



# Spotlight Seoul Retail

2H 2018





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"Amidst the rise of online commerce and the shrinking share of offline retail sales, changes in the retail real estate environment are highly visible. Owner/operators continue to liquidate hypermarkets and department stores as the market for these assets remains stable. Investment targets are becoming more varied, such as buying small- and medium-sized buildings, partaking in shopping mall development projects, and converting office floors to retail floors."

## → Sales of major retailers

While traditional retailers are experiencing stagnant offline sales, online sales have grown by double digits annually over the past three years, and grew 16.3% YoY in the first half of 2018. Online sales accounted for 19% of the total retail sector as of Q1/2018, and the sector's growth can be attributed to several factors: the rise of single-person households and working couples; the country's high penetration of smartphones; and the convenience of the online shopping environment, which retailers have created to spur consumers to shop online more.

South Korean President Moon Jae-in's recent pursuit of income-led growth policies delivered several minimum-wage hikes and shorter working hours. The minimum wage has risen 29% over the past two years, and the workweek has been shortened to 52 hours per week for companies with more than 300 employees. Sole proprietors and SMEs, especially those who operate convenience stores and hypermarkets that incur relatively higher payrolls as a percentage of operating expenses, have alleviated wage pressures and improved profitability by reducing their hours of operation and expanding the number of cashier-less stores by installing self-checkout machines.

## Expansion of online shopping

To provide consumers with the best shopping experiences, online retailers are building seamless shopping experiences by meticulously focusing on ordering, payment and

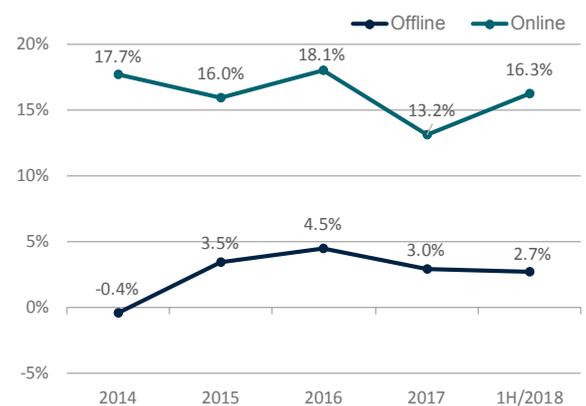
delivery solutions. As the number of tech-savvy consumers grows, the online share of the retail market is expanding faster than 10% per annum. Recently, retailers in the furniture, electronic goods and food categories have experienced strong sales growth. As of year-end 2017, online sales of furniture and electronic goods were valued at KRW11.2 trillion, and the online food sector was valued at KRW11.9 trillion, growing 85% and 150% respectively in only three years' time.

Improvements in convenient payment solutions and early morning delivery services have contributed to the growing demand for online shopping of fresh food and Home Meal Replacement(HMR) products. Because food products and brands tend to have relatively high customer loyalty and retention rates, retailers are focusing their efforts on acquiring and retaining customers. To gain competitive advantages in delivering fresh food products in a timely fashion, retailers are working hard at improving their logistics systems and delivery services.

As large retailers chase ever-faster delivery times, they are locating fulfillment centers closer to consumers in order to achieve accurate deliveries. Homeplus and Lottemart are utilizing their carparks and storage areas as send-off points, and repurposing existing facilities for receiving and processing merchandise to enable more efficient processing of online orders.

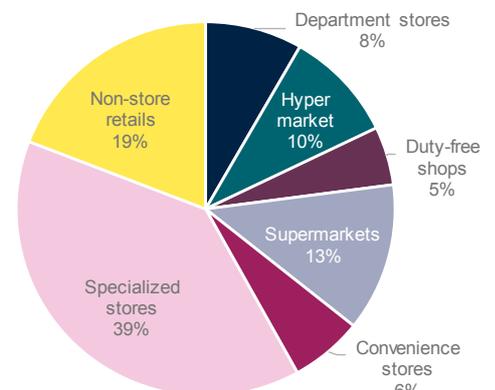
Because of this, offline retailers have an advantage over pure-play

GRAPH 1  
Offline and online retail sales growth, 2014 – 1H/2018



Source: Ministry of Trade, Industry and Energy, Major retail companies' statistics

GRAPH 2  
Retail sales share by channel, Q1/2018



\* Non-store retails including home shopping, online shopping, door to door sale  
Source: Statistics Korea

online retailers. They can utilize their own brick and mortar stores and distribution centers to facilitate delivery services quicker and easier. As such, Coupang, Wemakeprice and other online retailers as well as

➔ Lotte, Shinsegae, SK and other retail conglomerates are all planning to invest significantly in merging their online and offline businesses by strengthening online platforms and constructing fulfillment centers for handling online sales.

### Changes to offline stores

As offline department stores and hypermarkets experience stagnating and even declining growth, retailers are searching for ways to differentiate themselves, other than by price, and are executing strategies to improve their stores' competitiveness. Stores are tapping into the 'experience economy' by offering consumers unique retail offerings, a sense of community, and more opportunities to relax and socialize on site. Besides increasing footfall traffic and time spent in-store, retailers are aiming to improve average basket and transaction sizes. As such, store formats are becoming more flexible and varied.

'Category killers' focusing on a specific segment or product is a new and emerging trend. Emart opened its Pierrot Shopping store at Starfield Coex this June to cater to 20-to-30-year-olds. This store, offering 'fun' products at affordable prices, attracts consumers who are seeking an entertaining shopping experience. Shinsegae Department Store entered the health and beauty market by launching a multi-shop, Chicor, with curated cosmetic products. In addition to locations within shopping malls, Chicor is expanding its presence in major retail districts with standalone stores, such as its newly-opened premises located on Gangnamdaero high street. Sephora, the world's largest cosmetics multi-shop, is expected to enter the Korean market in Q3/2019.

Meanwhile, major retailers continue seeking improved operational efficiencies. New hybrid format stores are being established by razing existing offline channels and leveraging the advantages of alternative channels. Lotte supermarkets has partnered with the health and beauty chain LOHBs to create 'Lotte Super with LOHBs'. Homeplus created a low-price warehouse concept store called 'Homeplus Special Store' to offer new experiences to consumers.

Another development plan involves

retailers expanding their micro-stores at inner-city locations as well as stores within shopping complexes located on the city outskirts. Starfield is expected to open its first 'Starfield City' micro-store at Wiryu New Town in December 2018. In August, AK Plaza opened a neighborhood shopping center, 'AK& Hongdae', near Hongik University station. By expanding their customer bases and connection points, these neighborhood segment stores are likely to continue to rise in popularity.

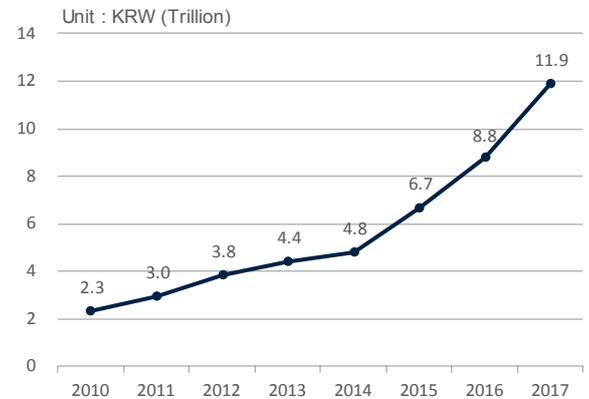
### Investment market

Even though the domestic retail market revolves largely around retail conglomerates, institutional investors are varying their investment targets by buying small- and medium-sized buildings, partaking in shopping mall development projects, and repurposing office facilities, in addition to participating in hypermarket asset liquidation.

For the past two to three years, institutional investors, in particular pension funds, have been managing retail funds that buy small- to medium-sized assets. This has led to increased retail investment in small- to medium-sized assets in key retail districts such as Myeong-dong, Hongdae and Garosugil. To improve retail asset values, the institutional investors are attracting influential brands as tenants and strategically partnering with retailers, who are able to sign master leases.

Recent investment transactions in Myeong-dong demonstrate this trend. Angelo Gordon bought KB Bank Myeong-dong HQ (completed in 1972) for KRW241.2 billion (KRW307 million/3.3m<sup>2</sup>) in Q1/2018 and plans to develop the building into a 17-floor complex comprised of commercial space (lower floors) and a hotel (upper floors). Angelo Gordon also bought a small-sized Sungshin building in Q2/2016, located near Euljiro 1-ga station, and re-developed it into a retail facility, which is currently being marketed for lease. The Myeong-dong's Chunghwui Building, which Morgan Stanley bought in Q2/2018, is currently under renovation in a project developed by partners IGIS AMC and SK D&D to create a retail and hotel complex, part of which has already been allocated to Sotetsu Hotels. Sotetsu will sign a master lease for the upper floors.

GRAPH 3 Online food category sales, 2010 - 2017



Source: Statistics Korea

TABLE 1 Category Killers

Type		Brand
Domestic	Large conglomerate	Pierrot Shopping, JAJU, Olive Young, LOHB's, Chicor
	Medium-sized company	Daiso, ABC Mart
	Online company	Musinsa, Moongori.com
Foreign		MUJI, Flying Tiger Copenhagen, Sephora, Boots

Source: Savills Korea

The Hongdae area is connected to all corners of Seoul, thanks to subway lines number 2, 6 and Gyeongui as well as airport express trains that link to the Hongdae commercial district. This district is changing rapidly, mostly due to the development of new hotels, retail stores and the Gyeongui Line Forest Park. Rents are also rapidly rising, prompting institutional investors to reposition office buildings surrounding Hongik University station by converting the lower floors into retail space.

DaeA Building, located near Hongik University station, was purchased as an office building by Invesco in 2016 for KRW59.2 billion. By converting the lower floors into retail space, this building attracted the Kakao Friends flagship store and concept museum (B2-3<sup>rd</sup> floor). The high-profile tenant led to increased rents as well as a high return on investment for Invesco when they sold the building to Kiwoom Securities for KRW101.6 billion (KRW24.2 million/3.3m<sup>2</sup>). Donggyo Building, also located near the station, was bought by Mercer Investment from Correctional Mutual Aid Association for KRW43 billion (KRW23.5 million/3.3m<sup>2</sup>). Currently

TABLE 2  
Major retail transactions, Q1-Q2/2018

Region	Building name	Transaction amount (KRW bil)	Transaction amount/py (Land value, KRW mil)	Seller	Buyer
Hongdae	DaeA Bldg (Share deal)	101.6	270	Vestas AMC (Invesco)	Vestas AMC (Kiwoom)
Hongdae	Donggyo Bldg	43.0	150	Correctional Mutual Aid Association	Mastern AMC (Mercer Investment)
Myeong-dong	Myeongdong Hollys Bldg	35.5	830	Individual	L&P Cosmetics
Myeong-dong	Chunghwui Bldg	97.0	650	Individual	SK D&D, IGIS AMC (Morgan Stanley)
Garosugil	YPlus Bldg	35.0	240	Individual	IGIS AMC
Konkuk Univ.	Mall of K (Public offering)	56.1	60	STS Development	IGIS AMC

Source: Savills Korea

→ under renovation, the building is scheduled to unveil its new look by November.

Meanwhile, IGIS AMC bought two buildings in Garosugil in Q4/2017 - Swatch Building and an adjacent low-rise building – with plans to demolish the old buildings and build one large retail space. Scheduled for completion in Q3/2019, the newly-constructed retail site will offer a multi-purpose space hosting small, individual retailers. Through a partnership with Wemakeprice, a social e-commerce platform, new and upcoming companies will be identified and invited to become tenants. As the rental property market becomes more tenant-

centric, investors are connecting offline and online channels in order to identify and attract high-quality vendors and sought-after tenants.

IGIS AMC also bought YPlus Building for KRW35 billion (land value, KRW240 million/3.3m<sup>2</sup>), located on the high street of Garosugil. Previously home to the cosmetics brand Aritaum, the YPlus Building currently hosts athletics leisure brand Stretch Angels, which uses the lower floors for its flagship store. The upper floors are occupied by a fashion and beauty curation company Qfora. Directly across the road, Oklim Building, bought by Angelo Gordon, is being used as an LG Electronics pop-up store for showcasing its products.

Thanks to increased ownership of buildings by institutional investors, the high street of Garosugil is seeing a greater diversity of tenants from Land Rover, Apple and LG Tromm Styler to other well-known flagship stores to popular fashion and cosmetic brands.

The recent practice of repositioning lower floors in office buildings into retail space shows no signs of stopping. Hana Card Dadong Building, AEW Capital bought through Pebblestone AMC in Q1/2018, is currently converting its lower levels (B1–4<sup>th</sup> floor) into retail space in a project scheduled for completion November 2018.

Another trend that's likely to continue is securitizing the underlying assets of hypermarkets by listing them as REIT products. E-Land raised KRW79 billion through 'E-REITs KOCREF', which will invest in three of E-Land's NewCore outlet stores in Gyeonggi-do. MBK Partners is considering establishing and listing REITs in a deal that would acquire 40 Homeplus hypermarkets. Similarly, E-Land, Homeplus, Lotte Shopping and other retailers are considering setting up their own REIT AMCs, in order to liquidate their hypermarkets to manage by themselves. Retailers are expected to seek improved profitability from low-growth hypermarket assets and invest in new growth engines generated by the proceeds from securitized assets. With more REITs being managed by professional retailers, the REIT market is certain to expand. ■

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