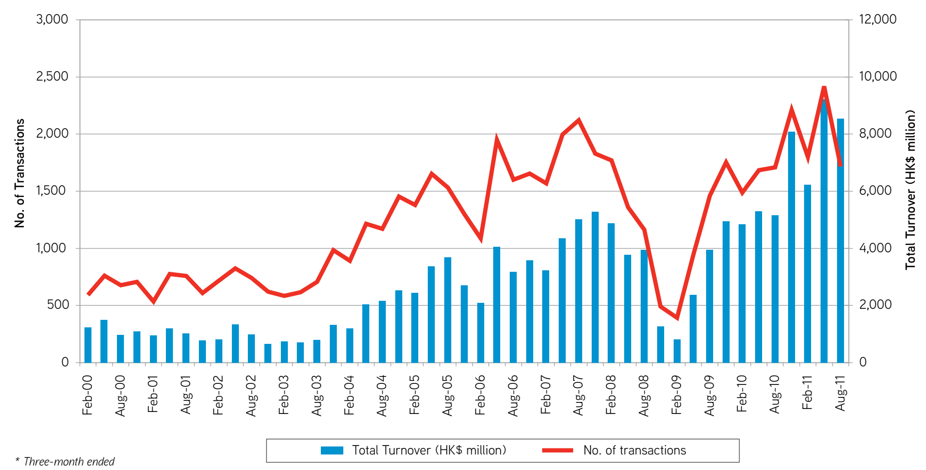
During the period from June to August 2011, industrial property prices increased further while the pace of price growth has tapered off. As of the end of August, the average price of factories increased 4.8% QoQ to HK$2,278 per sq ft. The average price of ramp access warehouses increased 4.8% QoQ to HK$2,600 per sq ft, while that for cargo lift access warehouses increased 4.7% QoQ to HK$2,488 per sq ft. Meanwhile, the average price of I-O buildings increased 3.7% QoQ to HK$3,332 per sq ft.

## SALES MARKET ACTIVITY DECLINED

In June 2011, the Hong Kong Monetary Authority issued guidelines to the banks requiring them to implement measures to strengthen risk management in the residential mortgage lending business. In view of the increasing uncertainty about future economic performance, the banks gradually tightened their loan policies in 3Q 2011. On the industrial properties front, the banks have lowered their industrial property valuations, as well as lowering the loan-to-value ratio for industrial properties to the level of 30 - 40%. The tightening of mortgage-lending policy has created difficult situations for prospective buyers, especially the investors, to raise sufficient debt. As such, more prospective buyers are maintaining a wait-and-see attitude.

On the vendors' front, the interest cost for holding industrial premises remains low. In view of sustained occupational demand from tenants, property owners are enjoying stable rental income from their premises. As a result, most of the vendors, especially the long-term investors, are holding firm with their asking prices.

STRATA-TITLED INDUSTRIAL PROPERTY TRANSACTION VOLUME




*Source: EPRC*

The difference in views held by the vendors and prospective buyers towards the industrial property market led to contractions in the volume of industrial property transactions in 3Q 2011. During the period from June to August, the number of strata-titles transactions decreased 29% QoQ to 1,717 while the total value of transactions declined 7.5% QoQ to HK$8,537 million during the same period. Even with the contractions, both the number and total value of strata-titled sales transactions were above their long-term average levels, at 1,188 transactions per quarter and HK$2,817 million per quarter respectively.

## WHOLE-BLOCK SALES MARKET

On the whole-block sales front, the transaction volume declined substantially in 3Q 2011 as the banks tightened their loan policies. A total of five transactions were recorded in June – August 2011, down from a total of nine transactions recorded in the preceding three-month period. Meanwhile, the total value of transactions dropped 79% QoQ to HK$671 million in June – August 2011 from HK$3,230 million in the preceding three-month period. Among the four transactions, Emperor Group and Jean-Marie Pharmacal acquired their premises for owner occupation.

**WHOLE-BLOCK TRANSACTIONS IN 2Q 2011**

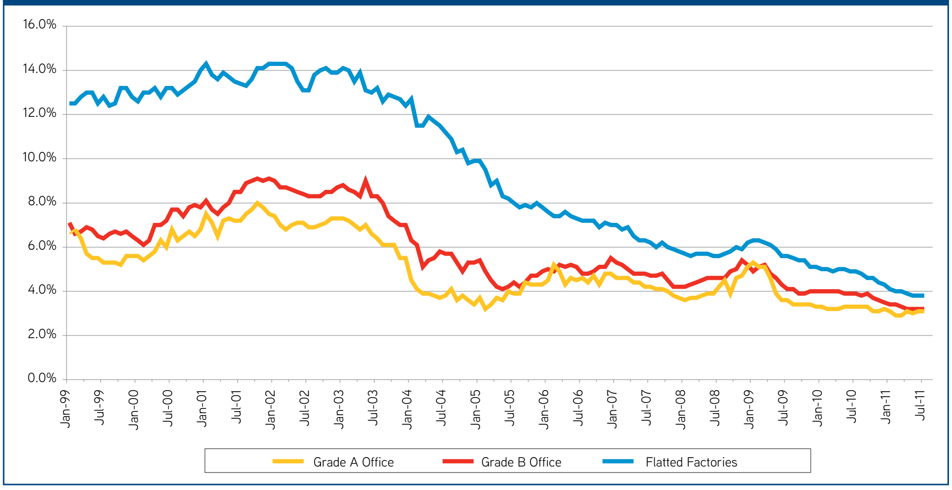
| MONTH | BUILDING | DISTRICT | PRICE (HK$ m) | AVERAGE PRICE (HK$ / sq ft) | PURCHASER | VENDOR |
|---|---|---|---|---|---|---|
| August 2011 | Shan Ling Industrial Building | Tuen Mun | $68 | $1,193 | Emperor Group | Tien Ling Real Estates Ltd |
| July 2011 | Pricerite Group Building | Sai Kung | $123.5 | $1,605 | Local investor | CASH Financial Services Group Limited |
| June 2011 | Philips Tai Po Industrial Building | Tai Po | $55 | Undisclosed | Jean-Marie Pharmacal Co. Ltd | Hitech Prop Ltd |
| June 2011 | Eric Lam Industrial Building | Kwun Tong | $146 | $3,466 | Honour Gain Investments Ltd | Knapwood Investment Co. Ltd |
| June 2011 | Wai Yuen Tong Medicine Building | Kowloon Bay | $278.9 | $2,202 | Local investor | Bank of China Investment |

*Source: Colliers*

## YIELD STOOD AT LOW LEVEL

According to the government statistics, industrial property yield stood at around the 3.8% level during the period from June – August 2011, which is the lowest level since the early 1990s. As the banks have tightened their loan policies and in light of increasing economic uncertainties in coming quarters, more potential buyers stay on the sidelines and it is expected that the room for further downward adjustment in yields is limited.

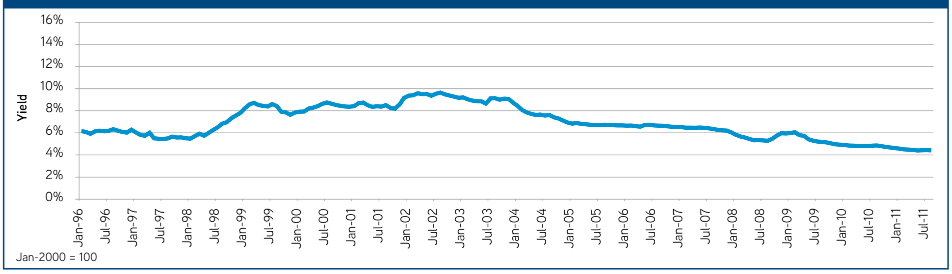
### OFFICE AND FLATTED FACTORY YIELDS TRENDS



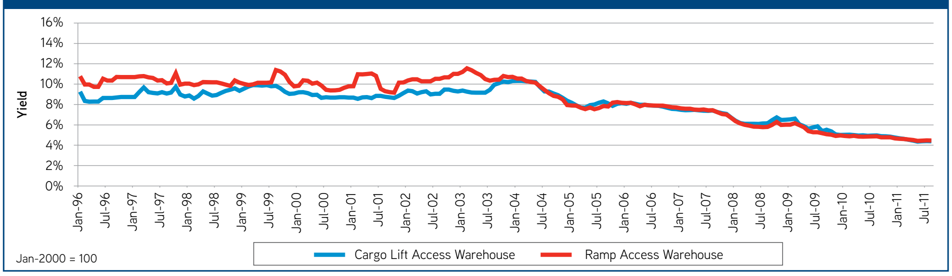

*Source: Rating and Valuation Department, HKSAR Government*

### FACTORY RENTAL YIELD


### I-O BUILDING RENTAL YIELD




### WAREHOUSE RENTAL YIELD




*Source: Colliers*

# Market Outlook

## POTENTIAL TURNING POINT AHEAD

The persistently weak economic recovery in the core export markets – the United States and the European Union – have had a negative impact on the performance of Hong Kong external trade, as reflected in deceleration in external trade growth. On the warehouse market front, as more cargoes are shipped by sea freight, the time that the cargo is being stored in warehouses will increase. As such, the short-term occupational demand for warehouse premises has increased.

Industrial rentals are expected to see downward adjustments if the global economic performance remains sluggish in coming quarters. Over the next twelve months, industrial rentals are expected to decrease 2 - 5%.

Looking ahead, in view of global economic uncertainties, various organisations revised their global economic growth forecasts downward for coming quarters. For example, the EIU revised its global GDP growth forecast for 2011 - 2013 from 3.2% per year during the period to the range of 2.7 - 3.1%. Besides, the EIU lowered the forecast growth for Hong Kong exports of goods and services for 2011 - 2013 from last quarter's forecast of 9.0%, 8.3% and 7.5% respectively to the latest forecast of 8.0%, 7.3% and 7.1% respectively. The Hong Kong private consumption forecast for 2011 is revised up from 6.1% to 6.9%, while the forecasts for 2012 and 2013 are lowered from 4.8% and 3.8% to 4.1% and 3.7% respectively.

On the property market front, the demand for industrial premises is anticipated to soften amid deceleration in growth of local consumption and exports of goods and services. Industrial rentals are expected to see downward adjustments if the global economic performance remains sluggish in coming quarters. Over the next twelve months, industrial rentals are expected to decrease 2 - 5%. For the whole year of 2012, industrial rentals are anticipated to decline 2 - 5%. In 2013 industrial rents are expected to resume positive growth if the global economy improves.

The interest cost for acquiring industrial properties is anticipated to increase as the mortgage interest rates are returning to normal levels. According to the EIU, interest rates are anticipated to increase by 10 - 40 basis points in 2011 and another 200 - 220 basis points in 2012 and 2013. It is anticipated that industrial yield would increase amid a rising interest rate trend. In anticipation of rental decline over the next twelve months, industrial prices are anticipated to decline 9 - 13% during the period. For the whole year of 2012, industrial prices are expected to decline 12 - 16%. For 2013, industrial prices are expected to see single-digit decline if the yield level increases further.

# Retail Sector

# Leasing Demand

## RETAIL BEING THE ONLY BRIGHT SPOT IN THE LOCAL PROPERTY MARKET

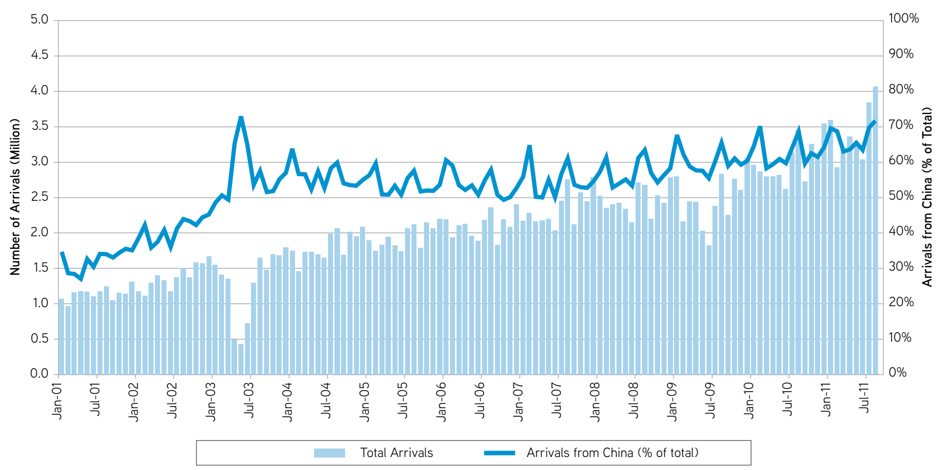
Japan's enduring recovery from its natural disasters, the fragile economy in the US and the lingering European debt crisis did not have a significant impact on the Hong Kong retail market in 3Q 2011 and in fact, it is the only bright sector in the real estate market. Its market fundamentals remained robust in consideration of the continual solid economic growth; rising inbound tourism, especially the strong inflow of mainland Chinese visitors; encouraging domestic demand; and visitor spending that continued to underpin the Hong Kong retail market.

## INBOUND TOURISM BOOM CONTINUES

As a result of the expanded Individual Visit Scheme policy, visitor arrivals to Hong Kong continued its robust growth, increasing by 18.8% YoY to a total of 10.9 million tourists for the three-month period ending 31 August 2011. Meanwhile, arrivals from mainland China increased strongly by 26.4% YoY during the same period.

In the month of August, total inbound visitors reached over 4 million, which was the first time on record it surpassed 4 million in a single month. Mainland China remained the leading growth driver, constituting 72% of total arrivals, which boosted visitor spending in Hong Kong. Looking forward, growth momentum of the inbound tourism market is expected to continue, benefiting from Asia's economic outperformance of the western part of the world.

### VISITOR ARRIVALS



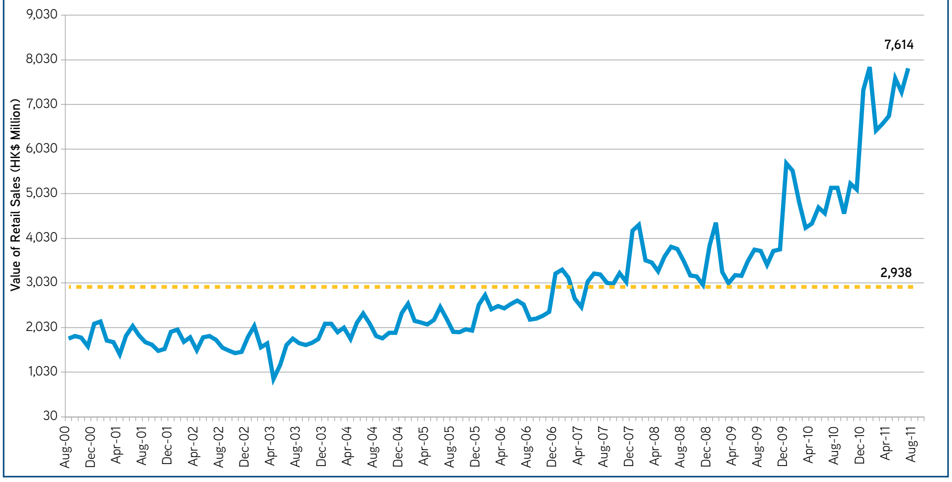

*Source: Hong Kong Tourism Board*

## BIG-TICKET ITEMS REMAIN ITS PROMISING GROWTH

Fuelled by promising domestic demand and escalating tourist arrivals, Hong Kong's retail sales market remained upbeat during 3Q 2011. Cosmetics and skincare products, clothing, electrical goods and photographic equipment, jewellery and watches, indicating high-ticket items, were the chief purchase targets for mainland tourists. Luxury items continued to be favoured by most mainland visitors due to the tax difference and quality assurance. As such, strong demand for big-ticket items continued, with sales of jewellery, watches and clocks and valuable gifts recorded robust growth of 51.8% YoY, to HK$7.84 billion as of the end of July 2011. Sales of other items, such as clothing and footwear (+33.4% YoY), electrical goods and photographic equipment (+65.3% YoY), medicines and cosmetics (+25.8% YoY), performed well.

In addition to the large contribution from these mainland tourists, locally driven necessities like supermarkets (+13.6% YoY) and consumer durable goods (+37.5% YoY) also experienced rising demand in August 2011. Underlying the strong retail growth, inflation was seen across various categories in the market such as food prices.

VALUE OF RETAIL SALES
(Jewellery, Watches And Clocks, & Valuable Gifts)




*Source: Census & Statistics Department, HKSAR Government*

According to the latest global survey released by Nelsen, inflation in food prices was still the key issue for local consumers as 40% of the respondents claimed it as their top concern for the next six months, surpassing concerns over economic conditions (27%).

## FOOD AND BEVERAGE OPERATORS CLOUDED BY SOARING FOOD PRICES

On the contrary, the food and beverage sector saw steady growth during the quarter, with the total value of restaurant receipts increasing by 6.0% YoY to HK$21.2 billion in 2Q 2011, after registering a growth of 5.9% YoY in 1Q 2011. The market continued to show great concern over imported food inflation. According to the latest global survey released by Nelsen, inflation in food prices was still the key issue for local consumers as 40% of the respondents claimed it as their top concern for the next six months, surpassing concerns over economic conditions (27%). Meanwhile, job security (12%), for the first time ever, was out of the top five concerns of Hong Kong consumers since the tracking of the survey, indicating that Hong Kong consumers have shifted their concerns from economy and job security to inflation. Besides, the market should be aware of more volatile capital flows, as the volatility in Hong Kong will continue to fuel inflationary pressure.

Rising food prices pose a threat to profit margins that will exert increasing pressure on rental affordability of F&B operators. Inflationary pressures are likely to act as a potential dampener on leasing demand from F&B retailers over the short- to medium-term. Notwithstanding surging inflation, leasing demand from brand-name retailers and jewellers, which are less cost-sensitive, will remain comparatively strong.

## BUSINESS EXPANSIONS OF OVERSEAS BRANDS CONTINUES AMID LARGER RISKS IN GLOBAL RECOVERY

The continual expansion of overseas brands into Hong Kong translated into stronger demand for retail spaces in the core shopping districts of Central, Causeway Bay, Mong Kok and Tsim Sha Tsui during 3Q 2011. Those international retailers were encouraged to tap into this lucrative market, given the vibrant domestic demand and visitor spending, to grab a share of Hong Kong retail sales. Since Hong Kong acts as a stepping-stone to tap into inland mainland cities, international retailers continued to establish their presence in Hong Kong. During 3Q 2011, overseas retailers, the fashion industry in particular, remained aggressive in securing retail premises, setting up their flagship stores to provide more flexible floor layouts and better brand image promotion. However, some smaller-sized retailers started to become more cautious and slow down their business expansion pace or become less aggressive in securing shops in prime locations or cut back on spending amid another round of global economic turmoil.

| PROMINENT RETAIL LEASING TRANSACTIONS IN 3Q 2011 | | | | | | |
|---|---|---|---|---|---|---|
| PREMISES | DISTRICT | FLOOR | RENTAL (HK$ / MONTH) | GFA (sq ft) | UNIT RENTAL (HK$ / sq ft / MONTH) | TENANT |
| 23-25 Lee Garden Road | Causeway Bay | G/F | 2,300,000 | 1,400 | 1,643 | Swatch |
| Hysan Place | Causeway Bay | - | 3,500,000 | 7,000 | 500 | GAP |
| Lee Theatre Plaza | Causeway Bay | B1-B2/F, G/F, 1/F | 2,300,000 | 30,000 | 77 | Uniqlo |
| Melbourne Plaza | Central | G/F | 1,600,000 | 1,000 | 1,600 | Pandora |
| Central Building | Central | 1/F | 2,000,000 | 18,000 | 111 | Central/Central |
| The Mira Hong Kong | Tsim Sha Tsui | G/F - 1/F | 2,300,000 | 6,449 | 357 | Tommy Hilfiger |
| The Silvercord | Tsim Sha Tsui | G/F - 2/F | 7,500,000 | 7,900 | 949 | Longchamp |
| MPM | Mong Kok | Portion of G/F, portion of 1/F and the whole of 2/F | 3,000,000 | 25,000 | 120 | GAP |
| Grand Tower Arcade | Mong Kok | - | 2,000,000 | 10,000 | 200 | Lowrys Farm |

*Source: Colliers*

In addition, the current credit crunch in mainland China did not slow the pace of business expansions of overseas brands into mainland China cities during 3Q 2011, as many enterprises continued to keep an eye on China's profitable franchise market on the back of growing local consumption. Companies are utilising franchise business models, as they offers a proven business model to follow, and is beneficial when it comes to adapting to the ways of a foreign country. The business owner hires local workers who are familiar with the methods of doing business in the country, which makes the transition much smoother. Established franchises are looking to expand into another country like China, where it can provide a more profitable alternative to an already saturated market in the home country.

## JEWELLERY RETAILERS STAY COMPETITIVE

Local and smaller retailers continued to face difficulties in finding suitable stores in prime locations, forcing them to relocate or take up smaller spaces in spite of skyrocketing rentals. With the exception of local jewellery entrepreneurs, who had gained substantial profits from mainland Chinese customers, they had a competitive edge when entering the intensifying bidding war among retailers.

## WIDENING GAP BETWEEN TOURIST AND NON-TOURIST RETAILERS

Between local and international retailers, businesses which are predominantly driven by tourists stay relatively competitive over non-tourist-driven retailers. In fact, the market is experiencing a widening gap between tourist and non-tourist retailers, where tourist-driven shops, such as the fashion and cosmetics stores and jewellery retailers, dominate first-tier streets and non-tourist retailers are pushed over to second-tier streets or even relocate to non-traditional shopping areas.

The growth rate of average retail rents of street shops in the four traditional shopping districts tapered off to 4.2% QoQ in 3Q 2011, compared to a strong growth of 7.4% QoQ in the previous quarter

# Supply

In the absence of new supply in core shopping areas in 3Q 2011, the pre-lease of Hysan Place, Causeway Bay, continued to be the market focus. It had drawn strong interest and demand from retailers who look for duplex and large-sized stores, particularly among international brands, e.g. Gap, Hollister and Apple Store. As of September 2011, over 60% of the retail spaces in Hysan Place had been pre-committed, according to Hysan.

In anticipation of the opening of Hysan Place in June 2012, expectations of an increase in shopper traffic have started to drive upwards the rentals of neighbouring streets such as Kai Chiu Road and Pak Sha Road. Hysan Place will attract a different crowd to the area than to Times Square, as it caters to the younger generation cluster, whereas many of the stores selling luxury goods in the district are aiming at mainland Chinese tourists.

# Rental Trend

### RENTS GROW WITH SLOWER IMPETUS

Retail rents in key shopping districts of Central, Causeway Bay, Tsim Sha Tsui and Mong Kok continued in a upward trend in 3Q 2011, predominantly underpinned by sustainable solid commitments by international retailers. Many of them continued to put their focus on Asia, as it is relatively well placed compared to the western part of the world which is subject to a prospective economic downturn. The Hong Kong retail market will continue to benefit from Asia's economic outperformance. In general, landlords stood firm in rental negotiations. However, the growth momentum of retail rents started to taper off during 3Q 2011 subject to growing uncertainties in the external environment where retailers had started to adopt a more cautious approach.

The growth rate of average retail rents of street shops in the four traditional shopping districts tapered off to 4.2% QoQ in 3Q 2011, compared to a strong growth of 7.4% QoQ in the previous quarter. Slower growth momentum was seen across the board, in which first-tier streets, such as Queen's Road Central, Russell Street – Causeway Bay, experienced stronger growth impetus compared to rents in second-tier streets. These individual street segments with average rentals fetching over HK$1,000 per sq ft per month indicated the affordability of retail trades that are highly geared towards the spending pattern of most mainland visitors.

RETAIL RENTAL INDEX BY MAJOR DISTRICTS (*)

| DISTRICT | 1Q 10 | 2Q 10 | 3Q 10 | 4Q 10 | 1Q 11 | 2Q 11 | 3Q 11 | 3Q 2011 (% QoQ) |
|---|---|---|---|---|---|---|---|---|
| Causeway Bay | 222 | 228 | 235 | 247 | 268 | 289 | 302 | 4.5% |
| Central | 226 | 231 | 239 | 252 | 273 | 295 | 311 | 5.4% |
| Mong Kok | 172 | 176 | 181 | 189 | 203 | 217 | 223 | 2.9% |
| Tsim Sha Tsui | 259 | 266 | 274 | 289 | 313 | 334 | 348 | 4.0% |
| **Overall** | **218** | **224** | **230** | **242** | **262** | **281** | **293** | **4.2%** |

*(Nov-2002 = 100) * Street level shops on key street segments*

*Source: Colliers*

The number of sales transactions in the four key shopping districts with lump sum considerations of HK$10 million or above dropped by 47% QoQ in 3Q 2011. Both local investors and end-users continued to eye assets for medium- to long-term growth potential.

# Investment Market Activity

## SIGNIFICANT SLOWDOWN IN SALES VOLUME

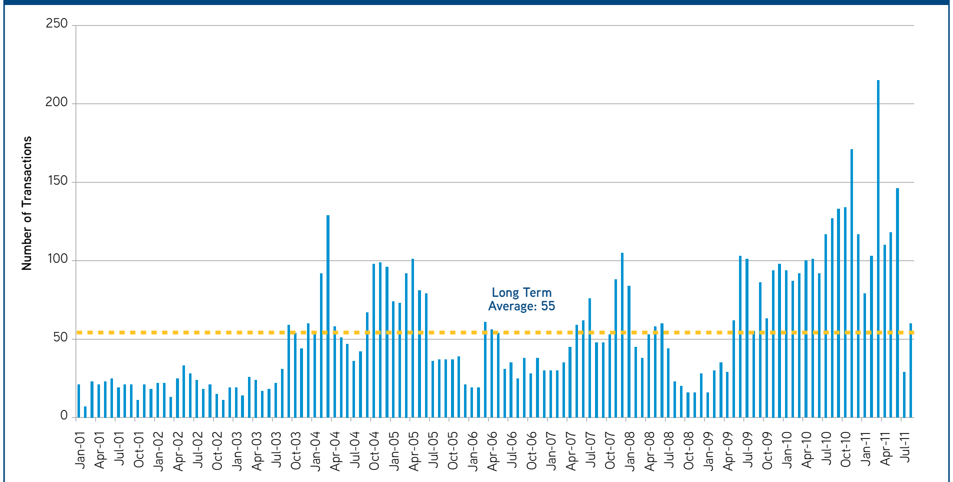
Due to the subdued market sentiment coupled with increasing difficulties in financing, sales activity in the investment market experienced a significant slowdown during 3Q 2011. The number of sales transactions in the four key shopping districts with lump sum considerations of HK$10 million or above dropped by 47% QoQ in 3Q 2011.

The majority of investors adopted a wait-and-see approach, while the rest started to look at retail premises in non-traditional shopping areas, such as Sheung Wan or the Western district, due to the lack of buying options in core areas as well as expensive prices, which had encouraged investors to seek buying options in the decentralised market. Both local investors and end-users continued to eye assets for medium- to long-term growth potential.

## FESTIVAL WALK THE LARGEST SINGLE ASSET SALE IN ASIA-PACIFIC

One of the very few sizable investment deals involving retail and office development was recorded during 3Q 2011, in which Swire Pacific successfully sold 100% of the Festival Walk retail and office complex in Kowloon Tong to Mapletree Investments, a unit of Singapore's Temasek Holdings, for a record-breaking price of HK$18.8 billion. It was the largest single asset sale in Asia-Pacific, outside of land sales. Situated at 80 Tat Chee Avenue, Kowloon Tong, Festival Walk consists of a 7-storey shopping mall (980,089 sq ft) and an office tower (228,665 sq ft) with a total gross floor area of about 1.2 million sq ft. The HK$18.8 billion price tag represents an average unit price of HK$15,553 per sq ft. Based on our assumptions on current market rentals, the estimated market yield of Festival Walk is 5.0% - higher than the market average of 3%. The premium yield reflects the characteristics of the shopping arcade as having a steadier rental income given a good mix of retailers.

THE NUMBER OF SALES TRANSACTION ABOVE HK$10 MILLION




*Source: Colliers*

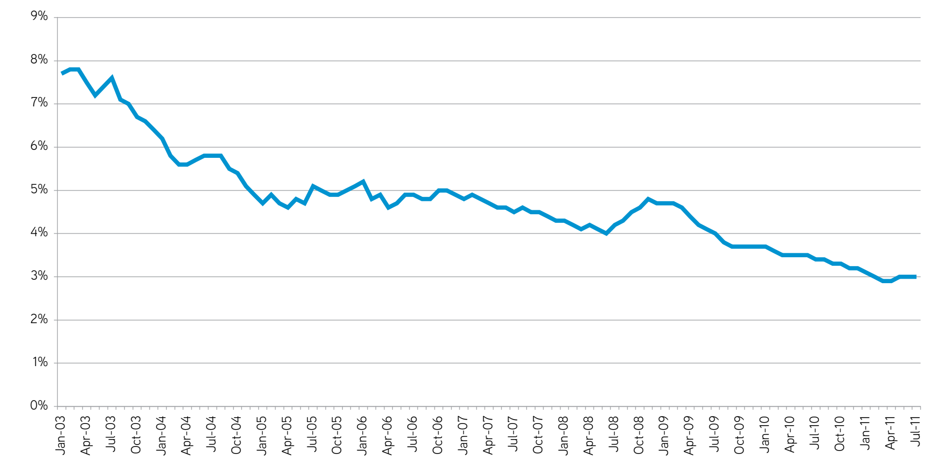
For strata-title sales, prominent transactions for the quarter were highlighted by the sale of shop 56 on G/F at Hennessy Apartment, Causeway Bay (at 1-3 Lee Garden Road, 48-52 Percival Street and 48 Hennessy Road) to a local investor for HK$195 million. Based on a gross floor area of 1,000 sq ft, the unit price was HK$195,000 per sq ft. The initial yield was below 2%. Meanwhile, a 1,000 sq ft ground floor shop at 18 Matheson Street in Causeway Bay fetched HK$127 million or a unit price of HK$127,000 per sq ft, with an initial yield of about 2%.

Prime retail premises in traditional shopping locations remained steady with average yields staying below 2.9%.

## YIELDS FOR PRIME STREET SHOPS REMAINED STEADY

The latest figures by the Rating and Valuation Department showed that overall investment yields increased slightly from 2.9% in April 2011 to 3.0% in July, indicating a faster growth rate in retail rentals than capital values. Meanwhile, prime retail premises in traditional shopping locations remained steady with average yields staying below 2.9%.

### RETAIL YIELD




*Source: Rating and Valuation Department*

# Market Outlook

While Hong Kong consumers remain relatively confident, the effects of inflation will continue to exert pressure and as a result cause them to tighten their wallets. The market should be aware of more volatile capital flow adding inflationary pressure to the city. This suggests that the market will be cautiously optimistic, in which consumers will bend towards economical choices against rising inflation in the near term.

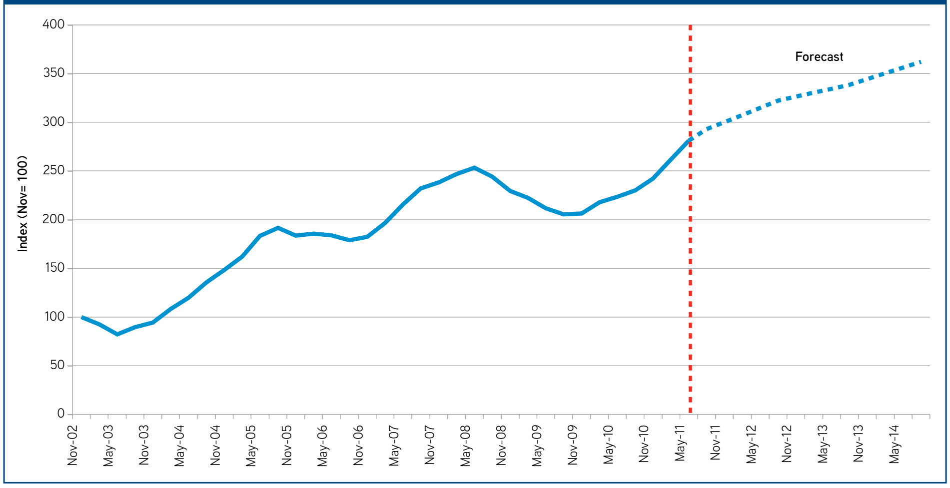
The expanding local economy and the escalating number of mainland tourists going after international brands and luxury products will remain one of the most important pillars supporting the Hong Kong retail market. Although some overseas retailers have become more cautious and have put a hold their business expansion plans, the trend among various global brands expanding their networks in Hong Kong will continue on the back of growth imbalances between the eastern and western parts of the world.

Overall retail rents in core shopping areas will continue their upward trend albeit at a slower rate of 12% in the next 12 months considering the fragile local economy.

Supported by the sustained economic growth, further increases in the number of inbound visitors, rising inflation and continual growth in retail sales, as well as the limited supply of shops in prime areas, overall retail rents in core shopping areas will continue their upward trend albeit at a slower rate of 12% in the next 12 months considering the fragile local economy. The retail market is subject to the risks of a further deteriorating global and local economy, as well as slowing consumer demand, in which the sustained growing number of visitor arrivals is not able to offset such downsides.

The ongoing growth of the retail sector is fundamentally policy driven and there is no doubt that inbound visitors from China will continue to render support. Given that the entire market relies on a single group of visitors (i.e. mainland Chinese, the key growth prospect) who favour particular retail trades, the retail sales volume will be very sensitive towards visitor arrival figures and more importantly, a change in the average spending per visitor will directly affect the sustainability of the current consumption patterns of inbound visitors. Whenever there is a slowdown in visitor spending, prospective growth in the Hong Kong retail market will very much depend on whether local consumption can take up the slack.

HONG KONG RETAIL RENTAL INDEX




*Source: Colliers*

## 512 offices in 61 countries on 6 continents

| | |
|---|---|
| United States: | 125 |
| Canada: | 38 |
| Latin America: | 18 |
| Asia Pacific: | 214 |
| EMEA: | 117 |

- $1.5 billion in annual revenue in 2010
- 979 million square feet under management
- Over 12,500 professionals

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