savills

Briefing
Seoul office sector

Q4 2013

Image: Seoul, CBD

SUMMARY

This year witnessed the largest volume of new office supply in five years, with the exception of 2011. Total transactions amounted to KRW5.06 trillion in 2013 and the cap rate is estimated to be in the low 5% range.

- In 2013, 604,497 sq m of prime office space from seven new projects was released to the market. New supplied area is now about 7.6% of total prime stock in 2012.

- The Seoul prime office market recorded a net absorption of 191,100 sq m in 2013, with Q4 witnessing the largest net absorption (136,800 sq m) of the year. The average annual vacancy rate in 2013 for prime office buildings was 10.8%.

- In 2013, Seoul prime office building rents increased by 1.3%, the same rate as CPI (1.3%). The maintenance fee, however, outpaced the CPI rate and rose by 2.3%.

- The total transaction volume amounted to KRW5.06 trillion in 2013. In Q4, 13 transaction deals were closed for office buildings for a combined value of KRW1.64 trillion.

"The office market witnessed an increase in demand but recorded a vacancy rate rise due to new supply. Sales transactions were completed by companies seeking to liquidate their assets, while investors continued to look for prime grade investment opportunities, despite high vacancy rates."

Supply

In 2013, seven new prime office buildings, with a combined GFA of 604,497 sq m, were released to the market. All the new office space is located in the CBD, with the exception of FKI Tower (168,507 sq m) in Yeouido business district (YBD).

In 2014, four new prime office buildings (with a total GFA of 240,877 sq m) are expected to be launched on the market. Their combined area is approximately 40% of the total space completed in 2013.

There is no building supply planned for YBD. However, Three IFC, which was completed in Q3/2012 but has not yet been marketed for lease, is expected to be put on the prime office market this year.

Supply and vacancy rate

According to Bank of Korea's (BoK) economic projections for 2014 announced in October 2013, the Korean economy is forecast to post a growth rate of 3.8% in 2014, up from the 2.8% growth rate of 2013. In its economic outlook for 2014, OECD explains that, despite financially distressed European banks, the fiscal woes of the US, and financial instability in the emerging economies, the US and Japan show a momentum for recovery. In addition, economic sentiment is bouncing back in the eurozone, and European countries are expected to show a gradual recovery, if not at the same speed.

The growth rate for 2015 is forecast to be approximately 4%.

The number of employees in the financial and insurance sectors, which has been on a steady increase since the global financial crisis, peaked at 894,000 in July 2013 but declined from August. The number fell to 859,000 at the end of December.

In Q4/2013, an increase in demand

TABLE 1

Monthly rents and vacancy rates by district, Q4/2013

District	Average rent (KRW per 3.3058 sq m based on GLA)	Average rent (KRW per 3.3058 sq m based on NLA)	YoY increase (%)	Net absorption (sq m)	Vacancy rate (%)
CBD	95,300	168,500	1.1	134,700	16.2
GBD	84,400	164,600	1.3	-58,200	6.1
YBD	75,200	155,600	0.2	60,300	13.7
Overall Seoul average	88,100	164,900	1.0	136,800	12.4

Source: Savills Korea

TABLE 2

Seoul prime office market and economic trends, 2009–2014F

Category	2009	2010	2011	2012	2013	2014F
Economic growth rate (%)	0.3	6.3	3.7	2.0	2.8 E	3.8
CPI (%)	2.8	3.0	4.0	2.2	1.3	2.3
Average annual rental increase rate (%)	3.5	2.1	1.7	2.9	1.3	2–2.5
Average annual maintenance increase rate (%)	4.4	2.3	1.9	2.8	2.3	2–3
Average annual vacancy rate (%)	4.3	7.2	8.0	8.5	10.8	12
Average annual rent (KRW per 3.3058 sq m, based on NLA)	146,500	150,200	154,400	160,100	163,700	168,000
Transaction volume (KRW 100 mil)	46,300	24,500	40,300	55,700	50,600	50,000
Cap rate (%)	6.5	5.8	5.7	5.4	5.2	5.2

Source: Savills Korea, BoK

TABLE 3

Prime office building supply, 2013

District	Building name	Date of completion	GFA (sq m)	Floors	Remarks
CBD	State Tower Gwanghwamun	Q1/2013	40,991	B6/F–23/F	In the middle of a sales transaction with Lina Life Insurance (to be closed in June 2014), to be owner occupied.
CBD	KDB Life Tower (Centreville Asterium Seoul)		82,116	B9/F–30/F	Acquired by Consus Asset Management (Q4/2013), leased out to KDB Life Insurance, Dongbu Corporation and its affiliates.
CBD	AIA Tower (formerly N Tower)	Q2/2013	51,380	B8/F–27/F	Acquired by AIA Life Insurance (Q4/2013), to be partially owner occupied and partially leased out.
CBD	Centre Point Gwanghwamun	Q3/2013	38,925	B7/F–20/F	To be occupied by Kim & Chang.
YBD	FKI Tower		168,507	B6/F–50/F	45% leased out to LG CNS and FKI member companies.
CBD	Yeonhap Media Center	Q4/2013	47,041	B4/F–17/F	70% owner occupied, 30% lease agreements signed (Hyundai Corporation and Dealim).
CBD	Gran Seoul		175,537	B7/F–24/F	100% master leased to GS E&C, lease marketing underway, GS E&C using the whole of Building A and part of Building B.
Total		604,497 sq m			

Source: Savills Korea

resulted in the net absorption of 136,800 sq m of prime office space. Unlike the CBD and YBD, Gangnam business district (GBD) witnessed a demand decrease, posting a net absorption of -58,200 sq m.

The vacancy rate in the CBD was 16.2%, 0.2 of a percentage point (ppt) down from the previous quarter. Demand in the area rose despite the departure of some tenants to other office districts, due to tenants relocating to newly completed buildings.

In GBD, the vacancy rate rose to 6.1%, 2.2 ppts up from the previous quarter.

The vacancy rise was mainly attributed to tenants relocating to other office districts. NC Soft moved to Pangyo, vacating its own office building to put it up for lease. However, only part of the building has been filled by new tenants, driving up the vacancy rate in the area.

The vacancy rate in YBD rose by 6 ppts from the previous quarter to 13.7%.

In Q4/2013, relocations from prime to prime buildings accounted for the largest proportion (73%) of all take-up in the prime office market. This stands in contrast to the tendency in previous quarters when most of the vacant space was absorbed through secondary-to-prime relocations. The change was caused by tenants leaving their existing prime office buildings to consolidate their offices in newly completed prime buildings such as KDB Life Tower and Gran Seoul.

Outlook

In Q1/2014, vacant office space is expected to be absorbed through the relocations of law firm Kim & Chang to Center Point Gwanghwamun; Maeil Dairies to The K-Twin Towers; DSME's R&D centre to Center1; and Bain & Company and BNP Paribas to State Tower Namsan. Therefore, in Q1/2014, the vacancy rate of Seoul prime office buildings is projected

TABLE 4

Planned new office supply, 2014

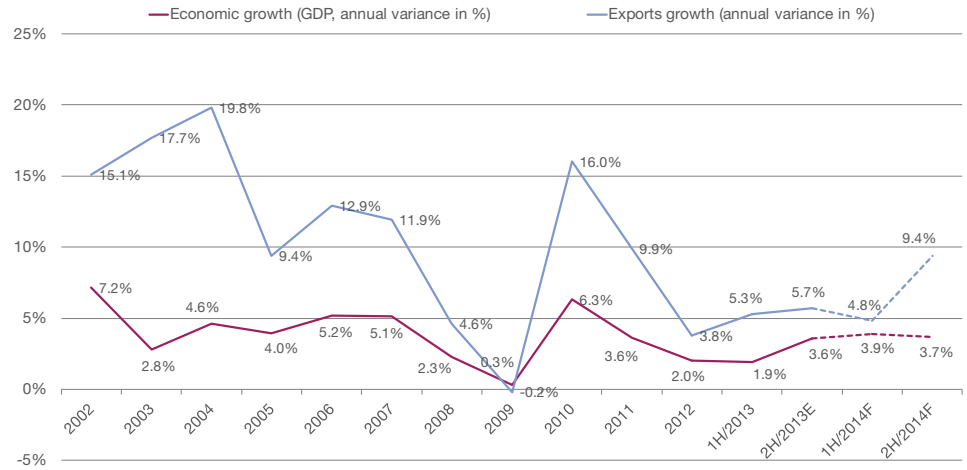
District	Building name	Date of completion	GFA (sq m)	Floors	Remarks
GBD	SK Networks' Daechi Building	Q1/2014	47,638	B5/F–9/F	Transaction deal underway
CBD	Dongjadong District 8	Q3/2014	36,657	B7/F–29/F, 30/F	Transaction deal underway
CBD	Cheongjin Districts 2, 3 (Gwanghwamun D Tower)	Q4/2014	105,462	B8/F–24/F	Transaction deal underway, currently being marketed
CBD	Cheongjin District 1 (Olleh Plex)	Q4/2014	51,120	B6/F–25/F	100% owner occupied by KT
YBD	Three IFC*	Q2/2014E	161,104	B7/F–55/F	Lease marketing expected in 2014
Total GFA		240,877 sq m (401,981 sq m if Three IFC is included)			

Source: Savills Korea

*Three IFC was completed in Q3/2012 but has not yet been marketed. Therefore, the building will be included in the analysis when it s put on the market and lease marketing is launched.

GRAPH 1

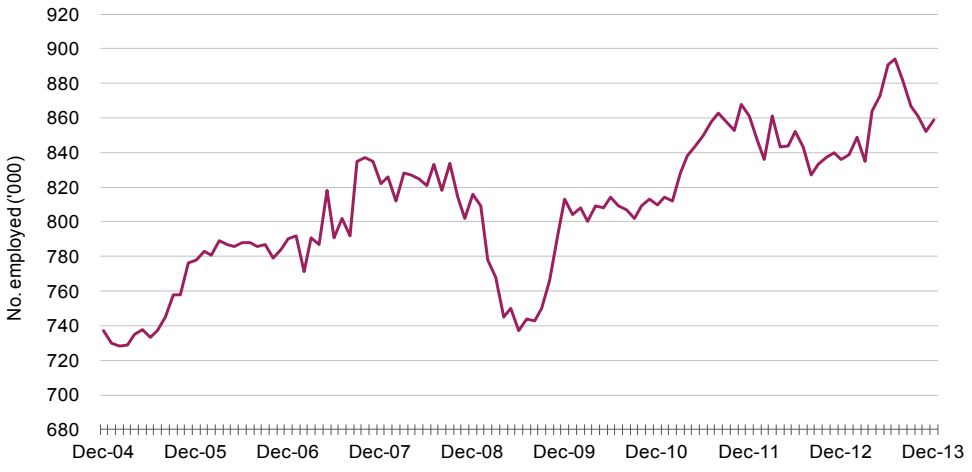
Real GDP and export growth rates, 2002–2014F



Source: BoK

GRAPH 2

Number of employees in the financial and insurance sectors, Dec 2004–Dec 2013



Source: BoK

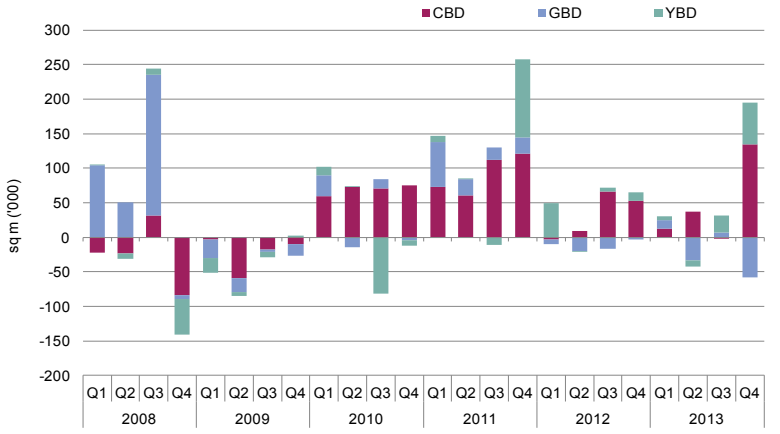
to decline to about 12%, down 0.5 to 1 ppt from Q4/2013.

In 2013, Seoul prime office building net absorption increased by 30% from 2012, from 145,000 sq m to 191,100 sq m. However, as the 604,497 sq m of area supplied in 2013 was not fully absorbed, the vacancy rate stood at 10.8% for the year.

In 2014, given the economic growth projections and tenant relocation plans (such as KT's relocation to Cheongjin District 1 and additional tenant relocations to Gran Seoul), as well as Three

GRAPH 3

Net absorption, Q1/2008–Q4/2013



Source: Savills Korea

TABLE 5

Major tenant relocations, Q4/2013

District	Current building	Tenant	Lease area (sq m)	District	Previous building	Lease area (sq m)
CBD	Gran Seoul	GS E&C	105,075	CBD	GS Yeokjeon Tower	39,908
				GBD	GS Tower (Gangnam)	40,661
				GBD	SI Tower	8,228
				GBD	GFC	4,735
	KDB Life Tower	KDB Life Insurance	32,079	CBD	Ace Tower	3,566
				CBD	Olive Tower	14,800
				GBD	Nara Banking Corp	1,520
				GBD	Secondary building	N/A
		Dongbu Corporation and its affiliates	24,634	GBD	Dongbu Finance Center Building	7,770
				CBD	Gateway Tower	N/A
	The K-Twin Towers	Microsoft	14,281	GBD	Posco Center	8,914
		Hyundai Steel's Gangbuk office	4,109	CBD	Secondary building	N/A
	State Tower Namsan	Mitsubishi Corp	2,921	CBD	Lotte Headquarters Building	N/A
	S Tower	Daewoo E&C TFT	4,483	New organisation		
GBD	Hanwha Finance Plaza's Seocho Building	LIG Insurance	4,066	GBD	Secondary building	N/A
	NC soft Building	Synaptics	1,950	GBD	Haesung 1	926
		Rian Communications	1,950	GBD	IT Tower	N/A
	SI Tower	Hyundai Mobis	2,743	Office expansion		
	Keungil Tower	Lina Financial Service	1,751	New organisation		
	Meritz Tower	Naver Business Platform	1,744	Bundang	Green factory	N/A
YBD	FKI Tower	LG CNS	46,612	CBD	Prime Tower	29,524
				CBD	Seoul Finance Center	1,699
		FKI affiliated companies	13,884	YBD	KT Yeouido	6,681
					Hana Daetoo Securities Building	2,942

Source: Savills Korea

IFC being placed on the market and anchor tenants moving to the building, net absorption will reach approximately 350,000 sq m. Despite the increase in net absorption, the additional office building supply planned for 2014 will push up the average vacancy rate of Seoul prime buildings by 2 ppts to 3 ppts.

Rents

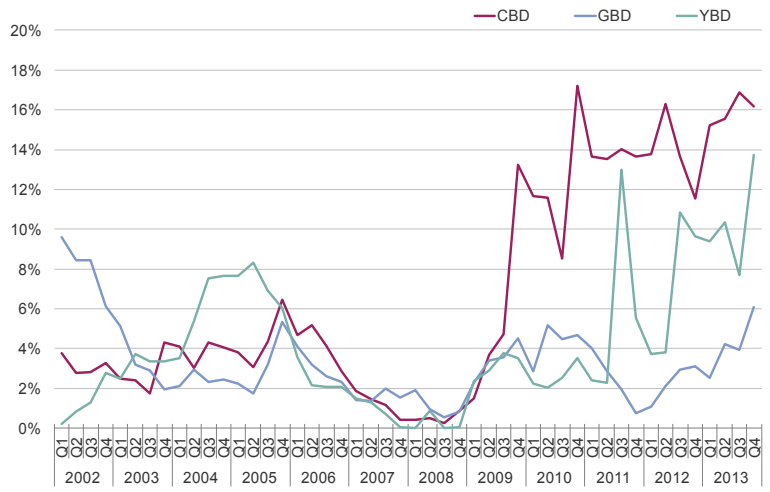
In 2013, the face rent of Seoul prime office buildings increased by 1.3% (annual average), recording the lowest increase rate in five years. However, the maintenance fee continued to rise to an annual average of 2.3%, which is higher than the CPI rate of 1.3%. In the CBD and YBD, landlords tended to provide longer rent-free periods and tenant improvements, depending on their location and vacancy rate, due to competition from the new supply. As such, the gap between the face and effective rents is growing wider.

Outlook

According to our survey, 15 out of 96 prime office buildings in Seoul are planning to raise rents by 3% to 5% in Q1/2014. By district, nine buildings in the CBD will adjust their rents upward, four in GBD and two in YBD. In general, buildings tend to raise rents in Q1. However, because of concerns over high vacancy rates and unfavourable market conditions, the Seoul prime office

GRAPH 4

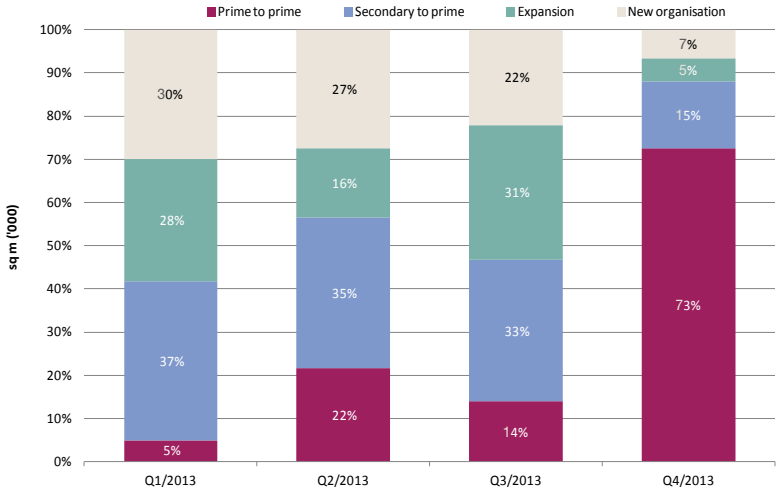
Prime office building vacancy rate, Q1/2002–Q4/2013



Source: Savills Korea

GRAPH 5

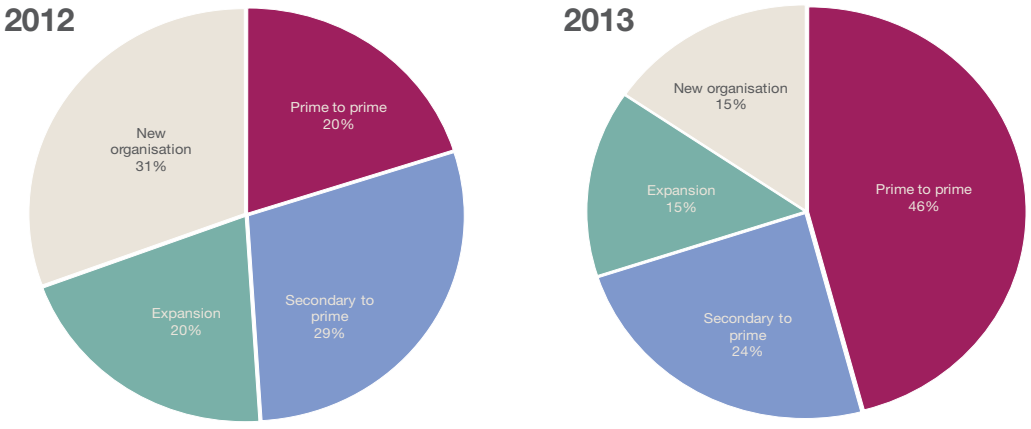
Take-up, Q1/2013–Q4/2013



Source: Savills Korea

GRAPH 6

Take-up, 2012–2013



Source: Savills Korea

market will witness the smallest number of buildings raising rents in Q1/2014, in comparison with the past five years. The rent increase is projected to remain in line with the CPI growth rate until the vacancy rate stabilises.

Transaction and investment market

In Q4, 13 transactions were concluded for four prime office buildings and nine secondary buildings, bringing the total transaction volume to KRW1.6 trillion for the quarter and approximately KRW5.06 trillion for the whole year.

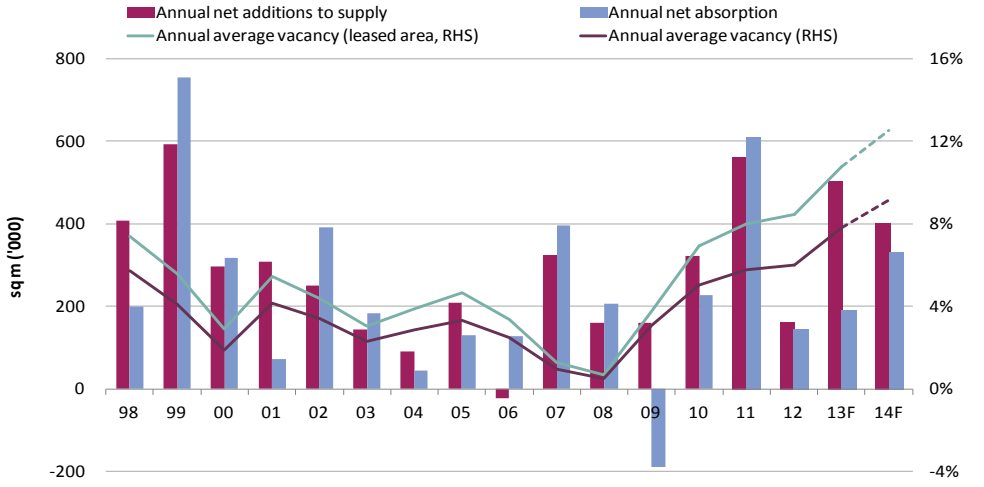
Transactions in Q4 mainly comprised property sales by companies, particularly engineering and construction firms, pursuing secure liquidation. Additionally, multinational insurance companies, continuing their pursuit of prime buildings, acquired prime office buildings in the CBD during the quarter.

KDB Life Tower (formerly Centreville Asterium Seoul), a prime office building completed in the CBD in 2013, was purchased by Consus Asset Management for KRW347.7 billion. Dongbu Corporation and its affiliates have master leased 30% of the building, which has achieved a 50% occupancy rate as KDB Life Insurance consolidated its offices that were scattered across the CBD and GBD. Through the KDB Life Tower transaction, the seller, Dongbu Corporation, is known to have secured liquidity.

Samsung Engineering sold Dogokdong SEI Tower (Samsung Engineering's office building in Dogokdong) and shares of its ownership in Glass Tower, a prime office building in GBD, to Koramco AMC for KRW243 billion. According to a recently issued public notification, an 83% share in these buildings is owned by Samsung Life Insurance (60%) and Samsung Fire & Marine Insurance

GRAPH 7

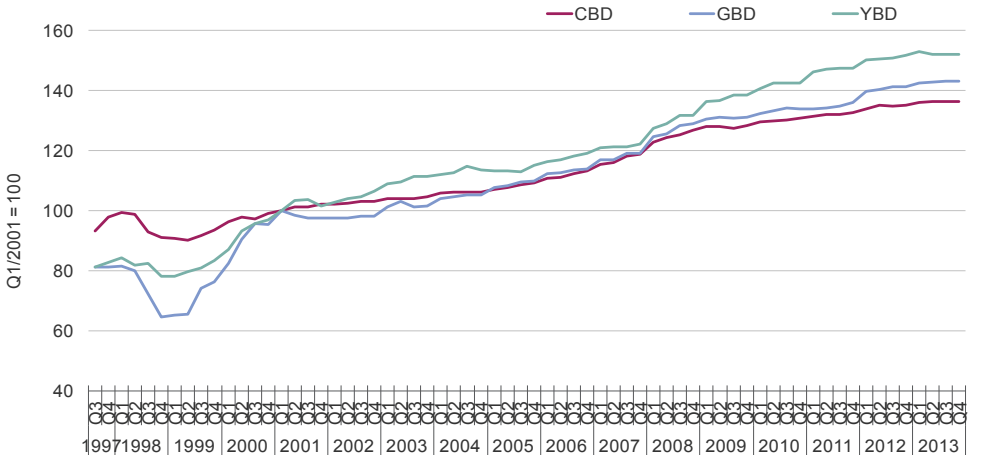
Annual supply and demand (including remodelled buildings), 1998–2014F



Source: Savills Korea

GRAPH 8

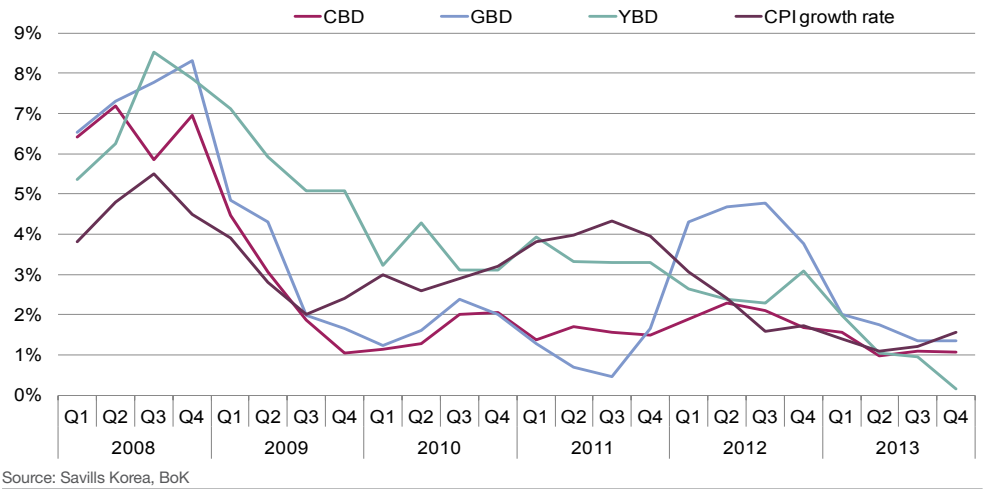
Prime office district rental indices, Q3/1997–Q4/2013



Source: Savills Korea

GRAPH 9

YoY rental increase rate by district, Q1/2008–Q4/2013



Source: Savills Korea, BoK

(23%), which are special related affiliates of Samsung Engineering.

Hanwha Chemical Co, Ltd sold 16,425 sq m of office area in Hanwha Sogong Building, a CBD prime office, to Hanwha Life Insurance which owns the remaining area of the building, while Samwhan Corporation's office building in the CBD changed hands to Hana Daol AMC for KRW135 billion, with a cap rate known to be in the mid-5% range. Shinsegae E&C disposed of its Jangchungdong office building to E-mart for KRW19.7 billion in an effort to secure liquidity.

In Q3/2013, Lina Life Insurance, an international insurance firm, signed an agreement to purchase State Gwanghwamun (the deal is to be closed in June 2014), and in Q4 another overseas life insurance firm, AIA Life Insurance, acquired AIA Tower (Sunhwadong N Tower, including the 4,988.22 sq m owned by KEPCO), a newly completed prime building in the CBD.

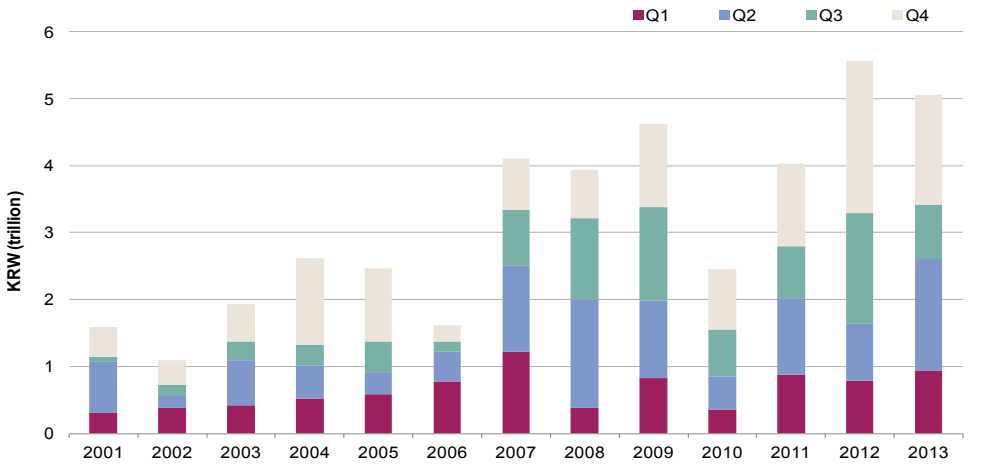
PCA Life Tower in GBD was sold by Mirae Asset AMC to Mastern Asset Management. The AMC company paid KRW130 billion for the building and the cap rate is known to be in the high 4% range. In addition, Mastern Asset Management acquired part of the office section and convention hall of the International Electronics Center located in Seochodong for KRW91.5 billion.

Mapo Credit Center, situated in Mapo, was sold by Nice Information & Telecommunication to Dongbu Asset Management with a price tag of KRW44.8 billion. Mapo Credit Center will be master leased by an affiliate of Nice Information & Telecommunication and its cap rate was around 6%.

In Q4, the benchmark interest rate was maintained at 2.5%, the same level as in Q3. While the interest rates on loans are likely to continue to be stable due to the benchmark interest rate remaining unchanged

GRAPH 10

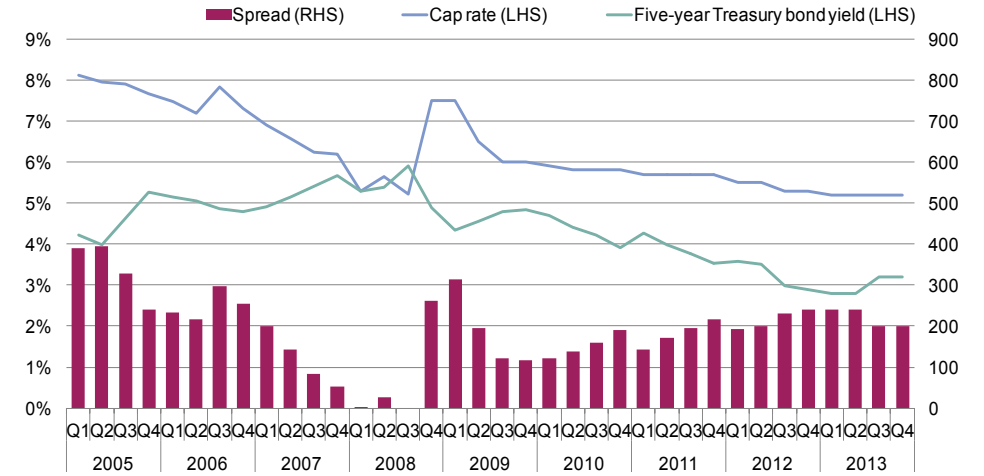
Seoul office market transaction volumes, Q1/2001–Q4/2013



Source: Savills Korea

GRAPH 11

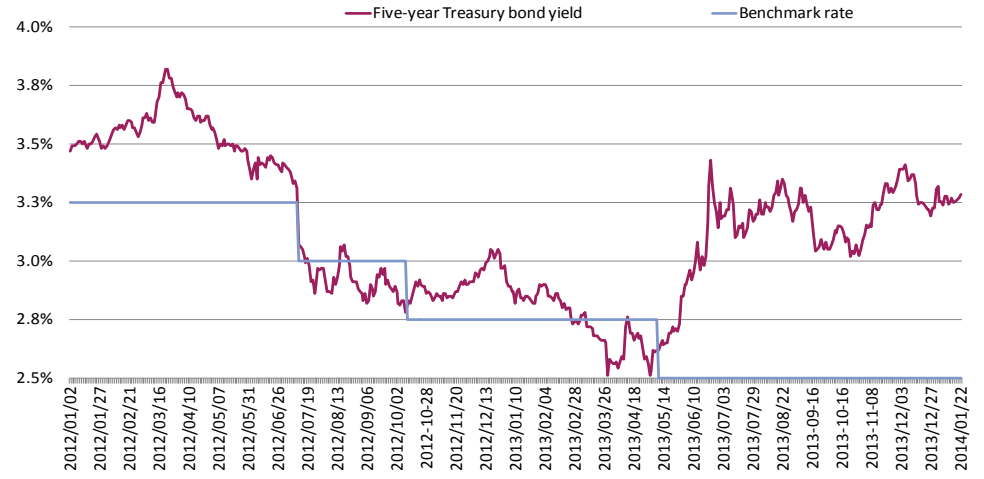
Prime office building cap rate trends, Q1/2005–Q4/2013



Source: Savills Korea, BoK

GRAPH 12

Five-year Treasury bond yield and benchmark interest rate trends, Jan 2012–Jan 2014



Source: BoK

for eight months in a row, the five-year government bond yields are in the low 3% range, showing no significant change from the previous quarter. The cap rate of prime office buildings is estimated to be in the low 5% range and the spreads with five-year government bonds are maintained at a level similar to that of the previous quarter.

It has been reported that the US government may taper quantitative easing in 2014. In the event of a tapering, interest rates are likely to increase, which may in turn push up cap rates temporarily. However, in the long run, cap rates are projected to stagnate at the current levels and spreads are forecast to remain stable in the current range of 150 to 200 basis points.

TABLE 6

Major investment transactions, Oct–Dec 2013

District	Building name	Seller	Buyer	Transacted area (sq m)	Transaction amount (KRW bil)
CBD	KDB Life Tower (Centreville Asterium Seoul)	Land owners' association of the Urban Redevelopment Project for Dongja District 4	Consus AMC	82,116	347.7
CBD	AIA Tower (N Tower)	Sunwhadong PFV KEPCO	AIA International Limited	46,906	252.6
CBD	Samwhan Building HQ	Samwhan Corp	Hana Daol AMC	31,402	135.0
CBD	Hanhwa Sogong Building (Strata)	Hanhwa Chemical Corp	Hanhwa Life Insurance	16,425	125.0
Mapo (Others)	Credit Center	NICE Information & Telecommunication Inc	Dongbu AMC	15,220	44.8
Dogok (Others)	SEI Tower	Samsung Engineering	Koramco AMC	41,439	126.0
GBD	Glass Tower (Strata)	Samsung Engineering	Koramco AMC	25,652	117.0
GBD	PCA Life Tower	Mirae Asset AMC	Mastern AMC	19,646	130.4
Seocho (Others)	Kukje Electronics Center	Wonik Corp	Mastern AMC	33,276	91.5

Source: Savills Korea

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Appendix

Overview of the Seoul office market and Savills Korea office survey

TABLE 7

Summary of surveyed buildings, Dec 2013

		CBD	GBD	YBD	Total
A	Number of buildings	22	14	8	44
	Average GFA (sq m)	85,175	96,231	92,771	90,074
	Average year of completion	2002	1999	2001	2001
B	Number of buildings	25	18	9	52
	Average GFA (sq m)	49,926	38,695	44,728	45,139
	Average year of completion	1999	1998	1996	1998
Total number of buildings		47	32	17	96
Total area (sq m)		3,122,006	2,043,744	1,144,724	6,310,473

Source: Savills Research & Consultancy

Close to 69% of large office buildings (30,000 sq m or more) in Seoul are located in three major business districts – the CBD (34.9%), GBD (20.4%) and YBD (13.3%). The CBD is the largest of these districts and is home to major government and multinational institutions. GBD also houses many multinational companies and is an information technology centre, while YBD, the "Wall Street" of South Korea, includes the headquarters of major securities firms and broadcasting companies.

The Savills Korea Quarterly Office survey is the longest running survey of prime office stock in Seoul. Established in 1997, it currently comprises 96 of the 126 buildings in Seoul classified as "prime" buildings.

Prime buildings: Buildings with a GFA greater than 30,000 sq m 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 standardised by Savills Korea to account for variations in the security deposits required by different landlords to produce an effective rental figure for NLA.

Cap rate calculation method
Cap rate: (income from interest on security deposit (5%) + face rent of a standard floor + residual income from maintenance fee) × occupancy rate (95%) × 12 / transaction amount

For comparison of cap rates of each transaction case, a 5% interest rate on security deposit and 95% occupancy rate were uniformly applied.