Office Sector Briefing

Seoul, Korea — February 6, 2009

"The impact of the economic crisis on Seoul's office market has been dramatic, with prices falling an estimated 30 per cent since September 2008. However, despite an easing in leasing demand, low vacancy rates saw rents continue to rise in Q4/2008 - a unique outcome in the Asian region."

- The global economic slowdown has had a major impact on the Korean economy, with Q4/2008 economic growth contracting at the fastest rate seen since the Asian Financial Crisis.
- There has been a sharp fall in prices, with sales transaction volumes also dropping. The bleak economic outlook means a significant recovery in prices is unlikely to occur during 2009.
- The leasing market has also been affected, with easing demand causing average vacancy rates to rise from a record low of 0.3 per cent in Q3/2008 to 1.1 per cent in Q4/2008.
- Despite weaker market conditions, rents continued to increase in Q4/2008, up an average 7.6 per cent on Q4/2007 – the fastest rate of increase since 2001.
- Current tight conditions in the leasing market, together with a lack of new supply, mean the average vacancy rate is unlikely to rise much higher than 5 per cent in 2009. This will help to ensure rents remain relatively stable over the year ahead.

Image: Gyeongbok Palace, Seoul, Korea

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Market Overview

The credit crisis and associated economic slowdown had a marked impact on Seoul's prime office market in Q4/2008. Sales activity was thin, but market prices for office buildings appear to have fallen around 30 per cent from their peak in Q3/2008. The average vacancy rate for leased prime office buildings, which fell to a record 0.3 per cent in September, rose to 1.1 per cent at the end of December 2008. However, in contrast to virtually all other major markets around the world, prime office rents continued to rise, with the annual rate of growth reaching 7.6 per cent in Q4/2008.

Seoul Prime Office Market Summary Table, Q4/2008

Business District	Rent (KRW/ sq.m.gross leasable area)	Rent (KRW/ sq.m. net leasable area)	Increase compared with Q4/2007	Vacancy Rate
CBD	25,800	43,600	6.4%	1.5%
Gangnam	23,000	44,500	8.6%	0.7%
Yeouido	17,900	37,000	8.5%	1.3%
Average	23,200	42,600	7.6%	1.1%

Source: Savills Korea

Grim economic conditions are forecast to persist through 2009 and will continue to adversely affect the office market. With financial markets remaining tight and the real economy weak, prices for office buildings are unlikely to recover significantly in the near future. In terms of the leasing market, declining employment levels will inevitably lead to further increases in vacancy rates. However, vacancy rates are unlikely to spike up to the levels expected in most other major markets. Seoul's prime office vacancy rate remains the lowest of all major Asian cities, and new leasable supply in 2009 is limited. These factors are likely to keep average rents relatively stable over the year ahead – a unique situation among property markets around the world.

Prime Office Leasing Demand & Vacancy

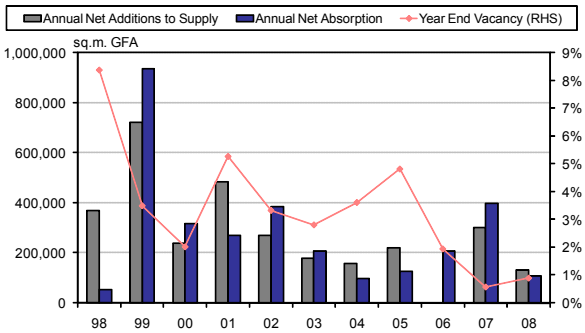
The economic downturn led to a softening in demand for leased prime office space over Q4/2008. The major tenant movements during the quarter related to Samsung Electronics' occupation of their new headquarters (196,507 sq.m., completed in Q3/2008) in Gangnam, with the most substantial relocation being from Samsung's previous headquarters in the CBD ("Samsung Main Building"). This building is currently being renovated and will be occupied from mid-2009 by Samsung Securities and Samsung Card, which are currently located in Jongno Tower and Samsung Card Building respectively.

Q4/2008 also saw a growing number of tenants relocate from prime buildings to more economical office space. One of the largest examples was Sky Life, which vacated approximately 4,500 sq.m. in the SC First Bank Building (CBD) to move to the KT District Office in Mokdong.

This trend of 'downgrading' to cheaper space, together with a few cases of downsizing, contributed to the rise in the average vacancy rate across leased prime buildings from a record low of 0.3 per cent in Q3/2008 to 1.1 per cent at the end of December 2008. This represents an increase of approximately 37,000 sq.m. in prime office space currently available for lease.

Of the three main business districts, both the CBD and Yeouido saw vacancy rates increase by 1.3 percentage points, to 1.5 and 1.3 per cent respectively. The emergence of vacancy in Yeouido followed three consecutive quarters of 100 per cent occupancy. In Gangnam, the rise in vacancy was more moderate, up to 0.7 per cent from 0.6 per cent in Q3/2008.

Seoul Prime Office Market: Net Increases in Supply, Net Absorption & Vacancy, 1998-2008



Source: Savills Korea

For 2008 as a whole we estimate net absorption of prime office space, including owner occupied buildings, at just over 100,000 sq.m. This is the second lowest level annual net absorption since 1998, a consequence of the small quantity of new supply provided over the year and the withdrawal of two large buildings - the 133,000 sq.m. Seoul Square building (former Daewoo Center), for renovation; and the 51,000 sq.m. Federation of Korea Industries Building, for reconstruction.

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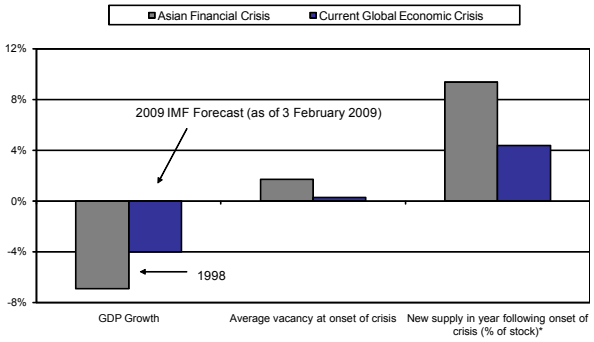
Outlook

Our survey of landlord expectations indicates that more vacant space is likely to become available over the coming months as companies look to downsize and/or move to cheaper offices. However, for the year ahead, we consider it unlikely that average vacancy will rise much above 5 per cent, a critical level for rent setting. The two key factors underlying this prediction are: (i) at 1.1 per cent, current vacancy is still at very low levels; and (ii) there is only one fully leasable addition to the prime stock - Seoul Square (former Daewoo Center) in 2009. This situation contrasts strongly, for example, with the situation following the Asian Crisis in 1997/1998, which is the last time the average prime office vacancy rate rose significantly above 5 per cent, peaking at nearly 11 per cent in Q3/1998. At the onset of the crisis, average vacancy was already 1.7 per cent (compared with 0.3 per cent in Q3/2008) and new building completions saw the total prime stock expand by almost 10 per cent in the year between the beginning of the crisis and the peak in vacancy in Q3/1998.

Economic Growth, Vacancy & New Supply Comparisons with the 1997/98 Asian Financial Crisis



Source: Savills Korea, Bank of Korea, Consensus Economics

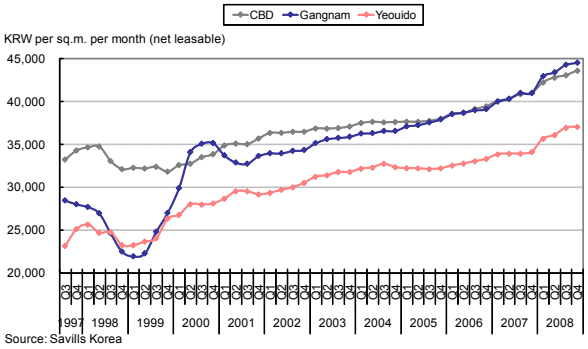
* Comprises Samsung Electronics' HQ Building (Q4/2008), Seoul Square (Q4/2009)

Prime Office Occupancy Costs

Rents

Despite a softening in demand since September, the persistent underlying shortage in prime office space saw rents continue on an upward trend into Q4/2008. Increases in office rents are traditionally rare towards the end of the year. However, rents rose in nearly 15 per cent of surveyed prime buildings in Q4/2008, compared with 5 per cent of buildings in Q4/2007. There were no reported cases of rent cuts across the 81 prime buildings surveyed. As a result, the average rent in Q4/2008 was 0.8 per cent higher than in Q3/2008 and 7.6 per cent higher compared with Q4/2007.

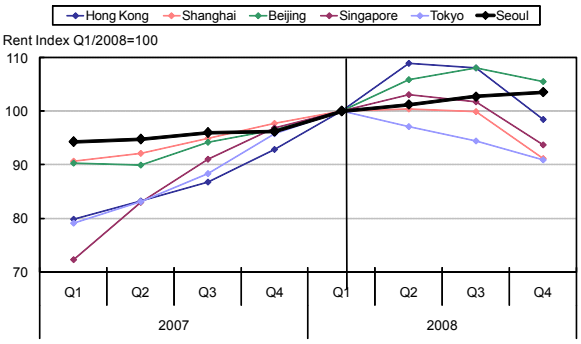
Prime Office Building Rents, Q3/1997–Q4/2008



Source: Savills Korea

The rate of rent increase continues to be highest in Gangnam and Yeouido, at 8.6 and 8.5 per cent respectively, compared with Q4/2007. Rental growth continues to be lower in the CBD, however some strong increases during Q4/2008 saw the annual rate of increase pick up from 5.4 per cent in Q3/2008 to 6.4 per cent in Q4/2008.

Regional Prime Office Rental Movements, Q1/2007 - Q4/2008



Source: Savills Research & Consultancy

Outlook

Consistent with landlord rent-setting behaviour in Q4/2008 and our expectation that vacancy rates will remain relatively low, we forecast rents to be stable over the year ahead. However, landlords are likely to consider offering more favorable terms and conditions to attract tenants, such as rent-free periods, as recent extremely tight leasing market conditions subside. Periods of absolute decline in average rents have been uncommon in Seoul's 3 main business districts, having only occurred when vacancy rates have been above 5 per cent. Most landlords conduct their major rent reviews once a year, usually in the first quarter, and our survey of landlord expectations indicated that many planned to implement rent increases of more than 5 per

cent in Q1/2009. This outlook contrasts with the sharp falls in rentals already occurring in other office markets around the world.

Maintenance Fees

Maintenance fees have continued to increase broadly in line with CPI inflation, up 5.5 per cent on average in Q4/2008 compared with the same period in 2007. By business district, average maintenance fees were up 6.7 per cent in Yeouido, 5.4 per cent in the CBD, and 4.8 per cent in Gangnam compared with Q4/2007.

Sales and Investment Activity

With the global financial crisis causing a dramatic tightening in credit markets and a high degree of uncertainty regarding the market outlook, there were only three major office building transactions during Q4/2008, in contrast to brisk levels of activity in the previous two quarters. Notably, the three buildings which were sold were all purchased by local corporates for their own use. An additional transaction, the sale and leaseback of Kumho Life Insurance Building in the CBD, was announced early in the new year. The buyer, JR AMC, is a local investment company.

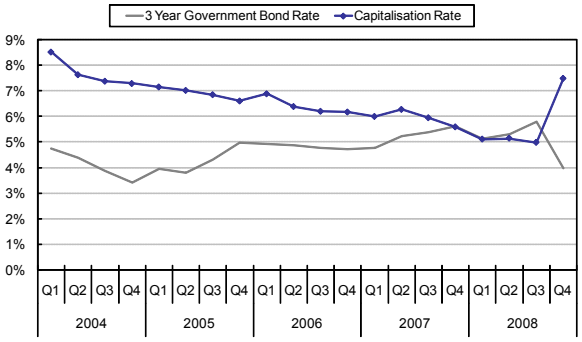
Selected Seoul Office Market Sales Transactions, October 2008 - January 2009

Building	Vendor	Buyer	Area (sq.m. GFA)	Price (KRW bill)	Price per sq.m. (KRW mill)
Mesa	ARA	Shinsegae	44,500	175	3.9
Samsung Card	ING Korea Property Investment	Hyundai Group	52,500	197	3.8
Naewei	GE Real Estate/Korea National Pension Fund	GyoKumon (private education institution)	29,400 (90% of total GFA)	134	4.6
Hohye	GE Real Estate	Alpha Mighty Private REIT 12	9,300	20	2.1

Source: Savills Korea

Although the number of completed transactions has been limited, a sharp shift in market pricing is clearly visible, with the Naewei and Kumho Life Insurance buildings (prime buildings) selling at prices approximately 30 per cent lower than their estimated value pre-September 2008. The sale of both of these buildings was reported as being related to financial liquidity pressures faced by the vendors. Reflecting this decline in prices, we estimate the average cap rate for prime buildings to have moved out from around 5 per cent in Q3/2008 to 7.5 to 8 per cent at the end of the year. Investors' "flight to quality" also appears to have led to a widening of the spread in cap rates according to building grade.

Seoul Prime Office Building Cap Rates vs Bond Rate Movements Q1/2004 - Q4/2008



Source: Savills Korea, Bank of Korea

Outlook

There appear to be conflicting forces acting on the outlook for prices. On the upside, there are tentative signs that the worst may be over in terms of the credit squeeze and that banks are becoming willing to lend again, albeit still at a considerable spread above risk-free rates. In addition, the sharp fall in prices, accentuated by the weak Korean won, is generating growing interest among both foreign and domestic investors. These developments should help to create a floor under current market pricing.

On the other hand, the economic outlook has continued to worsen and a recovery in 2009 looks increasingly unlikely. This raises the prospect of the current easing in lending conditions being short-lived and of additional distressed sellers coming onto the market. Indeed, until there is evidence of a solid recovery in the broader economy, it unlikely that there will be any significant recovery in prices.

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Overview of 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 Korea Office Survey & Definition of Terms

The Savills Korea Quarterly Office Survey is the longest running survey of prime office stock in Seoul. Established in 1997, it currently comprises 81 of the total 123 buildings in Seoul classified as "prime" buildings.

- Prime buildings: Buildings with a gross floor area greater than 30,000 sq.m. gross floor area, good accessibility and facilities, a high level of finishing materials, 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 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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