

Briefing Seoul office sector

Q4 2017



Image : CBD, Seoul

SUMMARY

With an active investment from institutions and domestic corporations, the total investment volume recorded a high of KRW 8.8 trillion in 2017.

- In 2017, new supply in both major (152,000 sq m) and non-core districts (415,000 sq m) impacted Seoul prime office leasing activity.

- In the face of new supply, total net absorption (220,500 sq m) was higher than that of the average from the last three years (122,000 sq m).

- At the end of December 2017, the Seoul prime office market vacancy rate was 13.3%. With limited supply and high leasing demand, the vacancy in the GBD decreased while the CBD and YBD experienced a slight increase.

- Overall face rent had increased by 1.5% year-on-year (YoY) by the end of 2017, in line with the CPI, although vacancy rates did dampen rental growth in certain locations.

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 "Based on strong exports and a satisfactory economic performance, the BOK raised the base rate for the first time in more than six years. The cap rate spread compressed slightly, but remains above 200 basis points (bps)." Savills Research

➔ Supply

In November 2017, Amorepacific Group completed their headquarters in Yongsan and moved from Signature Tower. Samil PWC will also take office space, using the 17th-20th floors for ten years (moving in Q2/2018). The lower floors of the building (B1-3rd floors) include common cultural areas, such as an art museum and brand show room. The 5th floor offers various staff amenities, such as a fitness centre, lounge and healing zone (massage room).

Demand and vacancy rate

On November 30 2017, the Bank of Korea (BOK) raised its base rate to 1.5% from 1.25%. Global economic recovery, strong exports of semiconductors, and petrochemicals are propelling economic growth. Consumption has also undergone moderate recovery. Due to this improving economic performance, GDP projections for 2017 have been revised upwards to 3.1%.

In Q4/2017, Seoul prime office demand increased 6,800 sq m. GBD demand increased 34,800 sq m, while CBD and YBD decreased 24,700 sq m and 3,300 sq m, respectively.

Looking at the Q4/2017 vacancy rate of the Seoul prime office market, the average overall vacancy rate fell by 0.5 percentage point (ppt) from the previous quarter to 13.3%. The GBD saw a decrease of 3 ppt, while the CBD and YBD witnessed a 0.5 ppt and 0.8 ppt increase.

Large scale prime-to-prime office relocations by Shinhan Card and Yulchon accounted for 42% of Q4/2017 take up, higher than the 2017 overall average of 29%. Secondary-to-prime office relocations from non-core office districts represented 35%. Expansion and New Organisations made up 23%, lower than the previous quarter.

By district, take up in both the CBD and GBD contributed 47% to total

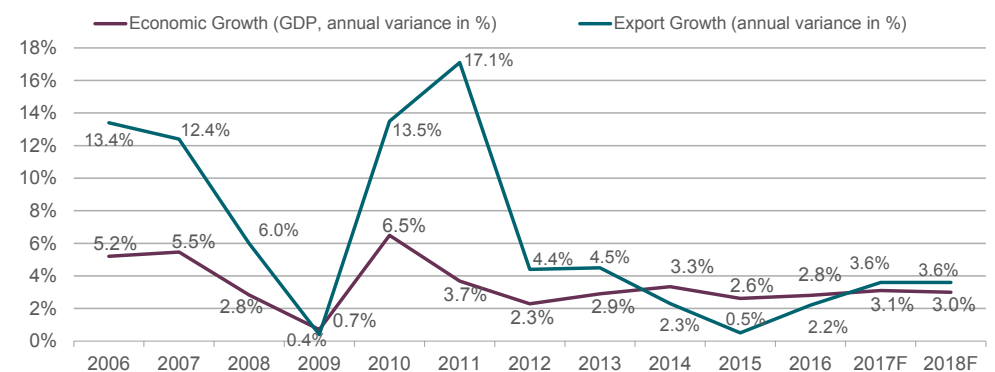
TABLE 1 Monthly rent, maintenance fee and vacancy rate by district, Q4/2017

District	Rent		Maintenance Fee		Net Absorption Area (Sq. m)	Vacancy Rate (%) (Prev. Q)
	Average Rent	YoY increase (%)	Average Maintenance fee	YoY increase (%)		
CBD	103,900	2.2%	41,500	1.9%	-24,700	15.9% (15.4%)
GBD	91,200	1.6%	37,800	1.1%	34,800	6.6% (9.6%)
YBD	78,600	-0.4%	36,500	1.3%	-3,300	17.6% (16.8%)
Overall Seoul Average	94,700	1.5%	39,300	1.5%	6,800	13.3% (13.8%)

Source: Savills Korea

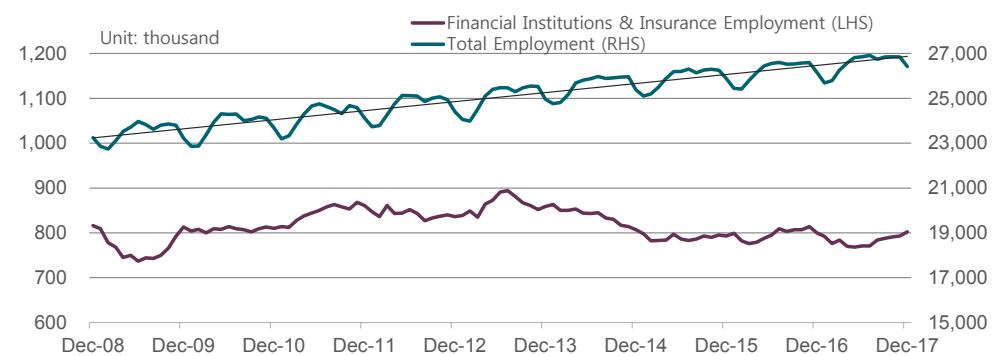
(Unit : KRW/3,3058sq m, GLA)

GRAPH 1 Growth rate of real GDP and real exports, 2006 - 2018 (F)



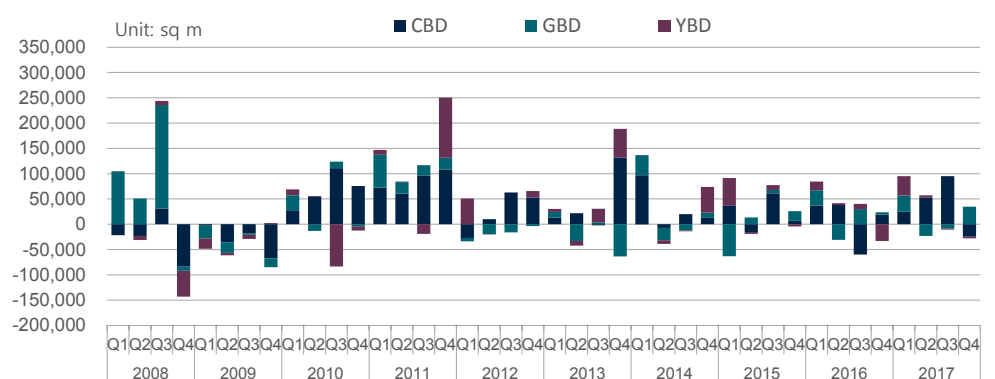
Source: Bank of Korea

GRAPH 2 The number of employees in the financial and insurance sectors, Dec. 2008 - Dec. 2017



Source: Korean Statistical Information Service

GRAPH 3 Net absorption, Q1/2008 – Q4/2017



Source: Savills Korea

→ take up. The YBD represented only 6%. With vacancies at Parnas Tower resolved, the GBD take up was materially higher than in the recent past.

In the CBD, the vacancy rate increased 0.5 ppt from the previous quarter to 15.9%. Leaving Signature Tower (48,500 sq m) for a new HQ in Yongsan, Amorepacific group's relocation raised the overall rate. The NPS Jung-gu branch (from KT Myeong-dong building) leased one floor of vacant space in Post Tower.

In the GBD, the vacancy rate dropped 3% from the previous quarter to 6.6%. Yulchon's relocation to Parnas Tower significantly reduced the vacancy rate. Following Yulchon's relocation, the Textile Center (GBD) landlord is considering remodelling or redeveloping the building and is only looking for temporary tenants. Parnas Tower's vacancy rate was lower than 5%, following Blizzard's relocation there. As WeWork opened a Yeoksam branch, Arc Place (former Capital Tower) reduced its vacancy rate.

In the YBD, the vacancy rate rose 0.8 ppt from the previous quarter to 17.6%. LG Electronics relocation to Magok created large scale vacancy (12,000 sq m), and the downsizing of the Federation of Korean Industries also created 10,200 sq m of vacancy. Conversely BNK Securities' relocation to Samsung Life Insurance Yeouido Building (former SK Securities Building) from the CBD reduced its vacancy.

Rent

In Q4/2017, the face rent in Seoul prime office buildings averaged KRW 94,700 (3.3m²), up 1.5% from the same period last year. By district, the CBD saw an increase of 2.2% as T-tower and Taepyeong-ro Building raised their marketing rents. In the GBD, the average rent rose 1.6% due to an upward rent adjustment by Gangnam Finance Centre. On the other hand, the YBD recorded a 0.4% decrease in rent, following IFC lowering its marketing face rents.

Review of 2017

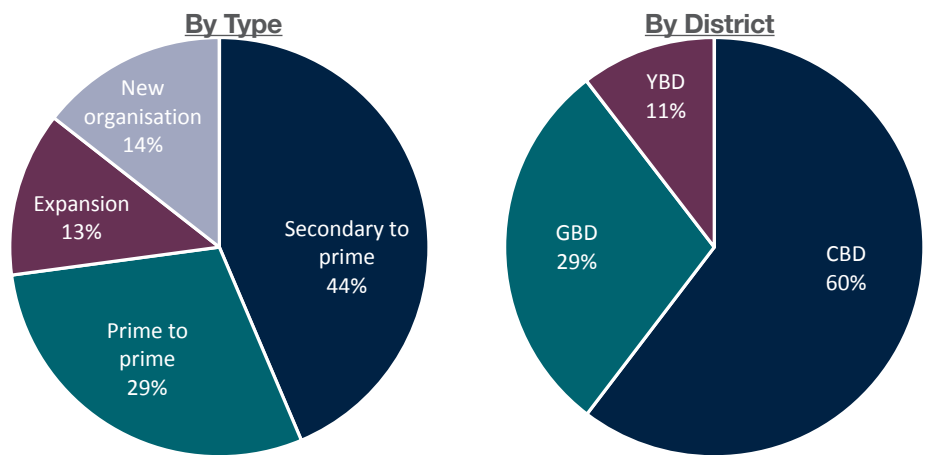
In 2017, six new prime buildings were completed.

In the CBD, Hana Bank and their affiliates occupied their new HQ Building in Eulji-ro. SK E&C and other SK subsidiaries also leased Susong Square. SK Securities and HP moved into new supply in Yeouido and took up significant vacancy. Lotte affiliates and Descente relocated to Lotte World Tower in Jamsil and absorbed some part of the vacancy in the building. The occupancy rate of Majestar City in Seocho is around 80% (Tower 1) and 50% (Tower 2, including seller's master lease), leased by tenants including Olympus, Greencross and PubG from Gangnam.

At the end of December 2017, Seoul prime office overall vacancy rate was 13.3%. The overall net absorption was 220,500 sq m, rising from the previous year's 66,000 sq m; and also the past three year's average (122,000 sq m). Three main districts rank in order as follows; YBD, CBD and GBD. Leasing activity was strongest in the CBD, although there remains a relatively high vacancy rate. With competitive rents and the local environment improving through the Seoulo (skypark) project, vacancy near Seoul Station halved to 12.5%.

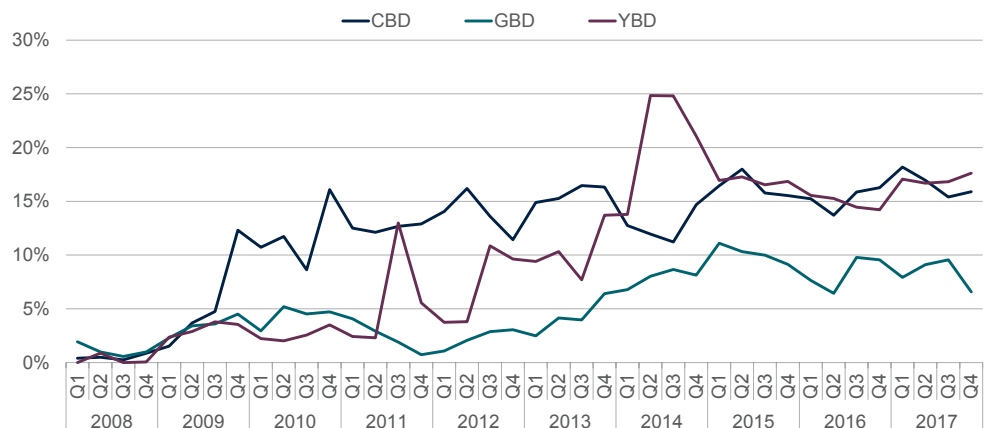
In 2017, 44% of prime office movement came from secondary to prime upgrading. Relocation to the CBD accounted for 60% of total movement. The major leasing demand came from;

GRAPH 4 Take-up, 2017



Source: Savills Korea

GRAPH 5 Seoul prime office vacancy rate, Q1/2008 – Q4/2017



* Textile Center (GBD) is excluded due to grade adjustment in Q4/2017

Source: Savills Korea

- 1) large company affiliates like SK Group 2) in-progress remodelling/ redevelopment tenants like CJ or BOK 3) expansion of co-working places 4) growth industries like gaming, IT and bio technology(BT) 5) back office functions like call centres for financial companies, and 6) e-commerce companies.

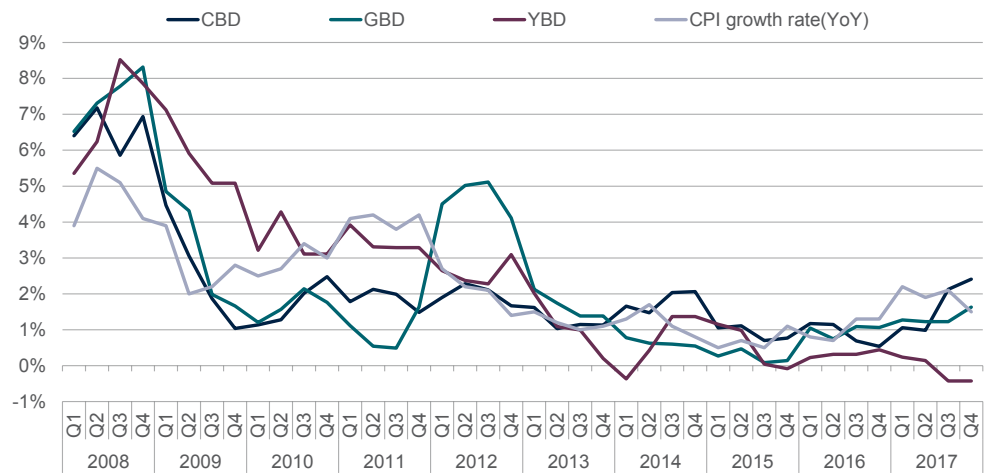
In 2017, rental rates and maintenance fees increased by 1.5% year-on-year (YoY) similar to the CPI rate, while tenant incentives, such as rent-free periods and TI remained broadly the same as the previous year. The trend of secondary building tenants upgrading their offices to prime buildings is expected to persist as prime buildings continue to provide diverse incentives.

Outlook

In 1H/2018, the CBD overall vacancy rate is predicted to rise slightly right after a public institution relocating to provincial cities, then drop after WeWork moves into three buildings in the CBD. In 2H/2018 the vacancy rate in the CBD is expected to increase with the completion of Centropolis (B8-26th floors) which will account for almost 4% of total surveyed space. Meanwhile, the CBD is set to continue to enjoy the most active leasing market of all the three major districts, with a strong tenant preference for the area, steady demand for office upgrading and expanding demand for co-working space.

With the completion of LuCeen Tower and Gangnam N tower (together comprised almost 4% of total surveyed space), the GBD vacancy rate is expected to rise. With limited further supply, the GBD, which has strong demand from growth industries in the tech and co-working sectors, is forecast to see the vacant area absorbed. In 2018, the YBD vacancy rate will rise most significantly among the major districts, with the relocation of LG Group affiliates and new supply, Korean Teachers' Credit Union Building. In addition, LG Group's affiliates will move from the FKI Tower to Magok and the

GRAPH 6 **YoY rental increase rate by district, Q1/2008 – Q4/2017**



Source: Savills Korea, Bank of Korea

CBD. WeWork will occupy seven floors of HP building in Q2/2018, reducing the vacancy rate, but will only absorb under 1% of the YBD surveyed area. With its relatively low demand compared to other districts, the YBD is expected to maintain a high vacancy rate throughout 2018.

In Q1/2018, the face rent is projected to inch up 0.8% from the same period in the previous year, as less than ten buildings are considering a rent increase at the beginning of the year. Incentives for tenants, such as rent-free periods and TI, will be offered at the current levels, but some YBD buildings facing large vacancy will progress aggressive leasing strategies.

Transactions and investment market

2017 saw a new record set in terms of total office investment volumes. The record high of KRW 8.8 trillion exceeded the figure posted in 2016, which included the sale of the IFC complex (three prime office buildings for a combined KRW 1.8 trillion). It is not just abundant liquidity that has helped investment activity in the Seoul office market continue to thrive, but also demand for headquarters from domestic corporations, and increased asset availability from fund maturities. The number of major office transactions also reached a record

high, with deals over KRW 200 billion accounting for 56% of volume in 2017. With the exception of KEB Hana Bank Myeongdong (SPA signed), transactions included; Signature Towers, Alpharium Towers, Booyoung Eulji Building, Susong Square and Metro Tower. International investors, remained active but contributed 20% to 2017 volumes, dropping from 40% in 2016. However, several cases of demand for HQ properties lead to an increase in domestic interest for office investment.

Office transaction volumes for Q4/2017 were KRW 2.4 trillion as Metro Tower, West Finance Centre, Gangnam POBA Tower, Icon Yeoksam and Hyundai Yeonjido closed. Additionally, KB Bank Myeongdong HQ, the K Twin Towers and several other deals are either signed or in exclusivity and will close in 1H/2018.

Mastern AMC acquired West Finance Centre situated in Guro-gu for KRW 295 billion, backed by Korea Scientists & Engineers Mutual-aid Association, and other securities companies. The property houses financial firm back office functions, such as call centres and insurance branches. The building has enjoyed a high lease renewal rate due to its reasonable rent level.

Despite geopolitical tensions

→ resulting from North Korean missile tests, international investor interest in Seoul office properties continues to grow. PAG purchased Gangnam POBA tower for circa KRW 300 billion for their core plus fund. IGIS AMC purchased this property in 2011 for KRW 256 billion, backed by investment from POBA (Public Officials Benefit Association) and other institutional investors. The sale to PAG was concluded via beneficiary certificate transfer with the tower stabilised approximately at 93% occupancy as of December 2017. The newly completed Icon Yeoksam (completed in October 2017) was purchased by the Singaporean investor Ascendas for KRW 103 billion. Ascendas is believed to have established a 10 year private fund with KRW 32.8 billion, and has taken out senior and mezzanine

loans. Ascendas plans to open “The Bridge”, a co-working office brand operated by a subsidiary of Ascendas group, in the lower floors (2nd-4th floor); while the rest of office area available for lease.

Anda Asset Management acquired Metro Tower near Seoul station for KRW 240 billion. The major investor was Tongyang life Insurance whose largest shareholder is the Chinese insurer Anbang. Anda Asset Management plans to convert the lower floors of the parking tower into retail, in order to take advantage of the increased foot traffic in the Seoul Station area.

More office buildings were purchased by domestic end-users in 2017. Hyundai Elevator acquired their current building for KRW 245 billion after exercising a call option.

The property was previously sold to Koramco AMC under a sale and leaseback in 2012. EGI (Engineering Guarantee Insurance) purchased the headquarters of MG Non-life Insurance in Yeoksam-dong for KRW 81 billion, with a plan to occupy floors two to five. MG will remain in the building with a sale and leaseback agreement.

Out dated office buildings were targeted by developers and domestic corporations for redevelopment purposes. JL United 1 (a development company) acquired three sites; Hite Jinro HQ, vacant land owned by Hite Jinro, and the Seocho Building owned by CMAA (Correctional Mutual Aid Association). Their strategy is to develop a residential complex on the consolidated site. KEB Hana Bank disposed of an old annex

TABLE 2 Major tenant relocations, Q4/2017

District	To			From	
	Building	Tenant	Area (sq m)	District	Building
CBD	Pine Avenue A	Shinhan Card	37,700	CBD	Post Tower
	KDB Life Tower	Booking.com	5,400	New	
	Post Tower	National Health Insurance Service	3,400	CBD	KT Myeongdong Bldg
	KDB Life Tower	CJ Olive Networks	2,700	CBD	CJ Namsan HQ
	Seoul City Tower	TESO Engineering and 4 affiliates	2,700	New	
	Centre1	Daiichi-Sankyo	2,600	CBD	SC First Bank HQ
	Taepyeongno Bldg	Hyundai Marine & Fire Insurance	2,400	CBD	KT Myeongdong Bldg
	D Tower	Met Life	2,200	Non-core	Branch Consolidation
GBD	Parnas Tower	Yulchon	30,200	GBD	Textile Centre
	Parnas Tower	Blizzard Korea	7,500	Non-core	Geumhwa Bldg (Cheongdam-dong)
	Prudential Tower	Renault Samsung Motors	6,500	Non-core	RSM Tower(Gasan-dong)
	Arc Place(former Capital Tower)	WeWork	6,200	New	
	Samsung Life Insurance Daechi Tower	Saengbo Real Estate Trust	6,000	GBD	Gangnam Metro Bldg
	Meritz Tower	Ericsson-LG	3,600	Non-core	Gyeonggi-do Anyang
	ASEM Tower	Gucci Korea	3,300	Non-core	Cheongdam-dong
	ASEM Tower	Stryker Korea	2,700	GBD	Dongsung Bldg
	Parnas Tower	MathWorks Korea	2,300	Non-core	Deok Myeong Bldg (Samseong-dong)
YBD	Samsung Life Insurance Yeouido Bldg	BNK Securities	5,800	CBD	Geumsegi Bldg
	KTB Bldg	Illumina Korea	1,300	New	
	KTB Bldg	Yeouido Post Office	1,100	YBD	Yeouido Post Office Bldg

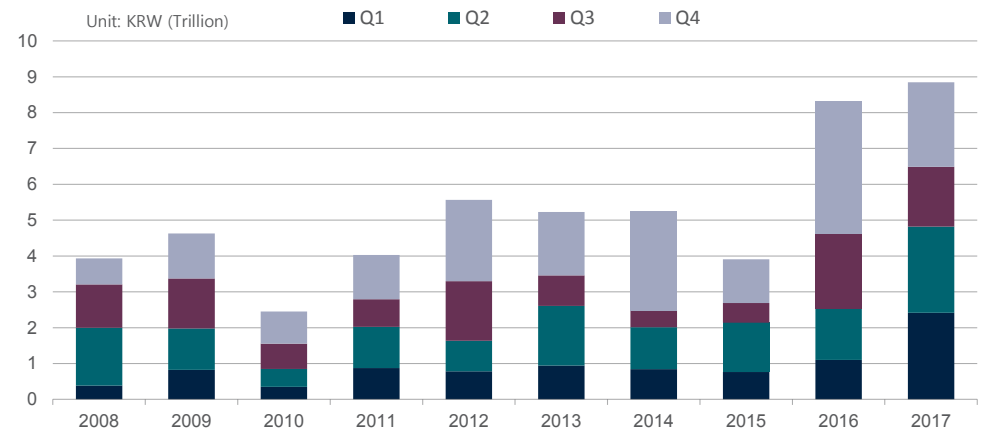
Source: Savills Korea

→ building in Euljiro to Kyowon. MDM Plus purchased KT Banpo building for redevelopment and AREITs (real estate investor) purchased LG Electronics Gangseo building to redevelop into an office/hotel complex.

Booyoung Group was selected as a preferred bidder for the aforementioned KEB Hana Bank Myeongdong in June 2017, signed an SPA with KEB Hana Bank in December. It is understood that Booyoung paid 10% of the total transaction price to the vendor, with the remaining balance due an estimated 2 years later upon closing. The property was sold with a sale and leaseback condition for 3 years, allowing Booyoung to prepare development plans for a mixed use complex.

In Q4/2017, the average prime office cap rate stood at 4.7%; calculated using marketing rent and 90% occupancy. However, considering leasing concessions (such as rent free, tenant improvement incentives) and actual occupancy rates, the NOI cap rate is in the low to mid 4% range. As of the end of December, the 5 year government bond yield increased to 2.3%, meaning a prime office cap rate spread of approximately 240 bps. Typical LTV rates in Korea remained at approximately 55%. ■

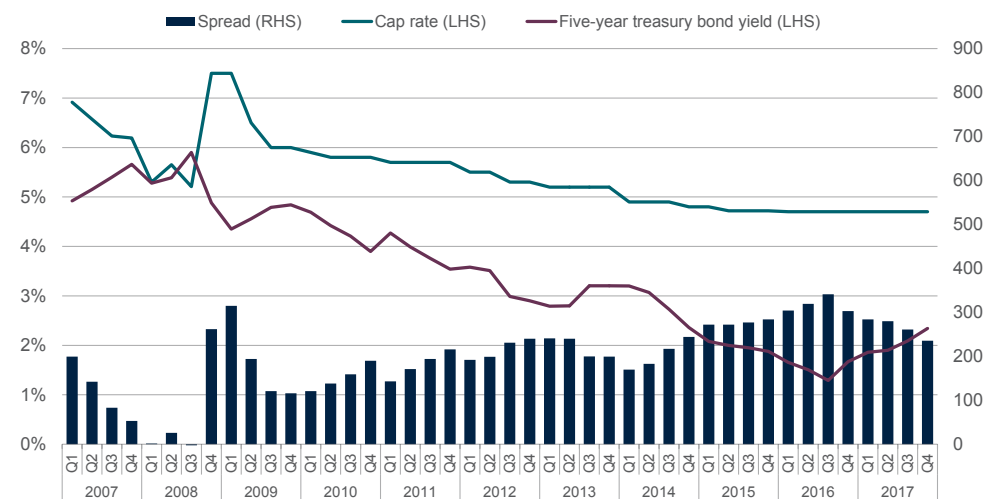
GRAPH 7 Office transaction volumes, Q1/2008 – Q4/2017



*In 2017, the transaction of KEB Hana Bank Myeongdong (SPA signed) is excluded.

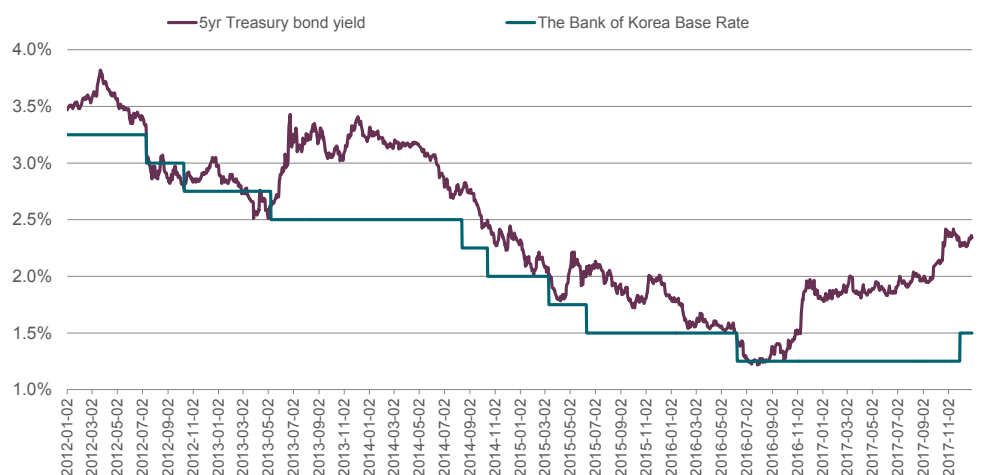
Source: Savills Korea

GRAPH 8 Prime office building cap rate trends, Q1/2007 – Q4/2017



Source: Savills Korea, Bank of Korea

GRAPH 9 Five-year Treasury bond yield and the BOK base rate trends, Jan. 2012 – Dec. 2017



Source: Bank of Korea

TABLE 3 Major investment transactions, Q4/2017

District	Building name	Seller	Buyer	Transacted area (sq m)	Transaction price (KRW bil)
CBD	Hyundai Group Yeonji-dong HQ	Koramco AMC	Hyundai Elevator	52,476	245.0
CBD	Metro Tower	Vestas Investment Management (Angelo Gordon)	ANDA AMC (Tongyang Life Insurance)	39,908	240.0
CBD	KEB Hana Bank Eulji Annex	KEB Hana Bank	Kyowon Group	13,244	91.5
GBD	Icon Yeoksam	Yeoksam Office PFV (GL)	Ascendas	19,580	103.0
Gangnam	Gangnam POBA Tower	IGIS AMC (POBA)	IGIS AMC (PAG)	44,411	Approx. 300
Non-core	West Finance Center	Shinhan BNP Paribas AMC (Ascendas)	Mastern AMC	92,173	295.0

Source : Savills Korea

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Appendix

Overview of the Seoul office market and Savills Korea office survey

TABLE 4
Summary of surveyed buildings, Dec. 2017

		CBD	GBD	YBD	Total
A	Number of buildings	23	12	9	44
	Average GFA (sq m)	85,000	99,000	101,000	92,000
	Average year of completion	2006	2004	2004	2005
B	Number of buildings	22	18	9	49
	Average GFA (sq m)	54,000	48,000	45,000	50,000
	Average year of completion	2004	1999	1996	2001
Total number of buildings		45	30	18	93
Total area (sq m)		3,150,000	2,040,000	1,310,000	6,500,000

Source: Savills Research & Consultancy

Close to 60.3% of large office buildings (30,000 sq m or more) in Seoul are located in three major business districts – the CBD (31.0%), GBD (16.7%) and YBD (12.6%). The CBD is the largest of these districts and is home to major government and multinational institutions. The 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 93 of the 120 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 (90%) × 12 / transaction amount.

For comparison of cap rates of each transaction case, a 5% interest rate on security deposit and 90% occupancy rate were uniformly applied.