

# Office sector briefing

**Seoul, Korea**

**July 18, 2008**

**“Prime office vacancy in Seoul fell to record levels in June 2008, driving annual rental growth to a 7 year high. Despite weakening economic conditions, a continuing shortage of new supply will ensure current strength continues into 2009”**



- Overall vacancy for prime office buildings in Seoul fell to a record low of 0.6 per cent. There was no recorded vacancy in Yeouido, while vacancy rates in Gangnam and the CBD were 1.0 per cent and 0.5 per cent respectively
- Gangnam's 33,554 sq.m. Daehan Life Insurance Building was the only major completion during the quarter
- Annual growth in rents has risen to 6.8 per cent – the highest rate of increase in prime rents since 2001
- Investment activity was strong, with 7 major office building transactions totaling KRW1.3 trillion
- The medium term outlook remains positive, with ongoing supply constraints likely to ensure current favorable conditions persist over the next two years

Image: Standard Chartered First Bank, Seoul, Korea

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## Market Overview

With only one major completion during the second quarter of 2008, robust demand for prime office space saw the Seoul office market continue to strengthen. A shortage of new supply is making office expansion virtually impossible in the finance industry, with prime office vacancy in Seoul falling to a record low 0.6 per cent in the June quarter. Stiff competition for space is being increasingly reflected in rental rates, with average prime office rents in the June quarter 6.8 per cent higher than a year earlier. This is the fastest rate of increase in prime rents since 2001.

Although adverse global economic conditions are expected to have a greater impact on the Korean economy from the second half of 2008, the shortage of new supply means that current buoyancy in the office market is unlikely to be significantly affected. Moreover, with new supply relatively constrained until 2011, Savills BHP Korea expects the current pressure on vacancy and rents to persist over the next two years.

## Supply

The June quarter saw only one new prime building completed, with the Daehan Life Insurance Building (33,554 sq.m. GFA) opening in Gangnam in May. Daehan Life Insurance and Samsung Electronics occupy approximately 30 per cent and 50 per cent of the building's office space respectively, with the remaining space vacant at the end of June 2008.

### New Supply, Q2/2008 - Q3/2008

Area	Building name	GFA (sq.m.)	Floors	Completion Date	Leasing status
Gangnam	Daehan Life Insurance Seocho Building	33,554	20F/ B6F	May 2008	Owner occupied -30% / lease -70%
Gangnam	Samsung Seocho Project Building C	197,428	44F/ B8F	July-August 2008	Owner occupied -100%
CBD	Kumho Asiana New Building	60,701	29F/ B8F	September 2008	Owner occupied -100%

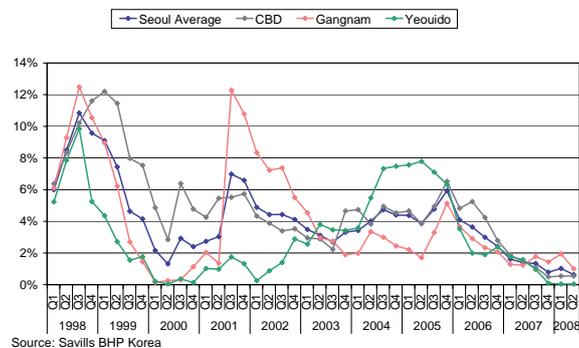
Source: Savills BHP Korea

The third quarter of 2008 will see the completion of two significant prime buildings - Samsung Seocho Project Building C (197,428 sq.m. GFA) in Gangnam and Kumho Asiana New Building (60,701 sq.m. GFA) in the CBD. Both will be fully owner-occupied, following relocation from lower grade sites, and therefore neither of these completions is expected to alleviate the current squeeze on supply.

Vacation of office space for renovation is also having an impact on overall supply through 2008/09. Renovation of the 133,000 sq.m. Daewoo Centre in the CBD has recently started, with the majority of tenants having moved out over the course of the last 9 months. The building is currently at approximately 25 per cent occupancy, but will be fully vacated by the end of the year. Reopening is currently scheduled for late 2009. Renovation of the 51,000 sq.m. Federation of Korean Industries Building in Yeouido is expected to start later this year or early next year and approximately one third of tenants had moved out by June 2008.

## Vacancy

### Prime Market Vacancy Rates, Q1/1998 - Q2/2008



Meanwhile leasing demand for existing prime office space remains strong. Net absorption has consistently outpaced new supply since the beginning of 2006, when average vacancy stood at 6 per cent. Vacancy reduced further from 1.0 per cent in the March quarter to 0.6 per cent in the June quarter – the lowest level seen since the inception of Savills' survey in 1997.

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In Yeouido, 100 per cent occupancy was recorded for the second consecutive quarter, with no major leasing transactions taking place. The vacancy rate in the CBD was also unchanged from the previous quarter at 0.5 per cent, with relatively minor leasing activity. In Gangnam the vacancy rate declined from 1.9 per cent in the March quarter to 1.0 per cent in the June quarter. Major leasing transactions included Samsung Electronics taking approximately 17,000 sq.m. of space in the newly completed Daehan Life Insurance Seocho Building, and Procter & Gamble occupying approximately 10,000 sq.m. in ING Tower.

The average monthly prime office rent in Seoul rose to KRW41,600 per sq.m. (net leasable area) in the June quarter – 6.8 per cent higher compared with the same quarter in 2007. This increase represents the fastest rate of annual rental growth since early 2001 and compares with an annual increase of 6.0 per cent in the March quarter of 2008. Across the different business districts, the rate of annual rental growth has been fastest in Gangnam at 7.7 per cent (KRW 43,300 per sq.m.), with slightly lower increases in the Yeouido at 6.4 per cent (KRW 36,100 per sq.m.) and the CBD at 6.2 per cent (KRW 42,700 per sq.m.).

## Selected Leasing Transactions, Q2/2008

Previous Location		Tenant	New Location		Approx Lease Area (sq.m.)
Gangnam	Olive Tower	Myongji Construction	CBD	Taihan Electronic Wire	N/A
Gangnam	Hansol Headquarters Building	Norske Skog	CBD	KCCI Building	2,800
Gangnam	Daechi Building, Hansin Inter-Valley 24 Building	Samsung Electronics	Gangnam	Daehan Life Insurance Seocho Building	17,200
N/A	Opening of a new branch office	Kumho Life Insurance	Gangnam	GFC	3,300

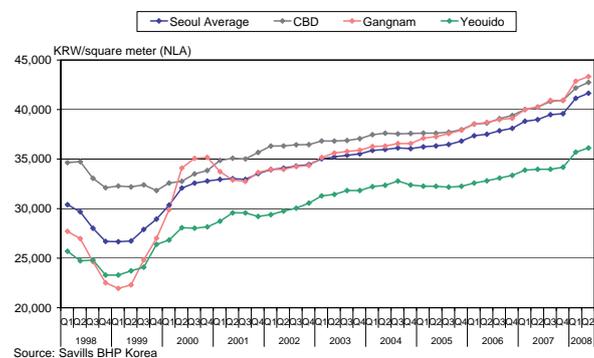
Source: Savills BHP Korea

Looking ahead to next quarter, a slight increase in the overall vacancy rate is possible given our understanding that several major tenants plan to relocate from Seoul's major business districts to outlying areas such as the Digital Media City in Mapo. However, overall conditions in the leasing market will remain tight, with vacancy rates likely to continue to hover between zero and 1.0 per cent.

## Rents

Office rental increases in Seoul have traditionally been relatively modest compared with other office markets. Many landlords have simply linked rental increases to the inflation rate – typically with one annual review scheduled in the first quarter of each year. Current historically low levels of vacancy are clearly changing this practice, with both the size and frequency of hikes in office rents increasing significantly.

## Average Prime Office Rental Rates, Q1/1998 - Q2/2008



An increasing number of buildings have been recording annual rental increases of around 20 per cent – rates of increase that were previously unheard of in the Seoul market since recovery from the Asian crisis. Looking ahead to the second half of the year we anticipate the average rate of rental increase to continue to rise, with the rate of annual increase likely to reach 8 to 10 per cent by the end of the year.

## Transactions

On the investment front, Seoul office buildings are continuing to fetch strong prices. The value of building transactions in the Seoul area during the June quarter totaled KRW 1.3 trillion – the highest quarterly total since the December quarter of 2004 (which was dominated by the sale of Star Tower for approx. KRW 930 million) and the second highest since our records began in 1997.

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Seven major office buildings were sold, with foreign real estate funds purchasing two properties and the remaining buildings bought by domestic investors and owner occupiers. The highest transaction price was recorded for the Hanwha Securities Building which was repurchased by Hanwha Securities for KRW320 billion from KOCREF 3. This price represents a sizable 130 per cent increase over the KRW140 billion Hanwha received when it originally sold the building to KOCREF in 2003 and reflects the chronic shortage of large contiguous office space confronting institutions wishing to house their operations under one roof.

## Selected Sales Transaction, Q2/2008

Building	Vendor	Buyer	Area (sq.m.)	Price (KRW bill)	Price per sq.m. (KRW mill)
Hanwha Securities Building	KOCREF 3	Hanwha Securities	59,641	320	5.4
Sindorim Prime Center	Prime Industrial	A-KOF Private REITs	92,172	300	3.3
Hanwha Non-life Insurance	Hanwha Non-life Insurance	Daehan Life Insurance	50,011	285	5.7
Bundang First Tower	AON	MAPS NPS REITs 1	58,924	215	3.6
Pantech R&D Centre	Pantech	Ostara Korea C9 CR REITs	66,649	200	3.0

Source: Savills BHP Korea

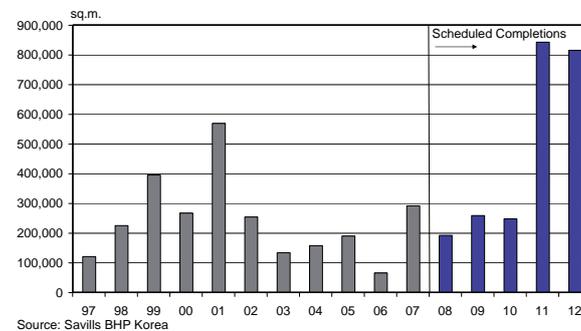
Other transactions of note were AON's sale of Bundang First Tower to MAPS NPS REITs 1 for KRW215 billion, and Pantech's sale of the Pantech R&D Centre to Ostara Korea C9 CR REITs for KRW200 billion. Both of these properties are located outside of the key business districts in Seoul, and their sale is indicative of broadening investor interest beyond central Seoul as the effects of tight conditions in the city centre spillover into surrounding areas.

At a time when global property markets are under severe stress, ongoing brisk activity in the Korean market suggests that investors remain confident in the underlying strength of the commercial property sector. It remains to be seen whether this positive sentiment will continue in the face of deteriorating economic conditions.

## Medium Term Outlook

Supply dynamics will continue to dominate market conditions over the medium term. According to the Savills BHP Korea survey of construction activity, pipeline supply is relatively constrained until 2011. Thus, although broader economic factors may dampen recently vigorous demand growth for premium space in the near term, we expect vacancy rates to remain at historically low levels over the next two years. Together with the high inflation outlook, ongoing scarcity in prime office space means that annual rent increases could reach up to 10 per cent over the next two years.

## Net Increase in Seoul Prime Office Stock, 1997 - 2012



Further out, the unprecedented swathe of prime office developments currently scheduled to come on line from 2011 will have a major impact on the market. To give a broad indication of the overall scale of this new supply, we estimate that scheduled prime additions in 2011 and 2012 are equivalent to roughly one quarter of the current total stock of Seoul's prime office space. In terms of distribution across the different Seoul business districts, roughly 35 to 40 per cent of this new space is planned for the CBD and Yeouido respectively, with the remaining 25 per cent to be located in Gangnam.

Although it is too early to be definitive, we consider that increases of this magnitude within the next four years will lead to substantial rises in vacancy rates and a corresponding negative impact on rental levels. However, in anticipation of such a scenario, it is possible that a number of currently scheduled pipeline projects may be deferred or cancelled. Developments over the coming year will be telling in this regard.

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## The Seoul Office Market

Close to 80 per cent of large office buildings (30,000 sq.m. or more) in Seoul are concentrated in 3 major business districts – the CBD, Gangnam and Yeouido. The CBD is the largest of these districts and is home to major government and multinational institutions. Gangnam also houses many multinational companies and is an Information Technology Centre. Yeouido, the “Wall Street” of South Korea, includes the headquarters of major securities firms and broadcasting companies.

## Description of Savills BHP Korea Office Survey & Definition of Terms

The Savills BHP Korea Quarterly Office Survey is the longest running survey of prime office stock in Seoul. Established in 1997, the survey currently comprises 81 of the 122 buildings in Seoul classified as “prime” buildings.

- Prime buildings: Buildings with greater than 30,000 sq.m. gross floor area, good accessibility, high quality facilities and finish, and creditworthy tenants

- Monthly rent: Surveyed rents are “face rents”, the asking rents reported by landlords for mid-level floors. These rents are standardized by Savills BHP Korea to account for variations in the security deposits required by different landlords to produce an effective rental figure for net leasable area
- Net absorption: The net change in occupied space over the quarter

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