

# Office Sector Briefing

**Seoul, Korea**

**October 14, 2009**

**"Average prime office face rents declined for the first time in 5 years in Q3/2009 as landlords brace for a doubling in Seoul's vacancy rate by the end of the year due to new supply"**



- Total vacancy for prime office buildings in Seoul rose from 3.4 per cent in Q2/2009 to 4.1 per cent in Q3/2009.
- Average face rents declined 0.2 per cent in Q3/2009, reducing the annual rate of increase to 2.3 per cent. This compares with the peak rental growth of 7.5 per cent at the end of last year.
- Largely to the reopening of Samsung Main Tower and Seoul Square, total prime vacancy in Seoul is expected to double to roughly 8 per cent or above in Q4/2009.
- Following a 10 per cent (annualized) GDP rebound in Q2/2009 and continuing strength in forward economic indicators, Korea's economy has clearly turned the corner. This should lead to some pick up in leasing demand in the new year.
- The improvement in investor confidence has continued into Q3/2009, with average prime building transaction prices having recovered to within 10-15 per cent of their peak in 2008.

Image: Changdeok Palace, Seoul, Korea

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## Market Overview

While Korea's overall economy has clearly turned the corner, the negative effects of the global economic crisis on Seoul's prime office leasing market are yet to show any sign of abating. Average face rents declined in Q3/2009 for the first time in five years, by 0.2 per cent, as ongoing negative net absorption pushed total vacancy up to 4.1 per cent. After taking into account the recent expansion in tenant incentives provided by landlords, we estimate that effective rents for some buildings have fallen by as much as 20 per cent compared with a year ago.

### Seoul Prime Office Market Summary Table, Q3/2009

Business District	Face rent (KRW/3.3058 sq.m. gross leasable area)	Face rent (KRW/3.3058 sq.m. net leasable area)	Increase compared with Q3/2008	Vacancy Rate
CBD	85,000	144,400	1.7%	4.7%
Gangnam	76,500	149,000	1.9%	3.7%
Yeouido	61,200	126,900	4.1%	3.7%
Average	77,100	142,600	2.3%	4.1%

Source: Savills Korea

Upcoming new supply will compound the effects of ongoing weak demand, leading to an approximate doubling of the current overall vacancy rate in Q4/2009 and placing further pressure on rent levels. Although net absorption is expected to turn positive early in the new year, additional completions in 2010 mean there is unlikely to be any sharp improvement in vacancy rates in the near future. Time will tell whether weak leasing market conditions will rein in the buoyant sentiment that has prevailed in the prime office investment market since Q2/2009.

## Prime Office Building Supply

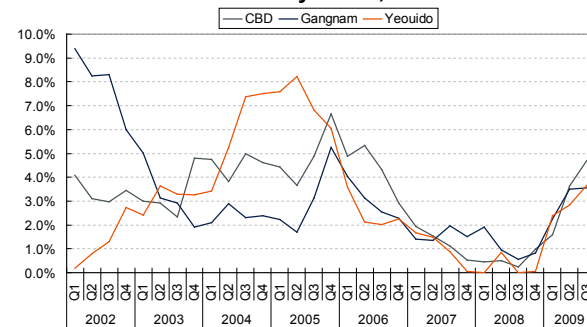
A large mixed development, Time Square, (total GFA 310,000 sq.m.) was completed in Q3/2009 in Yeongdeungpodong, approximately 2km south of the Yeouido Business District. Mirae Asset is understood to have leased approximately one third of the 40,000 sq.m. of office space, with the remainder available for lease.

Q4/2009 will see 2009's only two major additions to the prime office stock in core business districts with the completion of renovations to the 132,900 sq.m. Seoul Square building (former Daewoo Center) and the 83,600 sq.m. Samsung Main Tower building. Together these buildings will add just under 7 per cent to the CBD's total prime stock (including owner-occupied buildings) and will have a substantial impact on the leasing market as discussed below.

Although little new supply is expected early next year, the second half of 2010 will see the completion of a number of prime office developments totaling close to 400,000 sq.m. in new space. Approximately 80 per cent of this new space is located in the CBD and the vast majority will be available for lease.

## Prime Office Leasing Demand & Vacancy

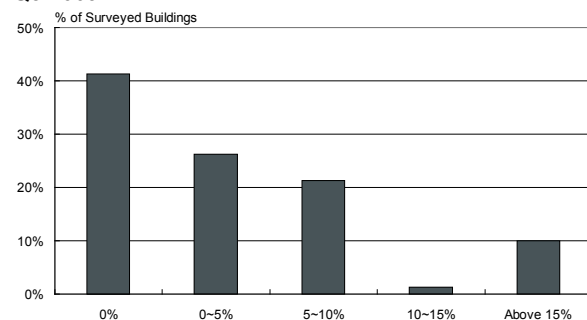
### Seoul Prime Office Vacancy Rates, Q1/2002 - Q3/2009



Source: Savills Korea

Demand for prime office space continued to shrink in Q3/2009. Overall prime building vacancy rose to 4.1 per cent, reflecting a total reduction in leased prime office space of approximately 160,000 sq.m. in the year since the collapse of Lehman Brothers. While roughly 40 per cent of surveyed buildings maintain full occupancy, a growing number of buildings have large spaces vacant, with 10 per cent of surveyed buildings now showing vacancy above 15 per cent.

### Distribution of Vacancy across Sampled Prime Buildings, Q3/2009



Source: Savills Korea

Consolidation in the finance and insurance sector continues to account for up to half of the net reduction in occupied space, with the closure of life insurance branch offices, in particular, responsible for a large proportion of surrendered office space. In Q3/2009, the fall in demand occurred across both Prime A and Prime B buildings in all three business districts, with the exception of Prime A office space in Gangnam, where vacancy was essentially unchanged thanks to the relocation of several large tenants.

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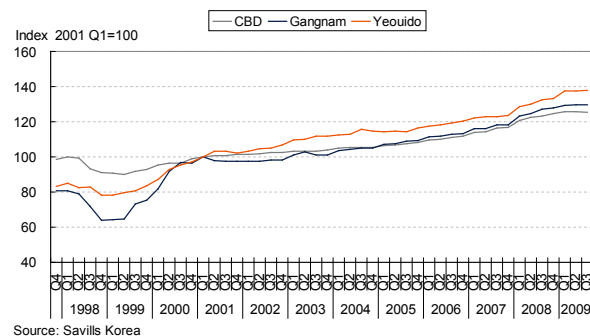
Leasing demand has fallen most rapidly in the CBD, with total vacancy rising to 4.7 per cent overall and 5.6 per cent for Prime A buildings. Prime A vacancy in Yeouido has also risen rapidly, up to 4.1 per cent in Q3/2009, compared with 3.3 per cent vacancy across Prime B buildings.

## Outlook

Already substantially higher than in Gangnam and Yeouido, the CBD's current vacancy rate is expected to rise to well above 10 per cent in Q4/2009, primarily as a result of the reopening of Seoul Square and Samsung Main Tower. Although the latter is to be owner-occupied by Samsung affiliates, their relocation will release a large amount of "backfill" into the CBD prime office market. The impact of this new supply will be exacerbated by our expectation that net absorption in the CBD will be low or negative, with Woori Bank's relocation out of Olive Tower likely to be the most significant negative contributor in this regard. The Bank is scheduled to vacate almost 30,000 sq.m. in Olive Tower to take up space in Shindorim Technomart and the recently completed Woori Finance Sangam Center in the DMC. With net absorption also likely to be negative in Gangnam and Yeouido, total Seoul vacancy is expect to rise to above 8 per cent by the end of the year.

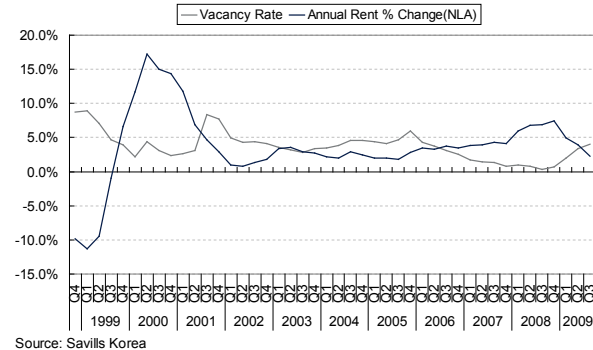
## Prime Office Occupancy Costs

### Seoul Prime Office Building Face Rents, Q4/1997 - Q3/2009



Reflecting the increasing pressure on landlords due to rising vacancy, average face rents in Seoul declined by 0.2 per cent in Q4/2009 - the first time face rents have declined in 5 years. As a result of moderate increases earlier in the year, the annual rate of rental increase was still positive at 2.3 per cent, but this is sharply lower than last year's 7 year peak of 7.5 per cent.

### Seoul Prime Office Building Rental Growth & Vacancy Q4/1998-Q3/2009



The slight quarterly decline was driven by a handful of landlords who reduced their marketing rents by between 3 and 14 per cent to attract and/or retain tenants in the face of high levels of existing or looming vacancy in their buildings. This was offset to some extent by several buildings - all with minimum or zero vacancy - that still managed to sign lease agreements at higher face rents than in the previous quarter. However, as we have noted in previous reports, virtually all landlords are now offering generous tenant incentives such as rent free periods and, in some cases fit-out allowances, to compete for shrinking demand. As a result, we estimate that average effective rents have fallen by around 10 per cent compared with one year ago, and by up to as much as 20 per cent in some cases.

## Outlook

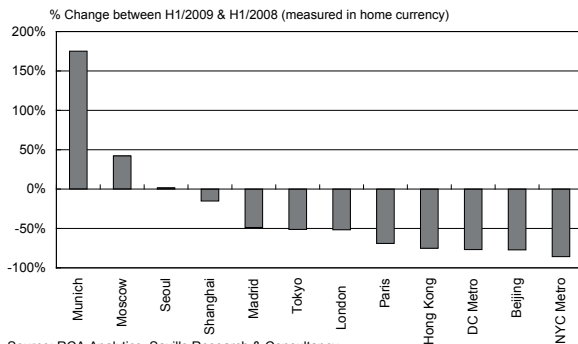
The slight decline in face rents that occurred in Q3/2009 is set to gather momentum from Q4/2009 as landlords are confronted with the highest vacancy rates seen in a decade and ongoing weak demand. Although much of the vacancy will be concentrated in several buildings, we expect the worst affected landlords to become very aggressive in their rent-setting, which will inevitably drive the overall market down.

## Sales & Investment Activity

International data recently released by Real Capital Analytics showed that Seoul was one of only 3 major office markets in the world that saw transaction volumes (measured in home currency terms) in 1H/2009 increase compared with a year earlier. High levels of activity continued into Q3/2009.

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## Office Transaction Volumes in 2009's 12 Most Active Global Markets



The two largest office transactions to close over the quarter were two prominent Prime A buildings in Gangnam: ING Tower and LG Dacom Building. ING Tower was sold to KB Wise Star Private Real Estate Fund #1 for KRW400 billion - one of the largest transactions on record for a single office building in Seoul. Dacom building was sold to Shinhan BNPP Private Real Estate Investment Trust #14 for KRW188 billion, with one of the major investors, Tomato Savings Bank, set to take up roughly 20 per cent of the office space for its own use. Both of these transaction prices were consistent with passing yields of around 5 1/2 per cent, and within approximately 10 to 15 per cent of the prices achieved by similar buildings at the peak of the market in 2008. A third significant transaction was the sale of the CBD's Samsung Life Insurance SK Sunhwa Building, which is fully occupied by SK Construction, to RREEF BVK Korea 1 ABS for KRW92 billion. This transaction represented only the third major office transaction to a foreign institutional investor since Lehman's collapse last year.

While the dramatic rebound in pricing for core-located prime office properties is undeniable, the wave of positive investor sentiment is yet to spread beyond prime hard assets, as evidenced by the large number of pending transactions for development projects and office blocks in secondary areas. It is difficult to see the market for non-prime office stock improving any time soon given weakness in leasing demand and the wave of new prime office supply. Indeed, the looming leasing supply/demand imbalances would seem to indicate that the risks are on the downside for the prime office market, despite continuing local ebullience.

## Selected Transactions, July – September 2009

Building	Vendor	Buyer	Area (sq.m. GFA)	Price (KRW GFA)
ING Tower	ING REIM	KB Wise Star Private Real Estate Fund #1	66,202	400.0
Samsung Life SK Sunhwa Building	Samsung Life	RREEF BVK Korea 1 ABS	21,773	92.2
Dacom Building	KOCREF CR-REIT V	Shinhan BNPP Private Real Estate Investment Trust #14	34,361	188.0
Neowiz HQ (former Onse Communication Bundang office)	Morgan Stanley	Neowiz (80%) + Neowiz Games (20%)	15,941	65.0

Source: Savills Korea

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## Appendix 1: Overview of Seoul office market & Savills Korea office survey

Close to 80 per cent of large office buildings (30,000 sq.m. or more) in Seoul are concentrated in 3 major business districts – the CBD, Gangnam and Yeouido. The 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
<b>A</b>	Number of Buildings	13	13	5	31
	Average GFA (sq.m.)	74,983	99,117	90,963	88,354
	Average Completion year	1996	1999	1994	1997
<b>B</b>	Number of Buildings	21	17	11	49
	Average GFA (sq.m.)	47,096	39,783	43,863	43,580
	Average Completion year	1989	1996	1994	1993
	Total Number of Buildings	34	30	16	80
	Total Area (sq.m.)	1,963,794	1,964,827	937,303	4,865,924

The Savills Korea Quarterly Office Survey is the longest running survey of prime office stock in Seoul. Established in 1997, it currently comprises 80 of the total 122 buildings in Seoul classified as “prime” buildings.

**Prime buildings:** Buildings with a gross floor area greater than 30,000 sq.m. gross floor area, good accessibility and facilities, a high level of finishing materials, and creditworthy 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.

\* Please note that recently implemented changes to Savills Korea's index calculation and sampling methodology have resulted in some minor changes to previously published historical data.

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