

Market summary

In H1 2011, the total volume of property transactions (by S & P Agreements) stood at 70,342, with a 17.7% drop compared with H2 2010. The drop in transactions is attributed to the series of cooling measures, including the introduction of the Special Stamp Duty (SSD), mortgage rate hikes - not to mention the series of natural disaster that occurred in Japan. As of June, the monthly S & P agreements stood at 11,601 and has yet to recover to the level prior to the introduction of the SSD since November 2010, which had stood at near 16,000.

However, the above cooling measures had little impact on the capital values of mass residential housing and luxury housing, which rose 11.1% and 16.3% respectively in H12011, compared with H2 2010.

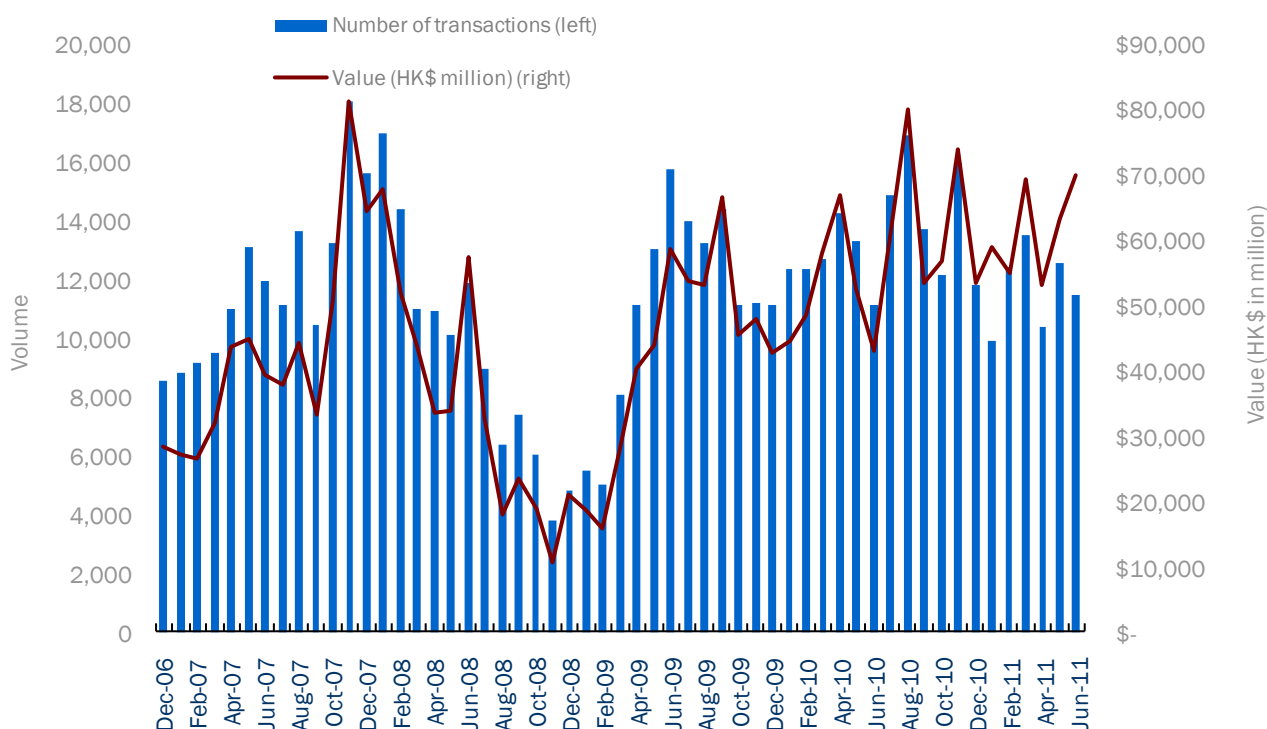
To cool down the property market, the government announced on 10 June the launch of eight sites for sale in Q3 2011 in order to increase the land supply. Simultaneously, the above measure coincided with the 4th round of mortgage tightening measures from the

Hong Kong Monetary Authority (the "HKMA") since October 2009. While all the previous measures were mainly focused on the luxury end of the property market, current measures have effectively expanded to properties valued at HK\$6 million, including those sold to "foreign" purchasers.

In light of the tightened anti-speculative measures by the Hong Kong government as well as monetary restrictions from Mainland—the latest being raising the bank reserve requirement ratio—it is expected that growth of capital values of both mass housing and luxury housing will inevitably slow down—to 0-5% and 7-12% respectively—towards the latter half of the year. On the other hand, it is expected that capital will be further directed towards the commercial property market.

Contributed by the continued low-interest environment and the large capital inflow, the capital value of prime offices soared 13.9% in H1 2011, compared

S&P agreements for all types of properties



Sources: The Land Registry, Vigers Research

with H2 2010. Yet, as the capital value approaches near its peak, it is predicted that the growth rate will slow down to 9-12% in the remaining half year. On the other hand, with superior economic growth in Q1 2011, along with the lack of office supply, office rents surged 21.2% in H1 2011 compared with H2 2010. With office supply continuing to run low, it is predicted that there is still room for rental growth of 13-17% in the latter half of the year.

In Q2 2011, external trade performance suffered due to the supply chain disruptions in Japan and the deceleration of growth in the developed economies. Nonetheless, this has limited impact on industrial rental values, which increased by 1.2% in H1 2011, compared with H2 2010. With the trade performance expected to recover in the Q3 2011, rental growth will maintain at 0-2% in the coming half-year.

As for the industrial investment market, with the favorable rate of return and affordable industrial properties, the market has been active, with the average capital value increased 6% in H1 2011, compared with H2 2010. With capital values reaching its peak, it is expected that there will be a moderate growth of 4-8% in H2 2011.

Key economic indicators

	Q210	Q310	Q410	Q12011	Q22011/ Latest
GDP growth* (% change y-o-y)	+6.4	+6.7	+6.4	+7.2	+4.6
CPI (% change y-o-y)	+2.3	2.9	+2.7	+3.8	+5.2% (May)
Unemployment rate (%)	4.6	4.1	4.0	3.4	3.4 (Mar-May)
Retail sales value (% change y-o-y)	+16.8	+17.8	+19.5	+20.9	+21.6 (May)
Value of Export Goods (% change y-o-y)	+24.3	+27.8	+14.3	+24.7	+10.1 (May)
Value of Import Goods (% change y-o-y)	+29.8%	+24.2%	+15.1%	+21.0%	+13.0% (May)

* at constant price in chained (2008) dollars

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

Policy updates: HKMA puts new limits on residential mortgages

Effective on 10 June 2011, the HKMA tightened the loan-to-value (LTV) ratio of mortgage lending for properties valued above HK\$7 million and, for the first time, imposed extra restrictions on mortgages to non-resident borrowers, including purchasers from the mainland:-

1. First, for residential properties valued between HK\$10 million and HK\$12 million, the maximum LTV ratio will be lowered to 50%. In other words, the 50% maximum LTV ratio introduced in November 2010 will be applicable to all residential properties with a value of HK\$10 million or above;

2. Secondly, for residential properties valued between HK\$7 million and HK\$10 million, the maximum LTV ratio will be lowered to 60%, with the maximum mortgage loan amount capped at HK\$5 million;

3. Thirdly, for those properties valued below HK\$7 million, the maximum LTV ratio remains at 70%, but a new cap of HK\$4.2 million will be added, effectively meaning only properties below HK\$6 million are not affected;

4. Fourthly, for borrowers who do not have stable income but only have assets, their maximum LTV ratio will be reduced to 40% from 50%;

5. Last but not least, new and tougher restrictions will also be added on non-resident borrowers (i.e. the mortgage loan applicants whose principal incomes are not derived from Hong Kong) such that the maximum LTV ratio they could be offered for all mortgages (including residential, offices, commercial property and regardless of the property values) will be reduced by at least 10% points. Waivers of these restrictions can only be given if borrowers are transferred by their employers to Hong Kong or if their parents, spouses or children live in Hong Kong.

Land auction results H1 2011

Month	Lot No. & Location	Address	Usage	Est. GFA (sf)	Price (HK\$M)	Price (HK\$psf)
March	NKIL 518	On Ning Road, Tai Kiu Road and On Lok Road, Yuen Long	Residential R1	644,150	44,116	3,629
April	KIL 11184	Ko Shan Road, Hung Hom	Residential R1	153,515	1,525	9,934
May	IL 8963	Stubbs Road, Hong Kong	Residential R3	180,838	4,490	24,829
	NKIL 6498	Begonia Road, Yau Yat Chuen, Kowloon	Residential R3	38,781	579	15,742
	LOT No. 2086 in DD 105	Ngau Tam Mei, Yuen Long	Residential R4	101,095	662	6,548
June	IL 8949	Borrett Rd, Hong Kong	Residential R2	435,292	11,650	26,764
	LOT NO. 2129 in DD121	Ping Kwai Rd, Ping Shan, Yuen Long	Residential R3	65,403	300	4,587
	HHIL 555	At the Junction of Gilles Avenue South and Bulkeley Street, Hung Hom	Residential R1	53,410	406	7,002
	HHIL 556	Lee Kung Street, Hung Hom	Residential R1	104,840	801	6,581

Source: Lands Department, Vigers Research

Land Auction

The favorable land sales result in H1 2011 has so far reflected an optimistic outlook on the residential property market. The sales of the site on Borrett Road and Stubbs Road have made itself to the city's top 5 expensive land auctions (by accommodation value) since 1997. The former was sold for HK\$11.65 billion at HK\$26,764 psf while the latter was sold for HK\$180.8 million at HK\$24,829 psf - both of which are ranked the 2nd and 3rd highest.

However, given that the tightening of home loans took place after June's land auction, it would not be until July will we see how the market view the impact of the latest cooling measure on the property market. According to the Lands Department, tender result of the residential site at Area 55A of Tung Chung will be revealed in July followed by the auction result of Area 56A of Shatin in August.

Land Supply

To cool the property market and the sky-rocketing property market prices, the government recently announced the launch of eight sites for sale in Q3 2011 (refer to the new tender and auction list in Pg. 4).

The eight additional sites are expected to offer about 6,000 residential flats in Q3 2011, doubling the estimated 3,000 flats provided by the nine residential sites put up for sale earlier in Q2 2011. Furthermore, in order to ensure those flats would be built to meet the demand of the mass public, the government imposed further requirements on developers, such as requiring them to build a minimum number of flats or to supply certain amount of small-and-medium-sized units.

Although the government has increased the residential land supply, its effect will not materialize in the short-term since it will take at least a few years for residential projects to be completed. Residential prices will continue to be supported by the relative low home completions. Compared with the historical average of about 18,600 units per year, there were 10,675 home completions as of June. In review of current efforts, the government has only auctioned/tendered out around 3,600 units in H1 2011, meaning that it has only achieved around 18% of its annual target of minimum 20,000 units thus far.

New tender projects on 2011-2012

Estimated Tender Invitation Date	Lot No.	Location	Use	Area (sf)
17-Jun-11	TCTL 36	Area 55A Tung Chung, Lantau	Residential R2	273,403
17-Jun-11	NKIL 6314	Junction of Kai Cheung Road and Wang Kwong Road, Kowloon Bay	Commercial	71,042
30-Jun-11	KIL 11111	Junction of Hung Luen Road and Kin Wan Street, Hung Hom, Kowloon	Commercial	147,498
15-Jul-11	IL 8920	Ex-Government Supplies Depot, Oil Street, North Point	Hotel and Residential/ Commercial	84,895
26-Aug-11	Lot 1613 in DD 222	Kap Pin Long, Sai Kung	Residential R4	18,654
Dec-11	IL 8947	123 Gloucester Road and 219-227 Lockhart Road, Former Wan Chai Police Station cum Wan Chai Police Married Quarters	Hotel/ Commercial/ Commercial/and Cultural	40,989
March-12	TWTL 415	Ex-Tai Wo Hau Factory Estate, Sha Tsui Road, Tsuen Wan	Residential and Commercial	107,639

Coming land auction

Lot No. & Location	Use	Site Area (sf) (About)	Date of Land Auction
STTL 525 Shatin Area 56A, Kau To (Site A)	Residential R2	248,173	9 August 2011

Source: Lands Department, Vigers Research

Prime office market

Sales market

In **HI 2011**, there were 1,971 transactions in the office sales market, the highest since 1997; in the same period, total transaction value stood at HK\$44.4 billion. With a vibrant office market, a price hike of 13.9% in HI 2011 was observed, which was contributed by the continued low-interest environment, large capital inflow, coupled with the lack of office supply.

In the latter half of the year, office supply will continue to run low while demand is predicted to fall. On the supply side, the overall office vacancy rate remains low at 4% in HI 2011, with a quarterly drop of 20 basis points. On the demand side, it is expected that the economic slowdown, at an estimated 5.1% y-o-y increase in GDP in Q3 2011, would dampen the office demand.

Meanwhile, the volume of capital inflow from Mainland may be impeded given the recent monetary regulation in the Mainland. Following the announcement on the CPI increase of 5.5% y-o-y in May, the People's Bank of China announced on 6 July that it would raise the reserves requirement ratio by 50 basis points, pushing the ratio to 21.5% for large Chinese banks. As such, expansion plans of Mainland enterprises to Hong Kong may be impeded.

Taking the above into account, it is predicted that the capital growth will slow down to 9-12% in the remaining half year.

Leasing market

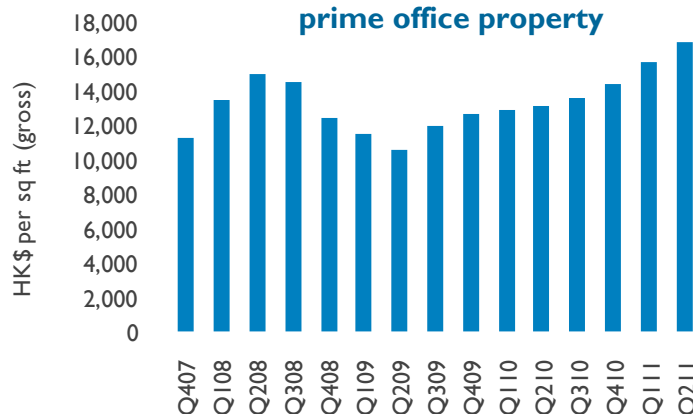
In **HI 2011**, office rents rose 21.2% compared with H2 2010 due to the low office supply. With rents approaching their peak, the momentum in rental growth slowed in Q2 2011. Nonetheless, office supply continues to run low, and it is predicted that there is still room for a rental growth of 13-17% in the latter half of the year.

The lack of office space is particularly prominent in the Grade A segment in Central, with a vacancy rate standing as low as 3.1%, compared with the overall average of 4%. Yet, once the market digested the new rental cost, it is expected that the rental market will return to its previous momentum. It is estimated that there is still room for increase in Grade A office rents in Central up to 10%.

Nonetheless, tenants are expected to continue to seek more cost effective spaces in decentralized areas which would support rental values in areas such as Kowloon East.

In **June**, Grade B offices' rental market in Central has become more attractive to investors given that the price hike in Grade A offices has pushed down rental yield. This is reflected in superior rental yield of Grade B offices as seen in the rental transactions during the month. Eurasia Building was rented for HK\$35 psf/month, with a rental yield of 3.5%. Far East Consortium Building, on the other hand, was rented for HK\$30 psf/month, with its rental yield standing at 3%. Taking the recent rental transaction of HK\$45 psf/month of a Grade A office,

Average capital values of prime office property



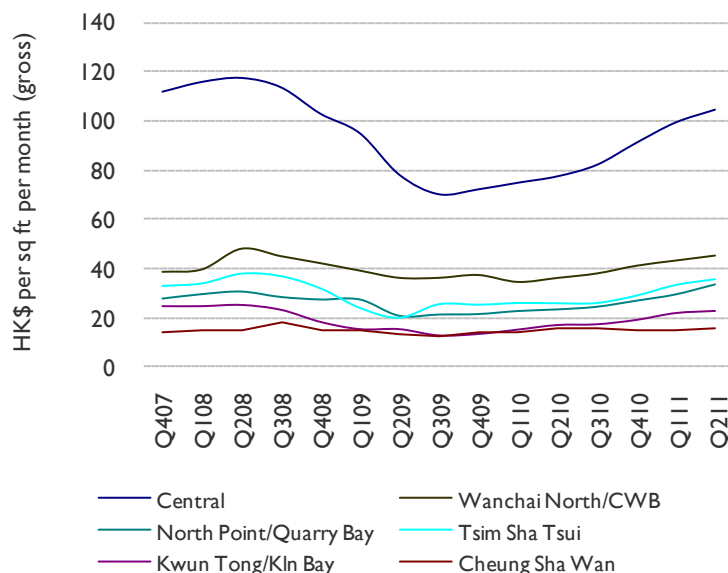
Source: Vigers Research

In **June**, the monthly office property sales volume fell 2.6% m-o-m to 347 while the monthly transaction value took a sharper fall at 29.5% m-o-m to HK\$3.1 billion.

Given the shortage in Grade A offices in Central, the demand of Grade B offices augmented in the area, which contributes to the high-price transactions during the month. A case in point is the whole 6/F in Hong Kong Diamond Exchange Building, which was sold for HK\$25,400 psf.

On the Kowloon side, the price hike continued. In June, Silvercord Tower, Tsim Sha Tsui, recorded a record-high transaction of HK\$14,900 psf. Since May, the said building has already made 3 record-breaking transactions, which reflects investors' continued confidence in the prime office market.

Average prime rents by major submarket



Source: Vigers Research

Worldwide House, its rental yield stood at 1.8%. In contrast, the Grade B offices, as revealed in recent transactions, provide superior rental yields of over 3%.

Office rental hikes in the Hong Kong Island has reached Kowloon as well. It was reported that an ocean-view unit in Star House, Tsim Sha Tsui, was rented out for HK\$34 psf/month - which presents a 3-year high since the global financial crisis in 2008.

Housing market

Residential S & P transaction volume for first-hand and second-hand homes stood at 5,256 and 43,695 respectively in H1 2011, with a drop of 5.6% and 22.2% respectively compared with H2 2010; even the transaction volume for luxury homes dropped 20.5% in the same period. The drop in transaction volume is attributed primarily to the imposition of the SSD, as well as the earthquake in Japan and the rise in mortgage rates.

Nonetheless, the average price of mass residential units rose by 11.1% in H1 2011 compared to H2 2010, as many property owners have held on to their assets given the overall satisfactory rental yield performance. Since the introduction of the new tightened regulation of home loans in June, there has been reported cases of 0-10% price cuts in the secondary home market. Though it has yet to become a trend, the growth rate of the

average capital value will inevitably slow down to an estimated 0-5% in the remaining half year.

On the other hand, the average prices of the luxury homes in H1 2011 rose up to 16.3% compared with H2 2010. The rise in price is attributed to the continued demand of Mainland buyers, which quickly recovered from the introduction of SSD. Yet, there are worries that the further tightening of money supply may drag down investment sentiments. With the People's Bank of China raising the bank reserves requirement, the inflow of capital from Mainland, which has been directed to the luxury home market, will inevitably be reduced. As such, it is expected that the momentum will slow down to 7-12% in the latter half of the year in this sector – which will still be significantly higher than that of the mass residential market.

Secondary home market

In **H1 2011**, the average prices of key housing estates exhibited double-digit increases at varying degrees compared to H2 2010: Residence Oasis (+25%), City One Shatin (+23%), Taikoo Shing (+18%) and Whampoa Garden (+17%).

In **June**, the transaction volume of second-hand homes was up 4.7% m-o-m to 7,360; sales turnover, on the other hand, increased 15.8% m-o-m to HK\$37.0 billion.

Prime residential market

In **H1 2011**, the average prices of prime housing estates exhibited increases at varying degrees compared with H2 2010: Residence Bel-Air (+21.7%), The Arch (+18.7%), Hong Kong Parkview (+8.6%) and One Beacon Hill (+1.1%).

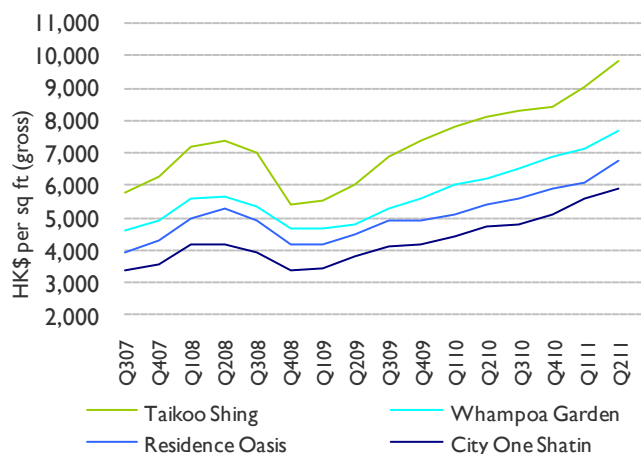
In **June**, the transaction volume and value of high-end homes (HK\$10m+), including those completed in the primary and secondary markets, stood at 682 and HK\$22.1 billion respectively, with an increase of 8.3% m-o-m and 31.3% m-o-m respectively.

New home market

Despite recent government cooling measures, Imperial Cullinan, owned by Sun Hung Kai Properties, is the first to release its first batch of units at the end of June; units were priced at HK\$18,688 psf, 20% above nearby second-hand home prices. Upper East 18, owned by Emperor Group, on the other hand, raised the price of its remaining 23 units to HK\$13,500 psf, with an increase of 8% from the previous. The Gloucester and Residence 228 further introduced 8 additional units for sale.

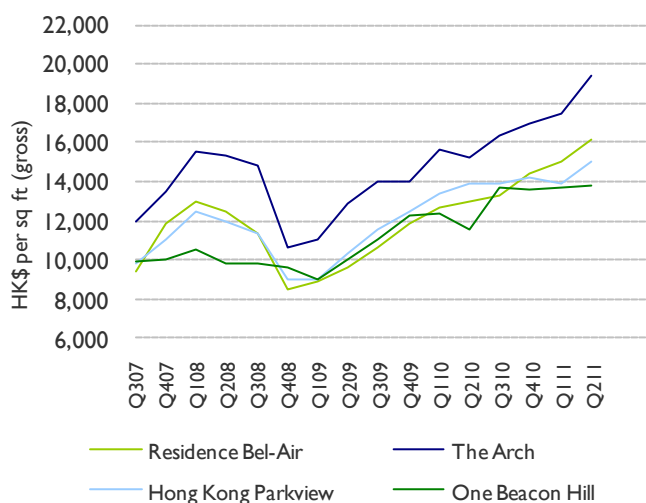
As of early July, developers started to introduce discounts for their respective residential projects to attract buyers. Serenade in Tai Tam has introduced discounts in price and restoration costs; Uptown in Yuen Long has introduced low mortgage interest rates; Grand Garden in Sai Wan Ho has introduced a pre-payment plan with a transaction period of 2 years.

Average flat prices by key housing estate



Source: The Land Registry, Vigers Research

Average flat prices by prime housing estate



Source: The Land Registry, Vigers Research

Selected new residential projects on sale

Project	District	Unit size sf	Units for sale	Unit price HK\$ psf (Base Price)	Developer
Lions Rise	Muk Lun Street, Wong Tai Sin	676 -1,463	968	10,390	Kerry Properties Limited
Imperial Cullinan	Hoi Fai Road, West Kowloon	655 -1,860	650	18,688	Sun Hung Kai Properties Limited
Upper East 18	Shing On Street, Sai Wan Ho	329 - 1,339	108	12,385	Emperor Group
The Gloucestor	Gloucestor Road, Wanchai	478-966 (Standard Floors) 1,004-4,175 (Executive Floors)	177	19,898	Henderson Land Development Group
Residence 228	Fuk Wing Street, Sham Shui Po	445 - 783 (Standard) 1,524-2,005 (Duplex)	88	8,819	Chinachem Group

Source: EPRC, Vigers Research

Industrial property market

Investment market

In **HI 2011**, transaction volume and value of S & P Agreements for industrial properties stood at 4,351 and HK\$17.3 billion respectively, with an increase of 9.8% and 10.5% respectively compared with H2 2010. The half-yearly transaction volume and value both reached to new heights since the peak in H2 1995.

Since the introduction of the SSD, a lot of investors have turned to the industrial property market due to the favorable rate of return (at around 6% per annum) and the more affordable cost – there have been a large amount of industrial properties selling below HK\$2 million during the year.

The market is further supported by the industrial revitalization policy introduced last year, which allows a "nil waiver fee" concession for the change of use of certain industrial buildings - thereby allowing owners to pay the land premium only when the building is redeveloped. Currently, there are already over 20 en-bloc transactions recorded since the introduction of the policy.

The active investment market has contributed to an increase of 6% in industrial capital value in HI 2011, compared with H2 2010; for en-bloc sales, capital values rose near 30% in the same period. With the continued high monthly transaction volume up till June, it is predicted that industrial capital values will continue to climb 4-8% in the latter half of the year.

Regional supply chains were disrupted by the earthquake in Japan as well as the sovereign debt crisis in Europe. As a result, growth in trade volumes dropped significantly. In May, the value of exports and imports only increased 10.1% y-o-y and 13% y-o-y respectively. While this has driven down the demand of logistics operator, it seems that rental values were largely unaffected. Rental values rose 1.2% in HI 2011 and is expected to maintain in the range of 0-2% in the remaining half-year.

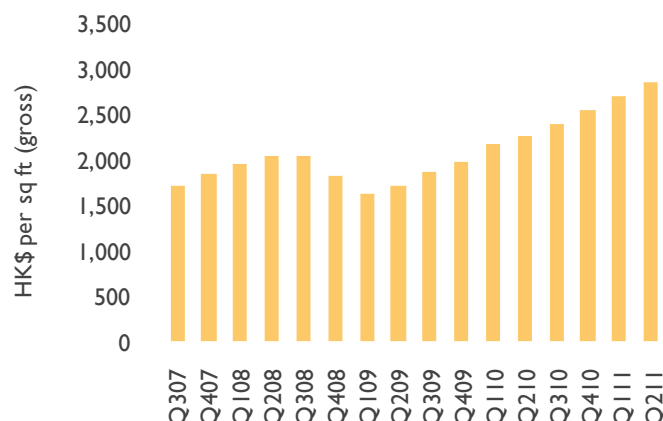
In **June**, investment activity in the industrial property market rebounded, with an m-o-m increase of 11.2% and 9.7% respectively in transaction volume and value.

Policy in Focus

As old industrial areas undergo transformation, more and more industrial buildings have been converted/redeveloped to office use. At the same time, the government has also been actively identifying industrial land for future residential supply; 30ha of industrial land was identified for future residential use as announced in the policy address. It is expected that the continued reduction of industrial space would further support capital and rental values.

Recently, the government also broadened the permitted land-use (including eating place, institutional use, public clinic and training centre), where appropriate, for industrial zones in a number of Outline Zoning Plans (OZPs) to facilitate the wholesale conversion of industrial buildings.

Average capital values of industrial property



Source: Vigers Research

Applications for wholesale conversion and redevelopment

Period	No of Applications	No. of Successful Applications	
		Wholesale Conversion (Cases)	Redevelopment (Cases)
(M/Y)	(Cases)		
4/2010 –	56	13 (6)	7 (1)

() - Number of Applications received in June 2011

Source: Vigers Research, Lands Department

The Lands Department has approved 13 wholesale conversion applications since April 2010. In June, 6 applications for wholesale conversion (for special waiver) were received while one application for redevelopment (for lease modification) was received.

With the government recently broadening the permitted land-uses in industrial zones, it is expected that there will be more successful cases of wholesale conversions of industrial buildings in the future.

On 30 June 2011, the Town Planning Board announced the amendment of six draft OZPs:

- ◆ Draft Kennedy Town and Mount Davis OZP No. S/H1/19
- ◆ Draft Chai Wan OZP No. S/H20/18
- ◆ Draft South West Kowloon OZP No. S/K20/26
- ◆ Draft Fanling/Sheung Shui OZP No. S/FSS/15
- ◆ Draft Sha Tin OZP No. S/ST/25
- ◆ Draft Ping Shan OZP No. S/YL-PS/13

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