Offices

April 20, 2010

"Demand for office space is improving, with vacancy dropping in Q1/2010 from its previous 8 year high while rents are rising slightly. On the other hand, the investment market has been relatively quiet to date compared with 2009, with investment deals taking a longer time to conclude due to the gap between vendor and buyer price expectations."

Image: A view of Seoul

- An increase in leasing demand across all the major office districts saw net absorption turn positive in Q1/2010 for the first time since Q3/2008, reducing the average vacancy rate to 6.2 per cent from 7.7 per cent at the end of 2009.
- Reflecting wider economic growth, leasing demand is expected to continue to recover through 2010, however, new supply will largely offset the impact on vacancy.
- Although the leasing market remains challenging, average face rents rose by 1.1 per cent on the previous quarter. Effective rents have also stabilised.
- Following strong activity levels in 2009, the investment market was relatively quiet in Q1/2010, with only two major transactions concluded during the quarter.

Offices

1. Market Overview

Consistent with Korea's rapid economic rebound in 2009, office leasing demand is clearly showing signs of recovery with net absorption for prime buildings turning positive in Q1/2010 for the first time since Q4/2008. Average vacancy reduced sharply to 6.2 per cent in Q1/2010, down from 7.7 per cent at the end of 2009. The turnaround is largely being driven by a revived financial and insurance sector, which had previously driven the downturn in demand. After flat-lining through most of 2009, average face rents edged up in Q1/2010, although the vast majority of landlords chose to leave rents unchanged, with the leasing environment still challenging.

Seoul Prime Office Market Summary Table, Q1/2010

Business District	Monthly Rent (KRW/3.3058 sqm Gross leased Area)	Monthly Rent (KRW/3.3058 sqm Net leased Area)	Rent Increase rate compared with Q1/2009	Vacancy Rate
CBD	88,500	153,000	1.1%	11.7%
Gangnam	78,200	152,400	1.2%	2.9%
Yeouido	62,800	132,700	3.2%	2.2%
Average	79,500	148,800	1.6%	6.2%

Source: Savills Korea

Despite strengthening demand, Seoul's vacancy rate is anticipated to fluctuate through 2010 due to new building completions, mainly in the CBD and Gangnam. Later in the year, large-scale expansion/ relocation by the LG Group, due to its Yeouido HQ refurbishment, is set to take up approximately half of all new office space supplied in 2009 and 2010, which should temporarily reduce overall vacancy to below 5 per cent. In 2011, new completions will see an increase in total prime office space equivalent to approximately 10 per cent of current stock, which will inevitably see vacancy rise again and restrain the scope for further rental increases.

The transaction market rebound which occurred in 2H/2009 appears to have paused, with only two significant office building deal closures since December. A number of transactions which were expected to close have failed to complete and some of these properties have since been withdrawn. Notably, all of the deals concerned were in secondary locations and/or perceived to involve other substantive risks. In contrast, core located, stabilized stock which has more recently come to market is again attracting high levels of investor interest. It is widely expected that pricing for this type of product will remain at or below 6 per cent cap rate levels.

2. Prime Office Building Supply

In Q1/2010 two prime office buildings were completed in Seoul: Jeongdong Building (CBD), the GFA of which has increased from 18,500 to 39,000 sqm after 20 months of reconstruction; and Samsung Life Insurance's building in Samseong-dong, Gangnam. Both buildings are available for lease from Q2/2010 and therefore are yet to be included in Savills' survey data. In the case of Jeongdong Building, the project is known to be approximately 60 per cent pre-leased, with the Korea Institute for Curriculum and Evaluation (currently located in a secondary building in CBD) accounting for the majority of the space taken up.

Buildings Supplied, Q1/2010

Date	District	Building Name	GFA (Sqm)	Floors
Mar	CBD	Jeongdong Building	39,144	20F/B5F
Mar	GBD	Samseong-dong Building	30,648	17F/B8F

Source: Savills Korea

The Samseong-dong building is the first prime building to be developed in Gangnam since Samsung Seocho Tower in April 2008 and will take in its first occupant in May.

New Buildings to be Completed in Q2/2010

Date	District	Building Name	GFA (Sqm)	Floors
Jun	CBD	L Tower (former Namsan Tra-Palace)	41,709	28F/B6F
Jun	CBD	Ferrum Tower	55,669 (40% planned for owner-occupancy)	28F/B6F

Source: Savills Korea

Q2/2010 will also see significant new supply with the completion of L Tower (formerly Namsan Tra-Palace) and Ferrum Tower. L Tower will house the offices of LG Telecom, LG Dacom and LG Powercom, consolidating current operations located across the city center and sub-centers. Ferrum Tower is being developed by Dongkuk Steel Mill and about 40 per cent of its total space as been pre-allocated for the owner's use. The remainder of the building is being marketed for lease, with some space understood to have been leased to a shipping company currently occupying premises in the CBD.

Offices

Posco E&C Towers, developed by New Songdo City (a joint venture by POSCO E&C and Gale International) in the Songdo International Business Complex, are expected to be completed in June. Posco E&C, which is currently leasing 100 per cent of the Daeryung Gangnam Tower (33,000 sqm), as well as part of the KTB Network Building in Gangnam, will occupy one of the two towers, while the other is being pitched to attract tenants.

New Buildings to be Completed in Songdo, Q2/2010

Date	District	Building Name	GFA (Sqm)	Floors
Jun	Song-do	Posco E&C Tower	149,217 (50% allocated for owner-occupancy)	39F/B5F (2 buildings)

Source: Savills Korea

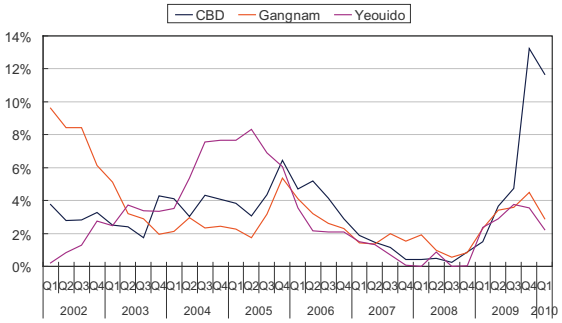
Looking further ahead, a number of large office projects are due for completion through to mid 2011, most notably the 168,000 sqm Center One Building in the CBD and the 88,000 sqm One IFC Building in Yeouido. All up, the total prime office stock is expected to grow by just over 10 per cent during the next 18 months.

3. Prime Office Leasing Demand & Vacancy

Following an unprecedented five consecutive quarters in negative territory, net absorption turned positive in Q1/2010 to register approximately 80,000 sqm. The growth in occupied space largely reflects a turnaround in the financial and insurance sector, which had previously been the key driver of rising vacancy rates due to branch closures/consolidations etc. The expansion mirrors labor market trends, with finance and insurance employment having now almost returned to pre-crisis levels following a 10 per cent drop to mid 2009.

The return to positive net absorption, together with the impact of some temporary stock withdrawals and resulting relocations, drove down the overall average vacancy rate from an 8 year high of 7.7 per cent in the previous quarter, to 6.2 per cent at the end of March 2010. While the ratio of fully occupied buildings has remained the same, the number of buildings with a vacancy rate of over 15 per cent fell from 13 to 8.

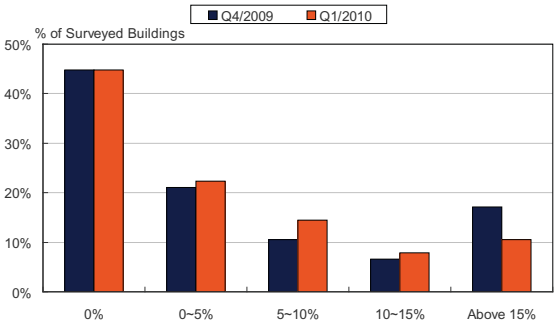
Seoul Prime Office Vacancy Rates, Q1/2002 – Q1/2010



Source: Savills Korea

The decline in vacancy rates was relatively uniform across business districts at approximately 1.5 percentage points compared with Q4/2009. In the CBD, newly leased space in Seoul Square (which reopened in November 2009) was equivalent to approximately half of the overall decline in vacancy. In particular, LG Electronics took up 3 floors after relocating from the LG Twin Towers in Yeouido, which will be 50 per cent vacated for refurbishment from September 2010. The Korea National Open University and the Goethe Institute also relocated to Seoul Square, due to the remodeling of their respective buildings at Hyehwa-dong and Namsan. Approximately 50 per cent of Seoul Square's total office area is now occupied, with most of the remainder to be taken up by LG Group later in the year.

Distribution of Vacancy Across Sampled Prime Buildings, Q1/2010



Source: Savills Korea

The decline in vacancy rates in Gangnam and Yeouido, to 2.9 per cent and 2.2 per cent respectively, was largely driven by the expansion of financial institutions.

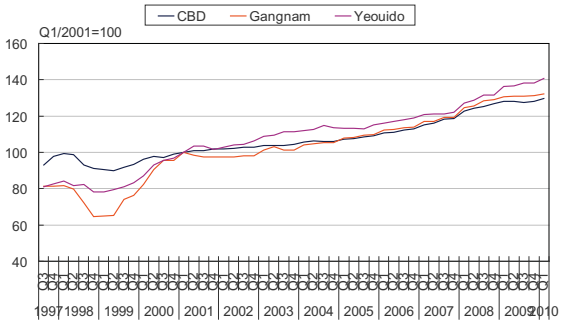
Offices

Outlook

While leasing demand is expected to continue to rise in line with Korea's wider economic recovery, Seoul's vacancy rate is anticipated to fluctuate through 2010 due to new building completions, mainly in the CBD and Gangnam. There will also be an indirect impact from the completion of Posco E&C's buildings in Songdo due to Posco's relocation there from Gangnam. Later in the year, large-scale expansion/ relocation by the LG Group due to its HQ refurbishment is set to take up approximately half of total new office space supplied in 2009 and 2010, which should see overall vacancy temporarily fall to below 5 per cent. However, this will subsequently be more than offset by the impact of the Center One, One IFC, and other developments, which are expected to be available for occupation in early 2011, suggesting that overall vacancy is likely to remain between 5 and 10 per cent over the medium term.

4. Prime Office Occupancy Costs

Seoul Prime Office Building Face Rents, Q3/1997 - Q1/2010

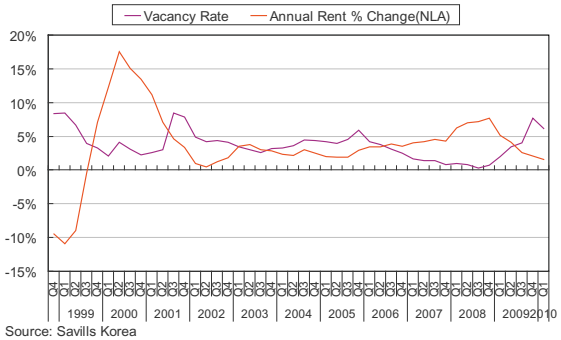


Source: Savills Korea

Following a period of essentially no movement through most of 2009, face rents edged up in Q1/2010 by an average of 1.1 per cent. However, within the context of Korean building owners traditionally undertaking their rent reviews in the first quarter of each year, the rise was relatively modest by historical standards. Nearly 80 per cent of building owners did not change their rents, and the quarterly increase was actually lower than what occurred in Q1/2009, during the height of the financial crisis. In addition to existing vacancy, the competitive pressure from pre-leasing campaigns for buildings under construction is clearly affecting rent setting behaviour.

In terms of effective rents, tenant incentives (principally rent-free periods) seem to have stabilized at an average of 1 month per year, with some variation according to building grade and location. With the pressure from new supply set to continue, rent increases are likely to remain modest through the rest of 2010.

Seoul Prime Office Building Rental Growth & Vacancy, Q4/1998 - Q1/2010

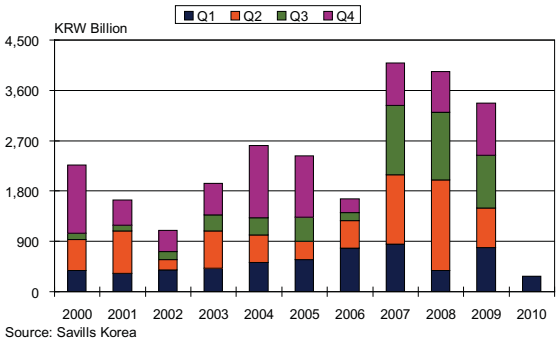


Source: Savills Korea

5. Sales & Investment Activity

The investment market was far more active than expected in 2009, despite the confusion in the financial sector, but has been relatively quiet to date in 2010. A number of transactions which were expected to close have failed to complete and some of these properties have since been withdrawn from the market. Notably, all of the deals concerned were in secondary locations and/or were perceived to involve other substantive risks.

Major Office Building Transaction Volumes, Seoul Metropolitan Area, 2000 - Q1/2010



Source: Savills Korea

*Note: The transaction of Samsung Headquarters Building has not been included in this chart given that the building was not transacted at 'arms length'.

Offices

The most significant transaction to close was the Jeongdong Building. The building had been under negotiation since 1H/2009 and was eventually sold to Samsung Asset Investment, the third investor to negotiate for the building acquisition, for slightly over KRW15 million per 3.3 sqm.

Another significant transaction involved a development project on the fringe of CBD, which was sold to Pungsan, a Korean manufacturing company. The building is understood to have sold for KRW94.9 billion on the condition that Pungsan should pay total additional costs estimated at KRW50 to KRW60 billion up until its completion in November 2011. Pungsan is expected to occupy around 30 per cent of the building.

Selected Office Market Sales Transactions, Q1/2010

Building	Vendor	Purchaser	Total Area (sqm)	Transaction Amount (KRW Bil)
Samsung HQ Bldg	Samsung Electronics	Samsung Life Insurance	83,640	505
Ottogi Bldg (former Korea Land Corporation's Seoul Office	Korea Land Corporation	Ottogi	17,017	54
Jeongdong Bldg	Individual investor	Samsung Asset Investment	11,841	178
Maporo Area 4, District 4-1	MIR Industrial Investment	Pungsan	36,599	95 (est. additional costs: KRW50~60 bil)

Source: Savills Korea

Outlook

Going forward, prime buildings in core areas are projected to continue to post initial yields at around or below 6 per cent due to high levels of interest from core funds and a perceived lack of properties for sale in this bracket. The outlook for buildings in non-core office districts or secondary buildings remains uncertain, with investors continuing to require substantial yield premiums to reflect leasing market risks and higher financing costs.

For further information, please contact:

korea

Robert Mckellar
Chief Executive Officer, Korea
+82 2 2124 4201
rmckellar@savills.co.kr

leasing services, korea

Simon Hill
President
+82 2 2124 4205
shill@savills.co.kr

research & consulting, korea

JoAnn Hong
Senior Manager
+82 2 2124 4182
jhong@savills.co.kr

investment advisory, korea

Gyehwan An
Senior Vice President
+82 2 2124 4203
ghan@savills.co.kr

asset management, korea

Leighton Hunziker
President
+82 2 2124 4279
lhunziker@savills.co.kr

research & consultancy, asia pacific

Simon Smith
Senior Director
+852 2842 4573
ssmith@savills.com.hk

address

Savills Korea Co., Ltd
11/F Seoul Finance Center
84 Taepyungro-1-ga, Chung-gu,
Seoul, Korea 100-768
T: +82 2 2124 4114
F: +82 2 2124 4188

corporate website

www.savills.co.kr

Offices

Appendix 1: Overview of The Seoul Office Market & Savills Korea Office Survey

Close to 80 per cent of large office buildings (30,000 sqm or more) in Seoul are concentrated in 3 major business districts – CBD, Gangnam and Yeouido. 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, September 2009

		CBD	Gangnam	Yeouido	Total
A	Number of Buildings	14	13	5	32
	Average GFA (sqm)	78,927	99,435	90,964	89,139
	Average Year of Completion	1997	1999	1994	1997
B	Number of Buildings	18	16	10	44
	Average GFA (sqm)	49,727	39,684	44,115	44,800
	Average Year of Completion	1993	1997	1995	1995
	Total Number of Buildings	32	29	15	76
	Total Area (sqm)	2,000,059	1,927,599	895,971	4,823,629

The Savills Korea Quarterly Office Survey is the longest running survey of prime office stock in Seoul. Established in 1997, it currently comprises 76 of the 115 buildings in Seoul classified as "prime" buildings.

Prime buildings: Buildings with a gross floor area greater than 30,000 sqm with good accessibility and facilities, a high level of finish, and creditworthy 'blue chip' 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.