RESEARCH



<section-header>

RENTS UP FURTHER AMID SUPPLY SHORTAGE

Hong Kong's average Grade-A office rent grew 3.2% in October, compared with 1.8% in September—the second-largest month-on-month gain over the past 30 months. Lagging districts continued to catch up. Rents in North Point rose 4.7% during the month—the largest increase among all major districts—closely followed by Quarry Bay and Causeway Bay, which registered increases of 4.6% and 4.4%, respectively. Rent growth in Central gathered pace again, increasing 3.1% after a mild gain of 1.1% in September.

The leasing market saw a number of financial institutions and professional services firms scrambling for limited offices in core areas. Bank of America reportedly took up three floors totaling 69,000 sq ft in Two IFC in Central, while a financial institution committed to more than 17,000 sq ft of space in Citibank Plaza in the same district. Another landmark deal involved Shell, which leased two floors in Landmark East in Kwun Tong, totaling 40,000 sq ft.



Office sales remained strong, with about 270 transactions registered in October—the 17th consecutive month to feature more than 200 deals. The average Grade-A office price edged up 2.5% to HK\$12,700 per sq ft. Central saw the largest increment of 7.8%, followed by Admiralty with 3.4% and Wan Chai with 3.3%. Last month, the average office price in Central was only 1.1% lower than its 2008 peak.

Amid the red-hot market sentiment, the sales market saw a number of record-breaking deals the past month, including a whole floor in The Center in Central which was sold for HK\$338 million, or a record-high HK\$25,581 per sq ft across the city. A whole floor in Nine Queen's Road Central in the same district was snapped up by a local investor for HK\$338 million or HK\$24,600 per sq ft, while a whole floor in Lippo Centre in Admiralty reportedly changed hands for HK\$300 million or HK\$19,600 per sq ft—a record high for the building.

So far, Grade-A office prices and rents have rebounded 83.5% and 32.0%, respectively, from their 2009 troughs. After a yearlong recovery in both sectors, how long and how far could the rebound continue? We believe the outlook for the leasing market hinges on the balance of supply and demand, while the outlook for the sales market would be shaped by the ratio of rental yields to interest rates.

The market is likely to face a shortage of premium offices in core areas in the coming year. About 530,000 sq ft of Grade-A office space is scheduled for completion on Hong Kong Island next year, 33% lower than the average take-up of 790,000 sq ft in the area over the past five years. Meanwhile, the corporate sector has been eager to expand and office demand from Mainland firms and investment banks has been robust. The supply-demand imbalance is unlikely to ease in the short term.

Grade-A office rental yields currently stand at 3.4%, compared with less than 2.8% in the luxury residential sector. The interest-rate environment remains favourable, with typical mortgage rates for Grade-A offices standing at only around 2.75%. Moreover, capital appreciation in the office sector has been lagging behind luxury residential and retail properties in the recent market rebound (see Table 1). Prices of luxury residential and prime retail premises have already surpassed their 2008 peaks, but Grade-A office prices remain 5.0% lower. The relatively high rental yields compared with mortgage rates are expected to help draw more investors to the office sector.

Some major office buildings in core districts have already seen deals marking new price-highs. We expect the trend to spread to other strata-titled buildings and Grade-A office prices to return to their 2008 peaks by the first half of next year. On the leasing side, the average rent is expected to rise 20% in 2011, after an increase of about 25% in 2010.

Table 1 Hong Kong prop	Table 1 Hong Kong property price movement							
	Previous peak	Previous trough	Change between previous peak and trough	Change from previous trough	Year-to-date growth	Change from previous peak		
Grade-A office	Feb 08	Feb 09	-48.2%	+83.5% (Oct 10)	+16.9% (Oct 10)	-5.0% (Oct 10)		
Luxury residential	Jun 08	Dec 08	-33.3%	+60.5% (Oct 10)	+14.3% (Oct 10)	+7.1% (Oct 10)		
Retail	Jun 08	Jan 09	-21.1%	+65.1% (Sep 10)	+18.8% (Sep 10)	+30.3% (Sep 10)		
Source: Knight Frank	Source: Knight Frank / Rating and Valuation Department							



Prime office report

Hong Kong's property sector is likely to benefit immensely from the second round of quantitative easing in the US.

Economic indicator	Period	Latest reading	2008	2009	2010 forecast
GDP growth	Q2 2010	+6.5%#	+2.4%	-2.7%	+4.5%
Inflation rate	September 2010	+2.6%	+4.3%	+0.5%	+1.5%
Unemployment	Three months to September 2010	4.2%#	3.6%	5.4%	4.0%
Prime lending rate	Current	5.00-5.25%	5.3%*	5.0%*	5.0%*

Provisional * HSBC prime lending rate

Office rents grew 3.2% in October—the second-largest month-on-month gain over the past 30 months.

Net effective rent			Change		Price		Change	
District	HK\$psf /mth	From Sep 10	From Jul 10	From Oct 09	HK\$psf	From Sep 10	From Jul 10	From Oct 09
Premium Central	146.7	3.4%	6.1%	40.3%	n/a	n/a	n/a	n/a
Traditional Central	99.2	3.0%	12.8%	31.1%	18,252	7.8%	12.7%	26.6%
Admiralty	71.2	3.7%	10.0%	22.2%	14,675	3.4%	6.5%	22.4%
Sheung Wan	49.1	1.7%	5.2%	23.1%	13,414	1.0%	2.7%	15.9%
Wan Chai	45.6	3.8%	7.3%	23.1%	10,741	3.3%	5.1%	11.1%
Causeway Bay	45.9	4.4%	12.9%	26.3%	11,232	2.5%	7.3%	15.1%
North Point	26.2	4.7%	9.4%	20.5%	n/a	n/a	n/a	n/a
Quarry Bay	37.6	4.6%	9.2%	14.7%	n/a	n/a	n/a	n/a
Tsim Sha Tsui	36.3	3.3%	8.4%	20.7%	9,404	0.5%	2.9%	7.2%
Cheung Sha Wan	18.2	0.0%	1.5%	26.5%	n/a	n/a	n/a	n/a
Hung Hom	23.5	0.0%	1.5%	24.8%	n/a	n/a	n/a	n/a
Kowloon East	23.1	2.0%	9.5%	25.9%	n/a	n/a	n/a	n/a
Mong Kok / Yau Ma Tei	37.7	0.0%	4.8%	17.0%	n/a	n/a	n/a	n/a

The leasing market is likely to face a shortage of premium offices in core areas in the coming year.

District	Building	Tower / floor / unit	Area (sq ft)	Tenant
Central	Citibank Plaza	n/a	Over 17,000	A financial institution
Central	Two IFC	Three floors	69,000	Bank of America
Causeway Bay	Times Square	31/F	17,000	A serviced office operator
Kwun Tong	Landmark East	35/F and part of 36/F	40,000	Shell
Sheung Wan	Vicwood Plaza	12/F and 20/F	23,800	A serviced office operator

The sales market saw a number of record-breaking deals last month.

District	Building	Floor / unit	Area (sq ft)	Price (HK\$M)	Price (HK\$psf)
Central	The Center	79/F	13,200	\$338	\$25,581
Central	Nine Queen's Road Central	33/F	13,800	\$338	\$24,600
Wan Chai	Convention Plaza Office Tower	High floor / units 10-11	2,600	\$52.6	\$20,200
Admiralty	Lippo Centre	38/F	15,300	\$300	\$19,600
Central	World-Wide House	10/F	16,700	\$300	\$18,000
Sheung Wan	Grand Millennium Plaza	26/F	15,500	\$208.9	\$13,500

RESEARCH



Americas

USA Bermuda Brazil Caribbean Australasia Australia New Zealand

Europe

UK Belgium Czech Republic France Germany Hungary Ireland Italy Poland Portugal Russia Spain The Netherlands Ukraine

Africa

Botswana Kenya Malawi Nigeria South Africa Tanzania Uganda Zambia Zimbabwe

Asia

China Hong Kong India Indonesia Macau Malaysia Singapore Thailand

Hong Kong contacts

Alan Child

Executive Chairman T: (+852) 2846 9522 E: alan.child@hk.knightfrank.com

Mark Bernard

Executive Director Commercial Agency T: (+852) 2846 4811 E: mark.bernard@hk.knightfrank.com

Xavier Wong

Director, Head of Research Research Department T: (+852) 2846 4819 E: xavier.wong@hk.knightfrank.com

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide, including developers and investors, as well as financial and corporate institutions. All recognise the need for the provision of expert independent advice, customised to their specific needs.

Our worldwide research reports are also available at www.knightfrank.com.

© Knight Frank 2010

This report is published for general information only. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no legal responsibility can be accepted by Knight Frank Research or Knight Frank for any loss or damage resultant from the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank in relation to particular properties or projects. Reproduction of this report in whole or in part is allowed with proper reference to Knight Frank Research.

