

Market summary

The uncertain global economic outlook has deteriorated the business condition of Hong Kong's private sector, as reflected in the HSBC Market Purchasing Managers' Index, which fell below 50% in August - the first time in 28 months. Falling overseas demand is already being felt in the export and transport sector. Exports contracted 1.9% y-o-y in real terms in August. In the same month, growth in sea cargo shipments dropped to 3.2% y-o-y from a double-digit pace for most of last year while air cargo fell to 7.8% y-o-y. Nonetheless, retail sales have remained high, contributed by continued tourist inflow from the Mainland. However, given that trade-related services, finance and transport make up approximately 70% of Hong Kong's service exports while tourism make up 20% - and given that service exports contributes half of the city's total GDP, the overall economy is expected to have slowed down in the latter half of the year.

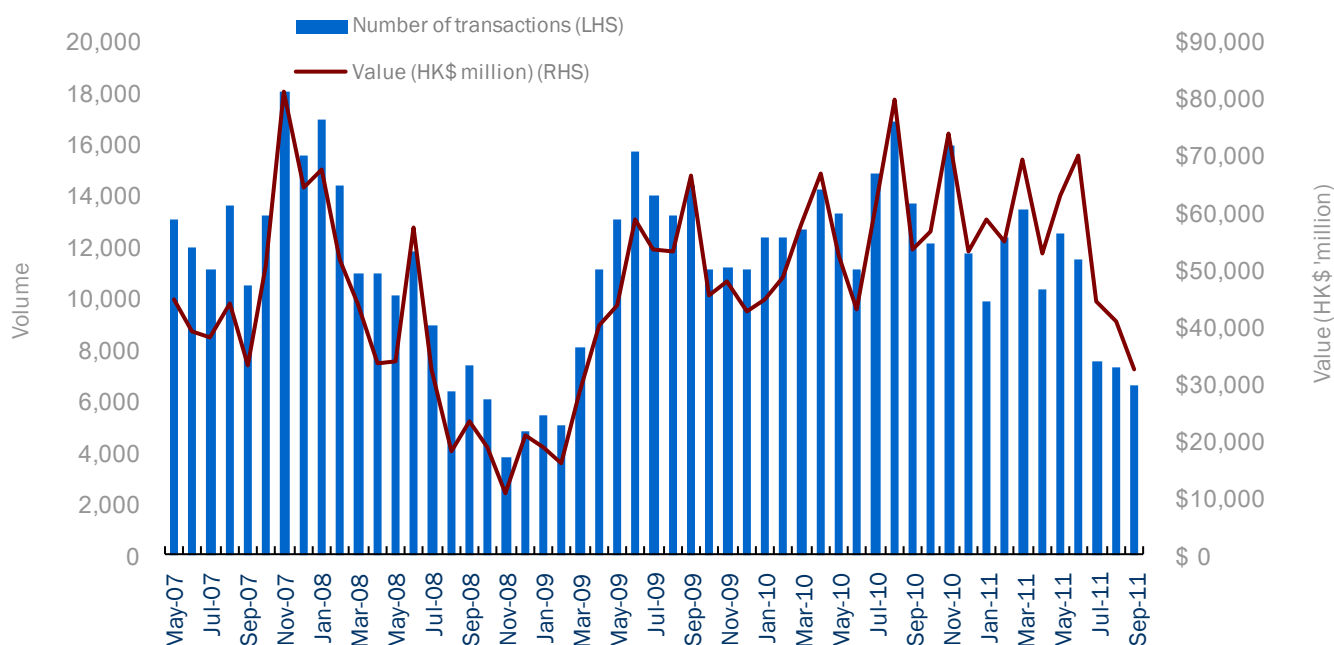
The worsened economic conditions is also reflected in property market. Transactions across all property sectors contracted over 30% q-o-q with the exception of the prime housing sector, which just dropped 16.9% q-o-q. Growth in capital values has also slowed down—quarterly growth rate stood at +1% q-o-q for the mass housing sector, +1.4% q-o-q for the office sector and +2% q-o-q for the industrial sector; the prime housing sector reported the largest drop of 4.3% q-o-q.

The introduction of the Operational Twist program (OT), coupled with the monetary tightening in China, have contributed to the recent mortgage rate hike; this has driven the current lending rate for residential and commercial properties to a significantly higher level - 3.25% and 5.25% respectively. While many cash-rich investors do not require much mortgage financing, particularly for less capital-intensive investment in residential and industrial properties, sales activity still took a hit.

For the luxury residential sector which saw capital values falling the sharpest, investors have become more cautious and have been seeking for bargain deals amid a weakened property market. On the other hand, sales activity in the industrial sector, initially driven by speculation over the government's revitalization policy, has lost much of its steam. Properties with revitalization potential has become scarce and as of this month, there remains to be only 7 special waivers executed for wholesale conversion, according to the Lands Department. For the office sector, amid economic uncertainties and the fallen hiring expectations, corporate occupier demand is expected to decline.

Looking forward, we expect that the growth rate of capital values for both residential and commercial properties will be in negative territory for the fourth

S&P agreements for all types of properties



quarter —ranging from 0 to -5%.

September overview

The property market did not get off on a good start in September with the unfavorable land auction result of the Tseung Kwan O site. While three sites were put out for auction, the large land plot in Tseung Kwan O, being the most indicative of market trend, was sold for HK\$3.12bn, below the low-end estimates of HK\$3.3bn.

Following the land sales, another round of mortgage rates hike took place, led by HSBC; the bank raised its Hong Kong interbank offered rate (Hibor)-based and Prime-based mortgage rates to H+2.3-2.7% (from the previous H+1.8-2.3%), and P-2.1-2.4% (from the previous P-2.7%). Subsequently, Bank of China (Hong Kong), Standard Chartered Bank, Citibank and DBS Bank followed suit, adjusting their rates upwards to as high as H+2.85% and P-1.75%. Overall, mortgage rates were raised by 40-50 basis points (bps).

Meanwhile, the Fed announced an Operation Twist program during the month. Given the pegged exchange rate system in Hong Kong, the OT may have a side-effect of causing higher short-term interest rates due to a flattening US yield curve. The Fed's latest move may gradually mark an end to the era of ultra-low mortgage rates in Hong Kong. In anticipation of a surge in Hibor as a result of the flattening yield curve, banks are raising their Hibor-based mortgage rates for new applicants to H+2.2-2.85% from less than H+ 1% in the past few years.

This helped narrow the gap between Prime-based rates and Hibor-based rates to around 5-60 bps from more than 200 bps. The upward momentum in home prices is expected to subside as the lure of using Hibor-based mortgage plans weakens, especially for multi-home buyers and large-apartment purchasers. This should be good news for the healthy development of the city's property sector in the long term.

As buyers have adopted a wait-and-see attitude prior to the Chief Executive policy address, coupled with the on-going uncertain economic outlook, developers have chosen to delay the release of their respective new residential projects despite being already approved for pre-sale. During the month, only a few residential projects were released to the market, and were offered at substantial discounts. A case in point is La Splendeur, which knocked 12% off its initial indicated price.

For the fourth quarter, the government plans to sustain its effort to boost the residential supply, providing five residential sites for tender, which will be located in Tseung Kwan O district, Tuen Mun and Lantau Island. Nonetheless, this will not impact the market in the near-to-medium term.

Key economic indicators

	Q2 10	Q3 10	Q4 10	Q1 11	Q2 11/(Latest)
Real GDP growth (% change y-o-y)	+6.4	+6.7	+6.4	+7.2	+5.1
Consumer price index (% change y-o-y)	+2.3	+2.9	+2.7	+3.8	(+5.7) (August)
Unemployment rate (%)	4.6	4.1	3.9	3.4	(3.5) (June—August)
Retail sales (volume) (% change y-o-y)	+16.8	+17.8	+19.5	+20.9	(+22.7*) (August)
Retail sales (value) (% change y-o-y)	+13.5	+17.0	+17.0	+16.5	(+29.0*) (August)
Value of import goods (% change y-o-y)	+29.8	+24.2	+15.1	+21.0	(+10.2) (July)

* At constant price in chained (2008) dollars

Sources: Census & Statistics Department, APEC Study Centre HKU and Vigers Research

Approaching the end of the month, the site at Nam Cheong Station was released for tender. While 13 developers have expressed interest in the site, should the dismal auction result of the Tseung Kwan O site is of any indication, it is likely that the tender result may again be disappointing. On the other hand, as the Chief Executive will be announcing his last policy speech with expectedly more coverage on housing policies, sales activity in the upcoming month is likely to remain flat as buyers adopt a wait-and-see approach. However, as we expect that the impact of government policies will be limited, in our view, the market will resume activity following the policy address with the policy overhang removed.

Market intelligence

Land auction

Three government lots were sold for a total of HK\$3.6bn. The first lot, Tseung Kwan O Town Lot No. 113 at Area 66A, Tseung Kwan O, New Territories, was sold to Crown World Investment Limited at HK\$3.1bn. The second lot, Lot No. 1282 in Demarcation District No. 253 at Pak Shek Wo, Sai Kung, was sold to Stanhope Holdings Limited at HK\$121.5mn. The third lot, Lot No. 4309 in Demarcation District No. 124 at Tan Kwai Tsuen Road, Yuen Long, New Territories, was sold to Advance Fame Investments Limited at \$361mn.

For the Tsueng Kwan O site, taking construction costs into account, the site is expected to be sold for HK\$6,000 psf, with a profit margin of 10%. This price is currently at the level of second-hand homes in the area, revealing that developers are not optimistic of the property market outlook due to the negative sentiment brought about by the uncertain economic outlook.

Land supply

The government has put out five residential sites for tender — located in Tseung Kwan O district, Tuen Mun and Lantau Island (Refer to the new tender list below). Nonetheless, the main portion of the supply will come from the three West Rail property development projects, generating another 3,326 units. Among which, the Tsuen Wan projects are expected to be further released in IQ 2012. .

Land auction and tender results

Month	Lot No. & location	Address	Usage	Est. GFA (sf)	Price (HK\$mn)	Price (HK\$psf)
September	TKOTL 113	Area 66A, Tseung Kwan O	Residential R2	792,898	3,120	3,935
	LOT NO. 1282 in DD NO. 253	Pak Shek Wo, Sai Kung	Residential R3	12,107	122	10,036
	LOT NO. 4309 in DD NO. 124	Tan Kwai Tsuen Road, Yuen Long	Residential R3	120,471	361	2,997

New tender projects in 2011-2012

Tender closing date	Lot No.	Location	Use	Area (sf)
21 October 2011	Lot 1950 in DD 221	Sai Kung town, Area 4	Hotel	193,105
28 October 2011	RBL 1168	Near 35 South Bay Road, Hong Kong	Residential R3	14,402
28 October 2011	STTL 463	Junction of On Yiu Street and on Kwan Street, Shek Mun	Business	86,079
22 November 2011	STLL	Junction of On Kwan Street and On Lai Street, Shek Mun	Business	70,396
22 November 2011	Lot 724 in DD 332	Cheung Sha Site 406, Lantau	Residential R4	79,761
22 November 2011	Lot 726 in DD 332	Cheung Sha Site 407, Lantau	Residential R4	81,268
March 2012	TWTL 415	Ex-Tai Wo Hau Factory Estate, Sha Tsui Road, Tsuen Wan	Residential and Commercial	107,639

Sources: Lands Department and Vigers Research

Housing market

Secondary home market

During the third quarter, the monthly transaction volume of second-hand homes fluctuated at around 4,200-4,300—totalling 12,790 in the whole quarter, with a q-o-q drop of 38.1%. Sales turnover, on the other hand, decreased 39.5% q-o-q to HK\$57.3bn.

The growth rate of the average price of mass housing slowed down significantly and reported a slight increase of 1.0% q-o-q. The average price of key housing estates even reported mild decreases: Residence Oasis (-2.1%), City One Shatin (-1.5%), Whampoa Garden (-1.4%) and Taikoo Shing (-1.0%).

Prime residential market

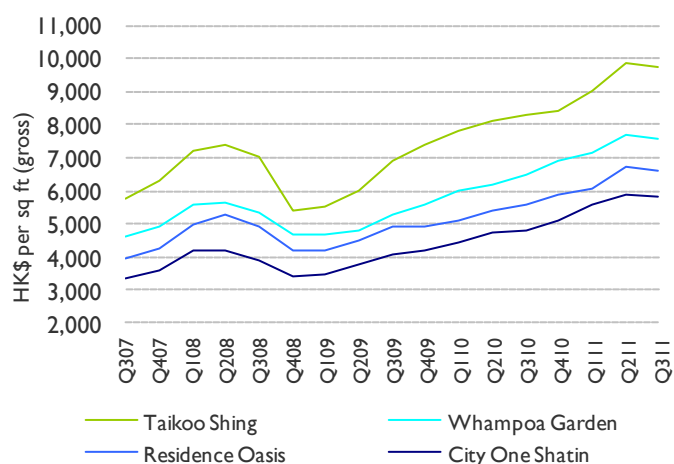
The transaction volume and value of prime housing estates (HK\$10m+) took a plunge of 16.9% q-o-q and 24.3% q-o-q respectively; the former stood at 1,471 and while the latter at HK\$39.6bn.

The average price of prime housing estates dropped by 4.3% q-o-q. Nonetheless, the performance of individual prime estates varied greatly during the quarter: Hong Kong Parkview (-4.5%), Residence Bel-Air (+1.6%), The Arch (+1.6%) and One Beacon Hill (+7.5%). Powered by only a handful of high-priced transactions, One Beacon Hill reported substantial growth during the quarter. Residence Bel-Air and The Arch, on the other hand, also lagged behind the overall downtrend of the sector, however, have finally taken a downfall in September.

New home market

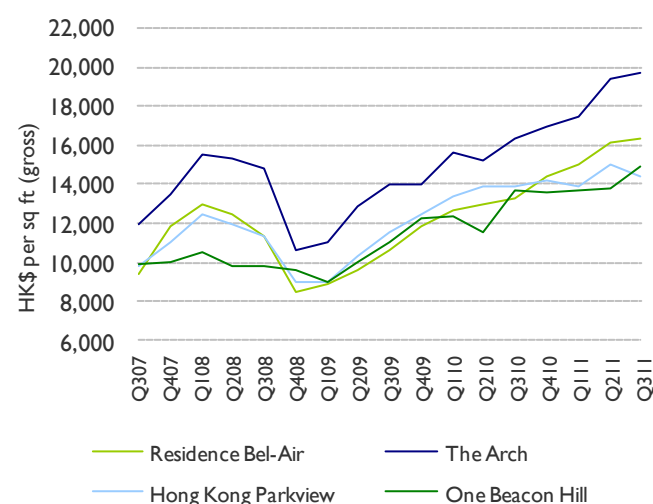
The transaction volume and value of the primary residential sector took a plunge, reporting a drop of 56.2% q-o-q and 33.9% q-o-q respectively. The former stood at 1,631 while the latter stood at HK\$27.7bn.

Average flat prices by key housing estates



Sources: The Land Registry and Vigers Research

Average flat prices by prime housing estates



Sources: The Land Registry and Vigers Research

Selected new residential projects on sale in August

Project	District	Unit size (sf)	Units for sale	Unit price (HK\$ psf)	Developer (s)
Lions Rise	Muk Lun Street, Wong Tai Sin	676 -1,463	968	10,390	Kerry Properties
Imperial Cullinan	Hoi Fai Road, West Kowloon	655 -1,860	650	18,688	Sun Hung Kai Properties
Residence 228	Fuk Wing Street, Sham Shui Po	445 - 783 (Standard) 1,524-2,005 (Duplex)	88	8,819	Chinachem Group
Soho189	Sheung Wan	678-2,049	149	15,000-16,000	K. Wah & Pei Xin
La Splendeur	Tsueng Kwan O	804-2,245	108 (first batch)	5,931	SHKP and MTR
Winfield	Happy Valley	1,940-2,468	70	23,586	Kerry Properties

Sources: EPRC and Vigers Research

Prime office market

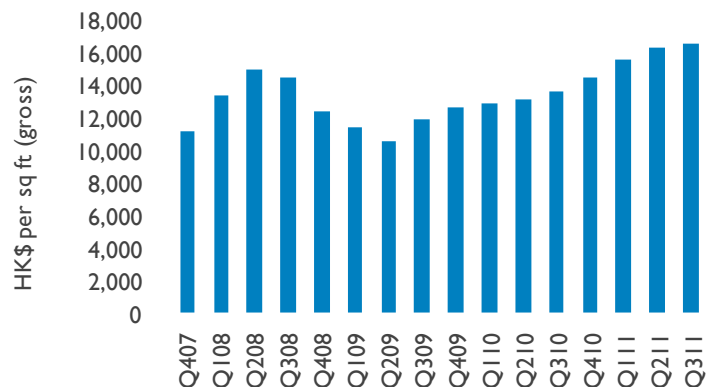
Sales market

Transaction activity in September rebounded after the 3-month slump since June. The monthly office sales volume increased 19.2% m-o-m to 219 while the transaction value went up by 82.0% m-o-m to HK\$35.1bn. Nonetheless, the third quarter reported a q-o-q drop of 36.0% while turnover fell 24.2%.

The average capital value of prime office properties have finally reached its peak with only a minute growth of 1.4% q-o-q compared with 4.7% last quarter.

The investment market continued to be quiet due to the difficulties in obtaining finances amid the mortgage rate hikes. Nonetheless, there were still notable deals being reported during the month.

Average capital values of prime office property



Source: Vigers Research

Market intelligence

- ◆ After selling two floors (12,700 sf) of Fortis Tower, US-based real estate fund AEW sold another two floors (29/F & 30/F) for HK\$158mn or HK\$12,441 psf (Hong Kong Economic Journal - 17.9.2011)
- ◆ A number of large transactions came from China-based funds during the month. A case in point is the sales transaction of an office unit by Capital Strategic Investment (497). The said office units are located on the 32/F (8,088 sf) of Bank of America Tower, sold for HK\$218mn or HK\$26,944 psf to Well Kent International Investment Company Limited. The above transaction smashed the previous highest price of HK\$26,000 psf in the same building. (Hong Kong Economic Journal - 22.9.2011)
- ◆ Grade A office prices in core areas have been pushed up due to the limited supply. An upper floor unit at United Centre in Admiralty was sold for HK\$90mn or HK\$16,237 psf, the highest in record; while a unit at Far East Consortium Building, Sheung Wan, was also sold at a recent high of HK\$9,300 psf. (Hong Kong Economic Journal - 28.9.2011)
- ◆ The commercial property market in Kowloon East has continued to attract investors during the month. 4 units (4,757 sf) at 55 King Yip Street, Kwun Tong were sold at HK\$6,130 - 6,233 psf. The units had been bought by the vendor two weeks ago and subsequently appreciated by around 10%. (Hong Kong Economic Times - 28.9.2011)
- ◆ Units A & B (6,046 sf), Camel Paint Centre Tower 2, Kwun Tong, were sold at a record-breaking HK\$3,200 psf. The previous owner had bought the property in 1992 and sold it at 2.62 times the original cost. (Hong Kong Economic Times - 15.9.2011)

Leasing market

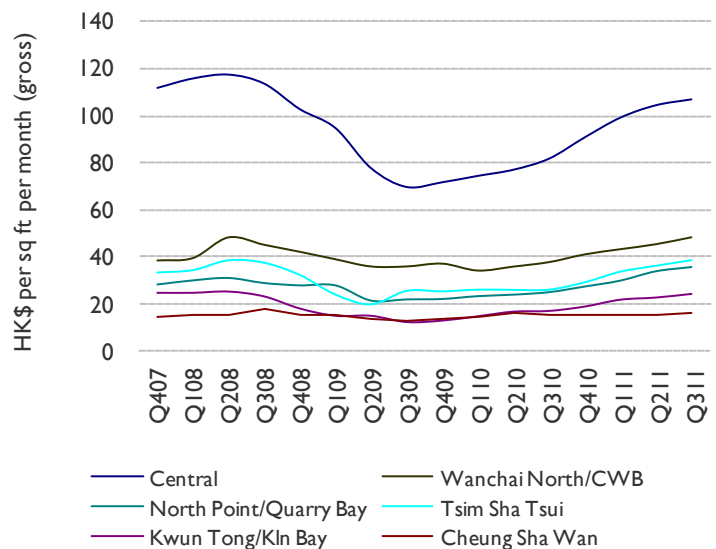
Leasing activity continued to slow down in September, with some companies reportedly putting their expansion plans on hold, while some have relocated their offices from the CBD. This has brought about a steeper rise in rents in decentralized areas such as Kowloon East and Cheung Sha Wan, which rose 6-7% q-o-q, exceeding the rental growth in core business districts. Rental growth at Central, Kwun Tong/Kowloon Bay and North Point/Quarry Bay finally showed signs of slowing down—quarterly growth rates were down by 200-300 basis points—rents in Central only grew 2.4% q-o-q.

Nonetheless, the average office rents were up by 6.0% q-o-q, and it is predicted that the remaining quarter will contribute another 5%, led by decentralized area such as Kowloon East.

Market intelligence

- ◆ More companies were reported to have vacated their office from Central during the month. Recently, the Hong Kong Mortgage Corporation left the IFC and rented the whole floor (20,506 sf) in Cosco Tower at a record-breaking HK\$56 psf/month. (Singtao - 2.9.2011)
- ◆ While we see companies have moved out of Central, vacated offices were quickly absorbed. Securities and Futures Commission rented 6 floors in Cheung Kong Centre for an average monthly rent of HK\$15mn or HK\$125 psf/month). (Hong Kong Economic Journal - 8.9.2011)
- ◆ Offices at Kowloon East continue to be on demand. And has driven rental values up in the area. US retail fashion brand Donna Karan rented the whole floor of Landmark East for HK\$27 psf/month. (Hong Kong Economic Journal - 17.9.2011)

Average prime rents by major submarkets



Source: Vigers Research

- ◆ 3 inter-connected units (5,012 sf) in Exchange Tower, Kowloon, were recently leased for HK\$25 psf/month—a relatively high price for the said building. In fact, rent has been rising in the area with some units rented for more than HK\$30 psf/month.(Hong Kong Economic Times- 14.9.2011)
- ◆ New World Development's redevelopment project in Central is near to completion and the company has re-named the new building as Prosperity Tower. The company will soon lease out the office units for at least HK\$65 psf/month; office space in each floor spans approximately 5,500 sf. (Hong Kong Economic Times - 14.9.2011)

Industrial property market

Investment market

Investment activity in the industrial property market took a further drop as a result of the uncertain economic outlook, coupled with the contraction on bank mortgages and the rise in interest rates. In September, transaction volume stood at 345, recording a m-o-m drop of around 40% compared with around 500-600 in July and August. In effect, the overall transaction volume in the quarter shrank by 39.1% q-o-q while turnover fell 52.3% q-o-q.

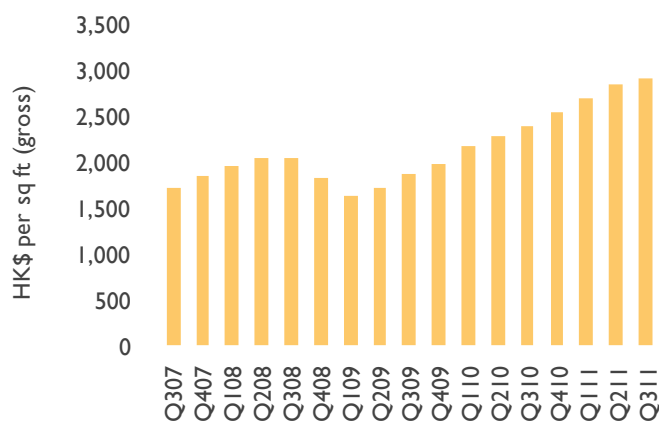
Prices has also leveled off, with only a 2% q-o-q increase in contrast to the previous steady quarterly increase of 6%. Throughout the quarter, the sector reported price cuts ranging from 5-10%.

Activity in the investment market remained subdued, with only one notable investment deals made during the month.

Notable deals

- ◆ An industrial site located on 48 Wang Lok Street, Yuen Long was sold for HK\$108mn to Chiho Tiande Group.

Average capital values of industrial property



Source: Vigers Research

Application for wholesale conversion and redevelopment of industrial buildings

Period	No. of applications	
	Wholesale conversion (Cases)	Redevelopment (Cases)
Start of industrial revitalization policy to date	52 (2)	8 (0)
April 2010 - September 2011	52 (2)	8 (0)

() - Number of Applications received in September 2011

Sources: Vigers Research and Lands Department

In September, two applications for wholesale conversion (for special waiver) were received while nil applications were received for redevelopment (for lease modification). As of 14 October, there have been only seven special waivers executed for wholesale conversion and one lease modification executed for redevelopment since the industrial revitalization policy began on April last year.

A lease modification for an industrial building at 135-137 Hoi Bun Road, Kwun Tong, was executed for redevelopment for non-residential use. A premium of HK\$386.5mn was paid. This is the second lease modification for an industrial building on Hoi Bun Road.

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