

Office Sector Briefing

Seoul, Korea

April 8, 2009

“Fallout from the economic crisis saw the sharpest quarterly contraction in office leasing demand in Q1/2009 since the Asian Financial Crisis. Nevertheless, with vacancy still at historically low levels, rents have continued to rise.”



- Korea's economic recession caused a sharp fall in office demand over Q1/2009.
- Vacancy for prime office buildings in Seoul rose from 1.0 per cent in Q4/2008 to 2.2 per cent in Q1/2009.
- Average rents continued to rise, although the rate of increase slowed to 4.9 per cent compared with a year earlier, down from an 8 year high of 7.7 per cent in Q4/2008.
- Sales activity over Q1/2009 provided confirmation of the fall in prices seen toward the end of last year, with transaction prices down by up to 30 per cent compared with the peak in Q3/2008.
- Weak economic conditions will mean continuing declines in demand for office space through 2009. Resulting increases in vacancy will bring an end to current rent increases, but a sharp decline in rents is not expected.

Image: 'Hanok' Korean traditional house

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Market Overview

The impact of the current economic recession on Seoul's office leasing market has become increasingly visible. Average vacancy rose from 1.0 per cent in Q4/2008 to 2.2 per cent in Q1/2009 - its highest level since 2006. Although average rents continued to rise, higher vacancy saw a moderation in the rate of increase compared with 2008. Meanwhile, sales activity in the New Year provided confirmation of a sharp drop in prices.

Seoul Prime Office Market Summary Table, Q1/2009

Business District	Rent (KRW/ sq.m. gross leasable area)	Rent (KRW/ sq.m. net leasable area)	Increase compared with Q1/2008	Vacancy Rate
CBD	26,100	44,000	4.3%	1.8%
Gangnam	23,100	44,900	4.6%	2.4%
Yeouido	18,300	38,000	6.6%	2.8%
Average	23,500	43,200	4.9%	2.2%

Source: Savills Korea

With no sign of improvement in economic conditions in the near term, leasing demand will continue to decline through 2009. Moreover, vacancy rates will rise more quickly in the second half of the year as two large buildings in the CBD are reopened following renovation. Higher vacancy will inevitably put downward pressure on rents, with some decline in average rental levels now likely by the end of the year. These developments will continue to weigh on prices, with a recovery in 2009 unlikely.

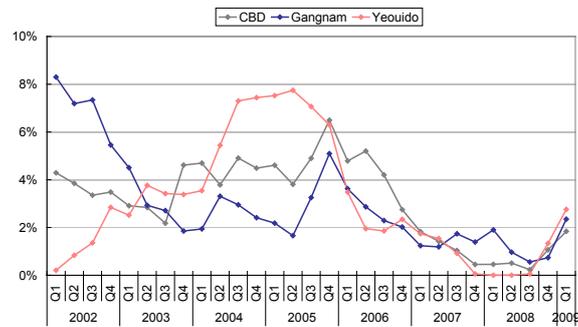
Prime Office Building Supply

Construction of the 124,600 sq.m. LG Electronic Seocho Research and Development Center, located approximately 4 km south of Tehran Road in Gangnam, was completed in Q1/2009. The Center has been fully occupied by LG Electronics, with the majority of new occupants having relocated from buildings in regional areas Gasan, Woomyeondong, and Bundang. The exception was relocation of staff from 6.5 floors (approximately 23,000 sq.m.) in GS Tower in Gangnam. Most of this vacated space has subsequently been filled by GS Construction, following relocation from several offices in the CBD.

Two buildings will be added to the CBD's prime stock later this year when renovations (begun last year) of the 83,600 sq.m. Samsung Main Building and 132,900sq.m. Seoul Square (former Daewoo Center) are completed in mid and late 2009 respectively. Together, these two buildings amount to 3 per cent of Seoul's total prime stock (including owner-occupied buildings).

Prime Office Leasing Demand & Vacancy

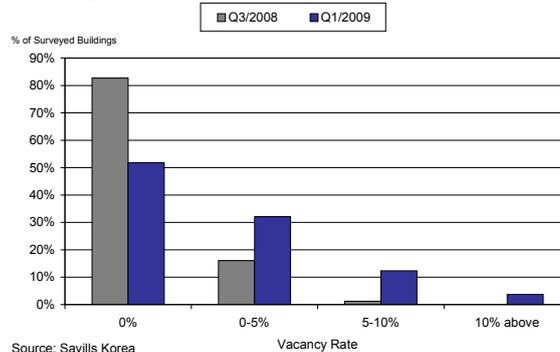
Seoul Prime Office Vacancy Rates, Q1/2002-Q1/2009



Source: Savills Korea

Leasing demand softened in the New Year, with overall vacancy rising from 1.0 per cent in Q4/2008 to 2.2 per cent in Q1/2009. This rise in vacancy resulted from the largest quarterly decline in occupied leasable office space – approximately 60,000 sq.m. – seen since the Asian Financial Crisis. Gangnam and Yeouido were most affected, with average vacancy rising from 0.7 per cent and 1.3 per cent to 2.4 per cent and 2.8 per cent respectively. The rise in vacancy was more modest in the CBD, from 1.1 per cent to 1.8 per cent.

Distribution of Vacancy Across Surveyed Prime Buildings, Q3/2008 & Q1/2009



Source: Savills Korea

We estimate that close to half of the overall increase in vacancy was caused by restructuring of firms in the finance and insurance industries, particularly the downsizing of life insurance companies. In Gangnam, where the financial sector is less dominant, the rise in vacancy was driven by tenants relocating out of prime buildings to smaller, cheaper premises. One significant example of this was the relocation of Hansol Construction from Capital Tower (approx 5,900 sq.m.) to Samsung Life Bangidong Building in Jamsil.

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Nevertheless, while rising rapidly, vacancy remains relatively concentrated. Almost 40 per cent of the total current vacant space across surveyed buildings is accounted for by only five buildings and half of surveyed buildings still report full occupancy.

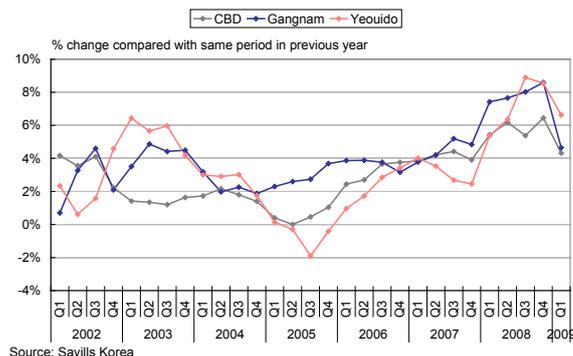
Outlook

Vacancy rates will rise further over the year ahead due to ongoing weak demand and the impact of new supply. The effects of new supply will be mostly confined to the CBD, where vacancy could reach as high as 10 per cent by year-end, largely as a consequence of the reopening of Samsung Main Tower and Seoul Square (former Daewoo Center). Samsung Main Tower will reopen in mid-2009 and be occupied by Samsung Securities and Samsung Card, which are currently located in Jongno Tower and Samsung Card Building respectively. Seoul Square will reopen in November 2009 and will be 100 per cent leased.

Prime Office Occupancy Costs

The effects of softening demand on rent levels became clearly visible in Q1/2009. Although overall average rents increased compared with the previous quarter, by 1.3 per cent, the annual rate of increase decreased for the first time since 2007, falling from 7.7 per cent in Q4/2008 to 4.9 per cent in Q1/2009.

Seoul Prime Office Building Rental Growth, Q1/2002 – Q1/2009



The CBD and Gangnam saw the greatest slowdowns in rental growth, with rents rising 4.3 per cent and 4.6 per cent respectively compared with a year earlier. At 6.6 per cent, annual rental growth was surprisingly strong in Yeouido given vacancy there has risen the most across the three business districts.

The first quarter of each year usually sees the largest increases in rents as landlords undertake their regular annual rent reviews. In Q1/2009, 30 per cent of buildings signed new contracts with rents at a higher level than in the previous quarter, compared with 60 per cent of buildings in Q1/2008. A number of other buildings raised their marketing rents from Q4/2008 levels early in Q1/2009, only to reduce them to the Q4/2008 level in the face of weak demand. Only one building in the survey sample reduced its marketing rent compared with the previous quarter.

Anecdotally, recent leasing transactions have seen the re-emergence of rent-free and other favorable conditions which were previously absent due to tight market conditions. In some cases these conditions may reduce effective rents by up to 10 per cent. Such reductions are not captured in our overall rental indices.

Outlook

Although we do not expect to see sharp declines in rents this year of the magnitude currently taking place in other office markets around the region, a softening towards the end of the year looks increasingly likely as vacancy continues to move up. Some discounting of rents later in the year is particularly likely in the CBD as new supply increases pressure on landlords to secure tenants.

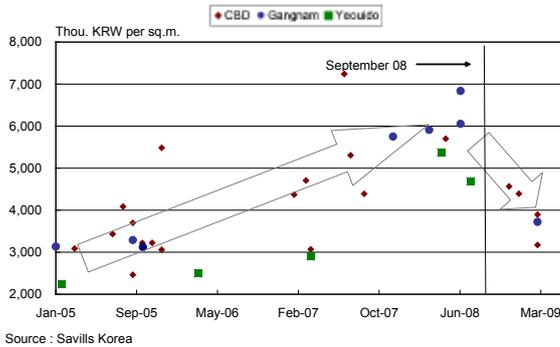
Sales and Investment Activity

Sales activity over Q1/2009 provided confirmation of the decline in prices that was seen in Q4/2008, with cap rates for transacted Seoul office buildings averaging around 7 to 8 cent. This compares with average cap rates of between 5 to 6 per cent for prime buildings sold over the first three quarters of 2008, and is consistent with a decline in prices of up to 30 per cent from the peak in Q3/2008.

There have been no transactions of 'landmark' quality buildings since Q3/2008 and therefore current market pricing for these buildings remains uncertain. However, given current investor 'flight to quality' the correction in prices for higher grade buildings is unlikely to have been of the magnitude seen for buildings transacted over the last 6 months.

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Transaction Prices for Large Office Buildings in Seoul, January 2005 - March 2009



In terms of major transactions, Kumho Life Insurance sold the Kumho Life Insurance Building in a sale-and-lease back transaction to a domestic investor, JR CR-REIT 1, following reported financial liquidity pressures. The deal was announced in early January and was closed recently. REIT fund expiry led to the sale of the YTN building to YTN (a local broadcasting company) through a buy-back option, and of the Platinum Building to KTB Confidence Private Real Estate Investment Trust. Notably, a number of foreign investors were actively involved in the bidding for both of these REIT owned properties. In late March, SK E&C sold their headquarters in the CBD in a sale-and-leaseback transaction to MPlus Private Real Estate Investment Trust 1.

Outlook

Looking forward, deteriorating leasing market conditions together with ongoing economic weakness will likely prevent any meaningful recovery in prices during 2009. Indeed, further declines over the coming months cannot be ruled out. However, improvement in lending conditions is helping to stimulate investor demand and to bring deal closures, and we expect this trend to continue over coming months. Foreign interest in the Seoul market has increased, and persistent weakness in the Korean won continues to make pricing even more attractive for investors with foreign currency.

Selected Seoul Office Market Sales Transactions, January – March 2009

Building	Vendor	Buyer	Area (sq.m. GFA)	Price (KRW bill)	Price per sq.m. (KRW mill)
YTN	KOCREF CR-REIT IV	YTN	42,322	165	3.9
Kumho Life Insurance	Kumho Asiana Group	JR CR-REIT 1	54,672	240	4.4
SK E&C	SK E&C	MPlus Private Real Estate Investment Trust 1	33,409	106	3.2
MIES	KTB Confidence Private Real Estate Investment Trust 9	Yeonho Electronics	12,918	55	4.2
Platinum	KOCREF CR-REIT IV	KTB Confidence Private Real Estate Investment Trust 28	37,182 (70% transacted)	95	3.6
Gangnam Mirae Asset	Mirae Asset Capital	Private Buyer	21,636	89	4.1

Source: Savills Korea

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Overview of Seoul Office Market & Savills Korea Office Survey

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.

Summary of Surveyed Buildings, March 2009

		CBD	Gangnam	Yeouido	Total
A	Number of Buildings	13	13	5	31
	Average GFA (sq.m.)	74,764	99,463	91,073	87,752
	Average Completion year	1996	1999	1994	1997
B	Number of Buildings	22	17	11	50
	Average GFA (sq.m.)	46,540	39,785	43,883	43,659
	Average Completion year	1991	1996	1994	1993
	Total Number of Buildings	35	30	16	81
	Total Area (sq.m.)	1,995,810	1,969,355	938,082	4,903,247

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 122 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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