

Seoul Prime Office



Demand for Seoul prime offices rises

The vacancy rate dropped by 1-2 percentage points (ppt) due to plentiful new leases and upgrade demand in the three major districts.

- Demand increased but differed by district as expansions by customer service and co-working operators, digital platform providers, and finance firms other than banks were notable in CBD, GBD, YBD, respectively.
- The total volume for the first half of the year—including Q2/2019 transaction volume of KRW4.6 trillion—exceeded the figure posted in 2H/2018 when the total annual investment volume hit a record high.
- The Bank of Korea lowered its economic outlook for 2019 due to the protracted US–China trade war, a sharp fall in semiconductor sales, and Japanese restrictions on exports.
- For Seoul prime office buildings, the average face rent recorded a 2.0% increase combined with a maintenance fee hike of 2.2% from the same quarter of the previous year, which is higher than the CPI of 0.7%.

“The sale of buildings in advance of the completion of several large-scale projects in 2020—as a hedge against uncertainty, to improve capital efficiency or because of demand for headquarter offices—is increasing despite concerns about a slowdown in the economy.”

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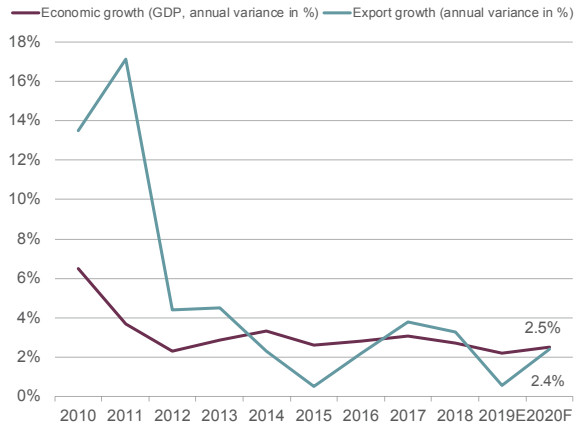
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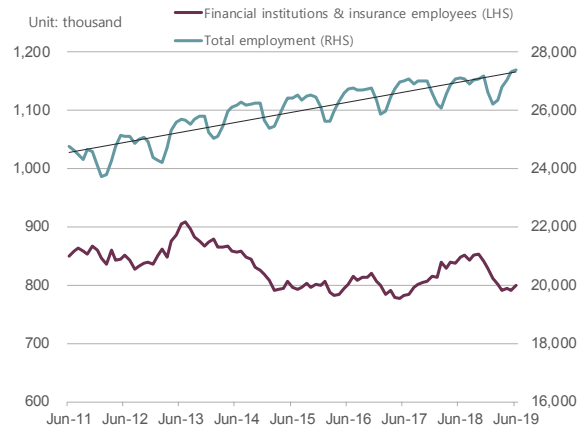
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GRAPH 1: Growth Rate of Real GDP and Real Exports, 2010 to 2020(F)



Source Bank of Korea

GRAPH 2: Number of Employees in Finance and Insurance Sectors, June 2011 to June 2019



Source Korean Statistical Information Service

SUPPLY

At the end of May, Eulji Twin Tower (formerly Summit Tower) was launched in the fringe CBD, delivering 146,680 sq m of space. After the completion, it became the new home for Daewoo E&C's headquarters as they moved into the whole west wing as well as the 3th-7th floors of the east wing on a ten-year lease. BC Card, which acquired some of those floors (5th-7th) as well as the 8th-20th floors of the east wing, will use the higher floors as its headquarters when it moves in a year's time. The remaining space (half of the 7th up to the 12th) in the east wing has been leased to other tenants.

ECONOMIC OUTLOOK

At its 18 July monetary policy meeting, the Bank of Korea (BOK) lowered the base rate to 1.5% (-25 bps) while adjusting the economic outlook to 2.2% (-0.3 of a ppt). The moves come eight months after the BOK announced it was raising the base rate 25 bps. The BOK is known to have adjusted its economic outlook due to: heightened tensions between the US and China over tariffs, which have restrained global trade; Japanese sanctions that will likely hamper the economy; and an already embattled semiconductor sector. The consumer price index is expected to slow down to 0.7% compared to last year's rise of 1.5%. While increasing household income concerns have resulted in a pessimistic consumer confidence outlook, inflation on the demand side remained steady. Furthermore, both supply factors and policy decisions have kept inflation in check. These include: curtailed oil prices in the face of an economic slowdown; lower food prices due to a bumper season for agricultural and marine products; and expanded welfare policies for education and healthcare.

DEMAND AND VACANCY RATES

Demand for Seoul prime office rose in all three districts in Q2. Net absorption increased more than 30,000 sq m in every district for a total of 97,600 sq m. GBD saw the largest net absorption of 33,600 sq m; its vacancy rate has been stable for seven consecutive quarters since Q4/2017. CBD, which had the highest vacancy rate among the three districts in the last quarter due to the large vacant space at Concordian (formerly Kumho Asiana Main Building.), recorded 32,200 sq m of net absorption, aided by plentiful new leases and upgrade demands compared to the other districts. Following on from the first quarter, active expansion and relocation demands from finance-oriented companies continued in Q2, and YBD recorded 31,800 sq m of net absorption.

The Seoul prime office vacancy rate decreased to 10.0%, down 1.6 ppts from the previous quarter. The CBD vacancy rate was 14.9% in Q2, down 1.1 ppts from the previous quarter. Although a high vacancy rate seemed inevitable following Daewoo E&C's relocation to Eulji Twin Tower from Vantage Tower (formerly Daewoo E&C Shinmunno Building), the impact on vacancy rate will be minimal as Kim & Chang will consolidate its offices to Vantage Tower. GBD recorded a vacancy rate of 3.8% after 18,700 sq m and 19,900 sq m of space were leased in Luceen Tower and Gangnam N Tower, respectively. YBD's vacancy rate dipped to 8.2%, dropping below 10% for the first time in six years. Even though net absorption increased evenly across the districts, CBD holds the largest building stock, and so the vacancy rate decrease in the CBD was the smallest.

Expansion of co-working spaces and upgrade demands were notably visible in

TABLE 1: New Supply, Q2/2019

BUILDING NAME	Eulji Twin Tower	
ADDRESS	170, Eulji-ro, Jung-gu, Seoul	
GFA (SQ M)	146,680	
COMPLETION DATE	May 2019	
FLOOR	20F / B8F	

Source Savills Korea

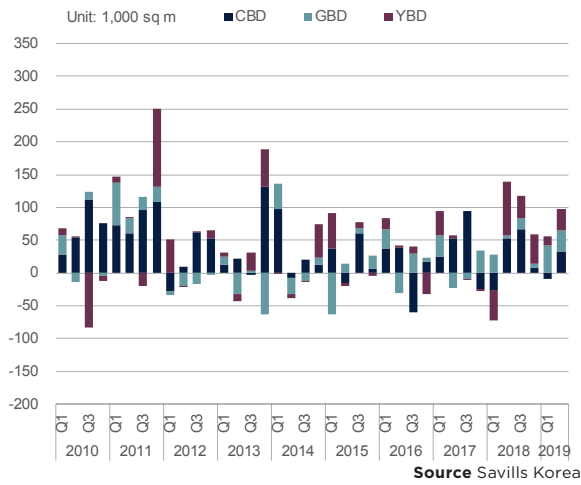
TABLE 2: Monthly Rents, Maintenance Fees and Vacancy Rates by District, Q2/2019

(Unit: KRW/3.3058 sq m, GLA)

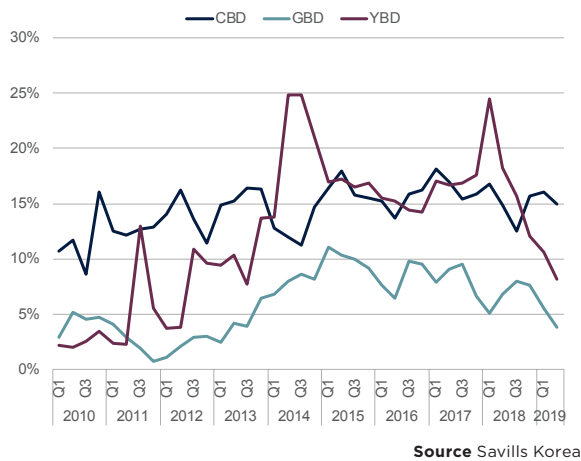
DISTRICT	RENT		MAINTENANCE FEE		NET ABSORPTION AREA (SQ M)	VACANCY RATE (%) (PREV. Q)
	AVERAGE RENT	YoY INCREASE (%)	AVERAGE MAINTENANCE FEE	YoY INCREASE (%)		
CBD	109,300	1.9%	43,300	1.9%	32,200	14.9%(16.0%)
GBD	95,600	2.3%	39,400	2.5%	33,600	3.8%(5.5%)
YBD	80,600	1.4%	38,700	2.2%	31,800	8.2%(10.6%)
Overall Seoul Average	99,300	2.0%	41,100	2.2%	97,600	10.0%(11.6%)

Source Savills Korea

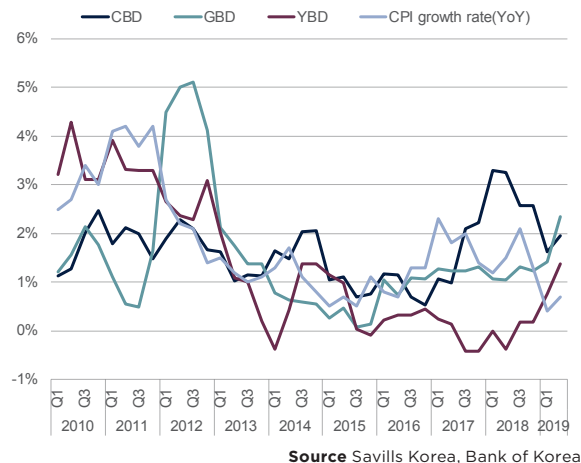
GRAPH 3: Net Absorption, Q1/2010 to Q2/2019



GRAPH 4: Seoul Prime Office Vacancy Rate, Q1/2010 to Q2/2019



GRAPH 5: YoY Rental Increase Rate by District, Q1/2010 to Q2/2019



CBD. JustCo, a Singaporean co-working space operator, opened its first branches at Seoul Finance Center (7,500 sq m) and Ferrum Tower (4,000 sq m), while FastFive, a local co-working space operator, opened a new branch at Center Place (5,200 sq m). Furthermore, Boram Mutual Aid moved into Taepyeongno Building from Yeoksam Heights Building, leasing 6,300 sq m of space. CJ Logistics, previously located in Pacific Tower, relocated to Taepyeongno Building, to occupy most of the remaining vacant space. However, as a relocation in-between the same district, the impact on the district vacancy rate was negligible.

As internet-only banks expand their services and financial transactions using digital channels become the norm, banks are looking for space, notably in CBD, to grow their customer relations and financial advisory services. Shinhan Bank added another floor to the four floors it leases in Booyoung Taepyeong Building, located next to Shinhan Bank headquarter building, in order to expand its customer service/data centre. Kakao Bank, which originally leased three floors in KDB Life Building, secured another floor to extend its call centre operations.

GBD vacancy rate decreased to 3.8%, down 1.7 of a ppt from the previous quarter, due to the shrinkage of huge vacant spaces in Luceen Tower and Gangnam N Tower. Coinciding with its listing on the stock exchange, Hyundai Autoever leased nine stories (19,900 sq m) in Luceen Tower. The move consolidated its offices, which had been spread over Autoway Tower, Hyundai-KIA Yangjae headquarters and Uiwang-si, Gyeonggi-do, and caused the vacancy rate of Luceen Tower to drop to around 40%. IT-related companies—EA Korea, a game developer;

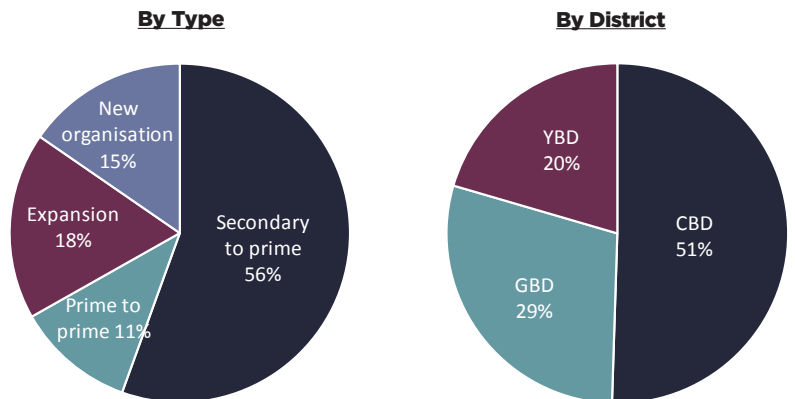
Unity Technologies Korea, a 3D platform developer for game and media; and Qoo10, an e-commerce platform provider, among others—took over a total of 18,700 sq m in Gangnam N Tower, which resulted in a drop in the GBD vacancy rate. With Google Korea expanding its offices at Gangnam Finance Center and Viva Republica opening new offices in Posco Tower Yeoksam (formerly Posco P&S Tower), the growth of digital companies was notable in GBD.

Upgrade demands from financial industries, in some cases following the disposal of their headquarters, as well as reconstruction plans drove down the YBD vacancy rate to 8.2%, a drop of 2.4 ppt compared to the previous quarter. Meritz Securities, which sold both its no. 1 and 2 headquarters and part of Meritz Capital (previously located in Meritz Fire & Marine Insurance Yeouido headquarters), upgraded their offices by relocating to six floors of Three IFC. Teachers' Pension moved into FKI Tower, leasing 3,600 sq m of space, as Korea Teachers Pension Building. (KTPB) emptied out in preparation for redevelopment. Plans there call for a skyscraper stretching from B5 to the 42nd floor with a launch in 2023. With Quantec, a fintech company based on Robo-Advisor algorithm, moving into KT Yeouido Building from a co-working office to launch investment advisory services and KDB Investment moving into Two IFC, financial institution demands for both upgrade and expansion seemed to continue. Lastly, 'The Smart Suites at IFC', a serviced-office operated by IFC Seoul, took over 3,000 sq m at Two IFC.

RENT

The average face rent for Seoul prime office was KRW99,300/3.3 sq m, up 2.0% YoY. By

GRAPH 6: Take-up, Q2/2019



district, GBD recorded the highest increase of 2.3%, while CBD and YBD increased 1.9% and 1.4%, respectively. Compared to other districts, GBD showed a higher rental growth rate because some buildings, including Autoway Tower, were able to increase rents after a number of long-term tenants moved out.

The average monthly maintenance fee for Seoul prime office was KRW41,100/3.3 sq m, which was an increase of 2.2% YoY. Though every district showed a similar increase, GBD showed the highest among the three. If the maintenance fee is calculated based on leasable area, the order may seem to be CBD, GBD, YBD, however, if it is calculated based on net area, YBD's maintenance fee is seen to be KRW400 higher than GBD.

OUTLOOK

In Q3/2019, face rents, maintenance fees and vacancy rates are expected to maintain similar levels to Q2.

CBD's average vacancy rate is expected to remain unchanged, although APEX Tower (formerly Seosomun 5 district) will be delivered in Q3. In anticipated moves, Hyundai Engineering & Construction will take over six floors (12,100 sq m) in Concordian Building while Netflix Korea will move into two floors (5,700 sq m) in Centropolis. Following a Q2 trend, customer relations and advisory services should continue to expand their footprints. Reports are that Agoda, which originally operated a call center at Pine Avenue, will add another floor to increase its customer relations operations while Google Korea will expand its call center in KDB Life Building.

The GBD vacancy rate will decrease to around 2% within the year as

demands from the IT industry continue to grow. Gangnam N Tower is expected to be fully occupied after Naver, originally from Pangyo, opens offices on two floors and Samsung Securities leases the remaining vacant space. As companies move into the district—Red Hat, an open source software provider, to Asem Tower; Npixel, a game developer, to Posco Tower Yeoksam; and Sangsangin Investment & Securities to Samsung Life Insurance Daechi Building—GBD's stable vacancy rate will last for a while.

The YBD vacancy rate will decrease on the back of finance companies' moves. However, a short-term rate increase is inevitable due to relocations and openings. Hanwha Engineering & Construction is expected to relocate to Hanwha Janggyo Building (CBD) from FKI Tower, generating eight floors of vacant space in Q4/2019. Furthermore, several large-scale projects, such as Parc. 1, Yeouido Post Office and KB Finance Town, will be delivered in 2020, increasing YBD's prime office stock (as of June 2019) by almost 30%.

TRANSACTIONS AND INVESTMENT MARKET

Total volumes for the first half of this year were recorded at KRW6.6 trillion, exceeding the KRW6.1 trillion figure posted in 2018 for the same period when annual total investment volume hit a record high. The transaction volume for Q2/2019 stood at KRW4.6 trillion, despite concerns about a slowdown in the economy, thanks to abundant liquidity and low interest rates.

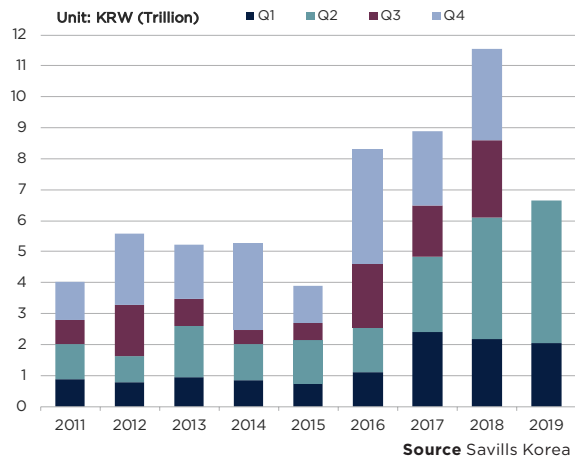
Transactions are especially active in YBD, where five deals closed in this quarter and four more deals are scheduled to close soon. Sellers disposed of their assets before the expected completion in 2020 of several large-

TABLE 3: Major Tenant Relocations, Q2/2019

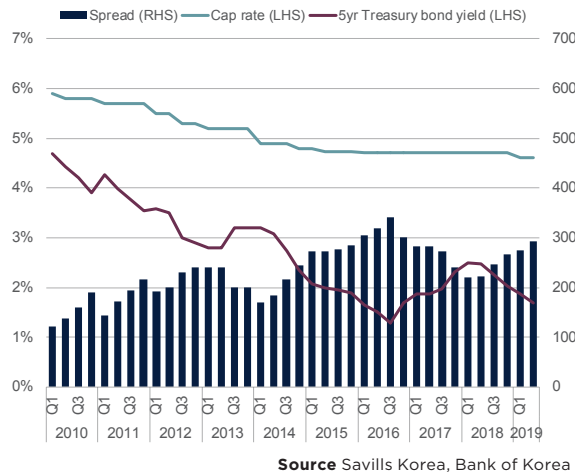
	TO			FROM	
	BUILDING	TENANT	AREA (SQ M)	DISTRICT	BUILDING
CBD	Seoul Finance Center (SFC)	JustCo	7,500	NEW	
	Taepyeongno Bldg.	Boram Mutual Aid	6,300	GBD	Yeoksam Heights Bldg.
	Taepyeongno Bldg.	CJ Logistics	5,500	CBD	Pacific Tower
	Centerplace	Spark Plus	5,200	NEW	
	Ferrum Tower	JustCo	4,000	NEW	
	Booyoung Taepyeong Bldg.	Shinhan Bank	3,700	Expansion	
	KDB Life Bldg.	Kakao Bank	2,700	Expansion	
GBD	Luceen Tower	Hyundai AutoEver	19,900	GBD / Non-core	Autoway Tower, Hyundai-KIA HQ (Yangjae-dong), Uiwang-si(Gyeonggi-do)
	Gangnam N Tower	EA Korea	7,400	GBD	NC Tower 1
	Gangnam Finance Center (GFC)	Google Korea	5,400	Expansion	
	Autoway Tower	Hyundai Motor Group	3,800	Expansion	
	Gangnam N Tower	Syneos Health	3,500	GBD	Maple Tower
	Gangnam N Tower	Unity Technologies Korea	2,400	GBD	Grace Tower
YBD	Three IFC	Meritz Securities-Capital	18,400	YBD	Meritz Securities Head Office Bldg. & Annex Bldg., Meritz Fire & Marine Insurance Yeouido HQ
	FKI Tower	Teachers' Pension	3,600	YBD	Korea Teachers' Pension Bldg.
	Two IFC	The Smart Suites at IFC	3,000	NEW	
	KT Yeouido Bldg.	KT	2,400	Expansion	

Source Savills Korea

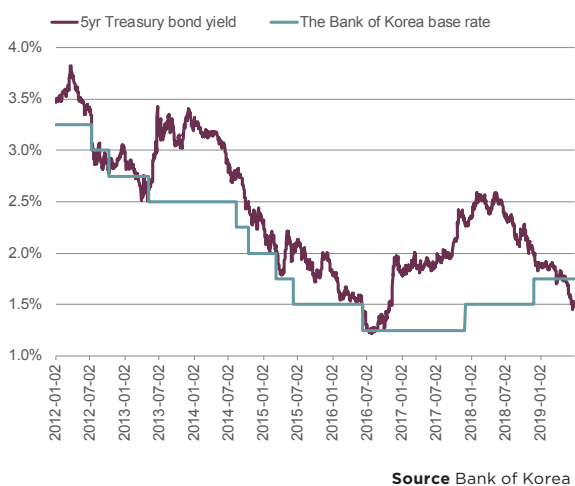
GRAPH 7: Office Transaction Volumes, Q1/2011 to Q2/2019



GRAPH 8: Seoul Prime Office Building Cap Rate Trend, Q1/2010 to Q2/2019



GRAPH 9: Five-year Treasury Bond Yield and the BOK Base Rate Trend, January 2012 to June 2019



scale projects including Parc.1, Yeouido Post Office and KB Finance Town, to hedge against uncertainty and improve capital efficiency through disposal of headquarters of financial securities. On the other hand, investors acquired assets to improve profitability by altering use to retail or housing facilities, with low costs relative to other districts and demand for use as headquarters after acquisition.

In CBD, the total transaction volume for Q2/2019 was KRW2.4 trillion. KT AMC and BC Card purchased Eulji Twin Tower West and East for KRW481.5 billion and KRW376.4 billion respectively in May, in the Sewoon redevelopment promotion area. KT AMC acquired office area in West Wing and retail area in East Wing through a REIT. Daewoo E&C, a construction company, moved its headquarters into West Tower, with KTCU as the major investor. BC Card plans to use East Tower as a consolidated HQ, gathering employees from HQ near Nambu Terminal and several other buildings.

Mirae Asset AMC acquired State Tower Namsan (STN) for KRW588.6 billion from CBRE GI, recording a unit price of KRW29.1mil/3.3sqm, despite large-scale vacancies caused by the relocation of law firm Shin & Kim to D Tower in the first quarter. KIC, a tenant in STN, and a blind fund from Korea Post are known to be the major equity holder. Mirae Asset Daewoo was reported to underwrite the remainder.

KB AMC purchased Jongno Tower from IGIS AMC for KRW463.7 billion (KRW25.3mil/3.3sqm), raising money partially from a public offering fund, with KB Securities underwriting rest of the deal. Samsung Life Insurance, previously a major tenant, moved out in Q1/2018 and caused

large-scale vacancies in Jongno Tower. However, as WeWork leased eight floors and tenants like McDonald's and Ctrip moved in, the occupancy rate increased.

In GBD, recent sales transacted after the vacancy rate was stabilised through securing coworking offices as anchor tenants. Woori AMC disposed of Mitta Tower, after securing WeWork on all floors, for KRW120 billion (KRW26.3mil/3.3sqm) to Shinhan REITs Management. Shinhan Capital and Shinhan Bank participated in the deal as equity investors and the public funding partial amounts.

Saengbo Real Estate Trust acquired Samsung Life Insurance Samsong-dong Building from Samsung SRA AMC for KRW233.2 billion (KRW25.13mil/3.3sqm). Teachers' Pension, KB Securities and KFCC are the major equity investors and Hyundai Engineering, a project management service provider, is known to invest partially as well. As of end-June, Samsung Life Insurance Samsong-dong building is fully occupied with Interpark, Kolon Industries and iMarket Korea as the major occupants.

In YBD, five asset sales (totalling KRW580 billion) closed. NH Investment & Securities HQ, KTB Building, Meritz Fire & Marine Yeouido Building and Samsung Life Insurance Yeouido Building are projected to close in the second half of this year. Korea Credit Bureau and Koscom purchased Meritz Securities Head Office Building and KB Kookmin Bank Yeouido Head Office Annex respectively to use as its headquarters. Mastern Investment Management acquired the Meritz Securities Annex Building to develop existing office space into housing. Also, as mixed-use complex developments like the Parc.1 project and Brighten Yeouido (a MBC site

TABLE 4: Major Investment Transactions, Q2/2019

DISTRICT	BUILDING NAME	SELLER	BUYER	TRANSACTION AREA (SQ M)	TRANSACTION PRICE (KRW BIL)
CBD	State Tower Namsan	CBRE-GI	Mirae Asset AMC	66,799	588.6
CBD	Eulji Twin Tower	The Unistar	KT AMC / BC Card	146,676	857.9
CBD	Jongno Tower	IGIS AMC (Alpha)	KB AMC	60,601	463.7
GBD	WeWork Tower (formerly Mitta Tower)	Woori AMC (Aberdeen Standard Investments)	Shinhan REITs Management	15,074	120.1
GBD	Samsung Life Insurance Samsong-dong Bldg.	Samsung SRA AMC	Saengbo Real Estate Trust	30,676	233.2
YBD	Yeouido Finance Tower	Samsung SRA AMC	Keppel Investment Management	42,346	232.2
YBD	Meritz Securities Head Office Bldg.	Meritz Securities	Korea Credit Bureau	11,042	51.1
CBD	Meritz Securities Annex Bldg.	Meritz Securities	Mastern Investment Management	12,223	62.9

Source Savills Korea

redevelopment project) are scheduled to deliver, thus improving living conditions, demand for housing facility in Yeouido might be increasing.

Amid active office acquisition from domestic investors, Keppel Capital investment stood out among foreign investors. Singapore's Keppel Investment Management purchased Yeouido Finance Tower (YBD), Nonhyun Building (GBD), and Naeja Building (CBD) for KRW232.2 billion, KRW125.5 billion, and KRW77.2 billion, respectively. Keppel REIT acquired T Tower for KRW252.6 billion from IGIS.

The number of transactions in Mapo and Yeongdeungpo increased, with Taeyoung Building, Times Square (office), D-Cube City (office) and Young City as ongoing deals. KEB Hana Bank Myeongdong headquarters is also reported to close this year. With the continuing low interest rate environment and a policy rate cut in July, if ongoing deals close, the total transaction volume for 2019 is expected to show a level similar to the previous year.

In Q2/2019, the average prime office cap rate stood at mid-4%, calculated using face rent and 90% occupancy. However, considering leasing concessions (such as rent-free periods and tenant-improvement incentives) and actual occupancy rates, the effective cap rate is in the low- to mid-4% range. Recently, it became known that an asset in GBD transacted at under 4%. The average five-year treasury yield in Q2/2019 decreased to 1.7%, indicating a prime office cap-rate spread of approximately 290 bps. Typical LTV rates in Korea remained at approximately 55%.

The government's pre-announcement of legislation last April to revise the tax base on private real estate funds (excluding separate taxation on the land owned by private real estate fund, and imposing a Comprehensive Real Estate Holding Tax) has spurred concern for AMCs and beneficiaries on profit margin erosion due to tax increases.

Overview of the Seoul Office Market and Savills Korea Office Survey

Table 5: Summary of Surveyed Buildings, June 2019

		CBD	GBD	YBD	Total
A	Number of buildings	24	12	10	46
	Average GFA (sq m)	87,000	99,000	99,000	93,000
	Average year of completion	2003	2004	2005	2004
B	Number of buildings	23	20	8	51
	Average GFA (sq m)	54,000	48,000	46,000	50,000
	Average year of completion	2000	2001	1996	2000
Total number of buildings		47	32	18	97
Total area (sq m)		3,340,000	2,140,000	1,350,000	6,830,000

Source Savills Korea Research & Consultancy

Close to 60% of large office buildings (30,000 sq m or more) in Seoul are located in three major business districts – the CBD (31%), GBD (17%) and YBD (13%). 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 97 of the 123 buildings in Seoul classified as “prime” buildings.

Prime buildings: Buildings with GFA greater than 30,000 sq m with good accessibility and facilities, 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.