

Briefing Seoul office sector

Q3 2017



Image : The K-TWIN Towers, CBD, Seoul

SUMMARY

Newly completed buildings attracted more demand in the CBD, while demand and rents in the YBD fell.

- In 3Q/2017, net absorption increased by 250 ppts, compared to the previous quarter, which led to a slight decline in the vacancy rate, this included a large space relocation of a tenant to an owner occupied building.

- The CBD saw increased office demand, with an active inflow and relocations by affiliates of large companies. However, the GBD saw a decrease in demand due to relocations to Lotte World Tower in Jamsil. The YBD also recorded a demand drop through office downsizing.

- Since June 2016, the BOK base rate has remained steady at 1.25%. However, the five-year Treasury bond yield increased by 20bps, due to political uncertainty.

- Although export volumes and domestic economic growth have expanded, the deficit in the service balance widened, due to a declining number of Chinese tourists visiting Korea.

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"Although the capital market displayed volatility due to geopolitical issues, investment activity in the Seoul prime office continued to thrive."
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Savills Research

→ Supply

In Q3/2017, KEB Hana Bank's HQ building completed in the CBD. The bank's operations, which were scattered across KEB Hana Bank's former HQ building in Myeong-dong, Gran Seoul and Seoul Square, all relocated to this new asset. The new HQ supports smart office functions and includes a bank branch for customer service on B/1, instead of 1/F. The building's design offers customers and staff various amenities, including a library and venues for performing arts, situated in the basement area and 2/F.

Demand and vacancy rate

On October 19th 2017, the Bank of Korea adjusted its projection for 2017 economic growth to 3.0% from 2.8% and kept the BOK base rate at the current level of 1.25%. Even though the Korean economy is recovering, supported by expanding exports and a rebound in domestic consumption, uncertainties still linger over both the domestic and global economy. In August, despite YoY growth in the current account surplus driven by the recovery of exports, the deficit in the service balance widened due to a reduction in Chinese tourists visiting Korea.

In Q3/2017, Seoul's prime office market posted a net absorption of 85,600 sq m, an increase of 250 ppts, compared to the previous quarter. However, major office districts showed differing performance: in the CBD, a net area of 95,500 sq m was taken-up, showing an uptick in demand for prime office space, while the GBD and YBD both recorded reduced demand with their respective net absorption being -7,800 sq m and -2,200 sq m respectively.

Looking at the Q3/2017 vacancy rate of the Seoul prime office market, the CBD saw a decrease of 1.6 ppts, while GBD and YBD witnessed a 0.4 ppts and 0.2 ppts increase


TABLE 1 Monthly rent, maintenance fee and vacancy rate by district, Q3/2017

District	Rent		Maintenance Fee		Net Absorption Area (Sq. m)	Vacancy Rate (%) (Prev. Q)
	Average Rent	YoY increase (%)	Average Maintenance fee	YoY increase (%)		
CBD	103,800	2.1%	41,400	1.8%	95,500	15.4% (17.0%)
GBD	90,500	1.2%	37,700	1.2%	-7,800	9.5% (9.1%)
YBD	78,600	-0.4%	36,500	1.4%	-2,200	16.9% (16.7%)
Overall Seoul Average	94,400	1.3%	39,200	1.5%	85,600	13.8% (14.3%)

Source: Savills Korea

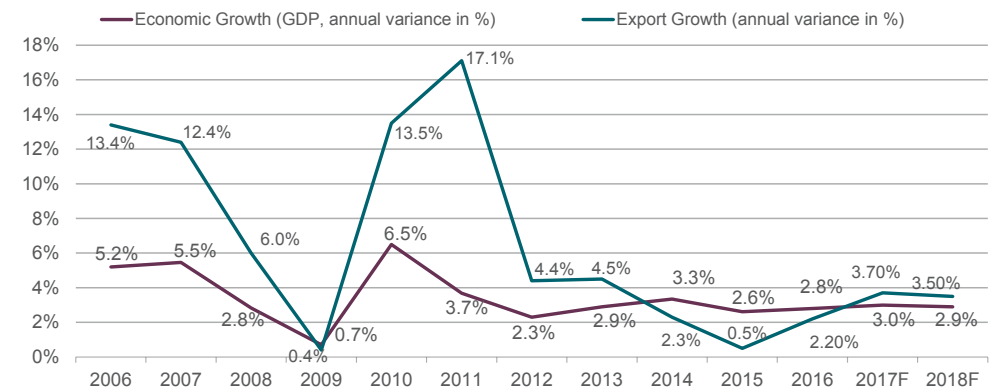
(Unit : KRW/3,305sq m, GLA)

TABLE 2 New supply, Q3/2017

	Building Name	KEB Hana Bank's HQ Building (Eulji-ro)		
	Address	101-1, Eulji-ro 1-ga, Jung-gu	GFA (sq m)	53,981
	Completion Year	2017. 08	Floor	26F / B6F
	Remarks	100% Owner-occupied		

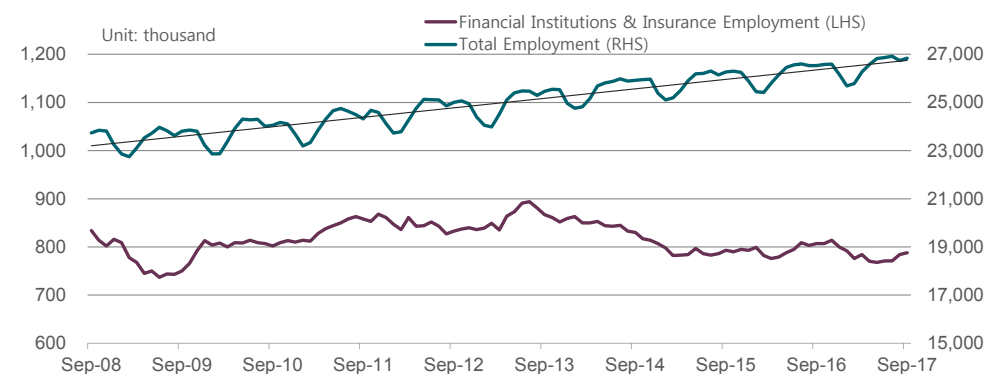
Source: Savills Korea

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, Sep 2008–Sep 2017



Source: Korean Statistical Information Service

→ respectively. The average overall vacancy rate for prime offices fell by 0.5 ppts from the previous quarter to 13.8%.

In Q3/2017, prime-to-prime office relocations accounted for only 13% of the overall vacancy absorption, while secondary-to-prime office relocations mainly from non-major office districts represented 53%. In addition, office expansion made up a greater proportion (20%) in the vacancy absorption compared with previous average other quarters.

By district, the CBD saw an array of relocations by large company affiliates and accounted for 66% of vacancy absorbed, posting the highest proportion of all three major office districts. Meanwhile, the GBD absorbed 23% of vacancy and the YBD 11%, similar to that of the previous quarter.

In the CBD, the vacancy rate dropped 1.6 ppts from the previous quarter to 15.4%. Even though a net area of 95,500 sq m was absorbed in the district, such an absorption led to only a slight decline in the vacancy rate, as the vacancy absorption included the space filled by relocations to KEB Hana Bank's newly completed owner occupied asset. After the building's completion, 39,400 sq m of vacant space was created in Gran Seoul (23,200 sq m) and Seoul Square (16,200 sq m) following Hana Bank's departure. The vacancy rate fell thanks to demand from both large domestic company affiliates and multinational firms moving to the CBD from elsewhere. The Q3 vacancy rate for the Seoul Station area declined dramatically by 8.2 ppts from 21.8%, as posted last quarter, to 13.6%; due to large deals in both Seoul Square and Twin City Namsan. In addition, Dutch co-working space company, Spaces, opened its first branch in Korea, leasing one floor of Gran Seoul.

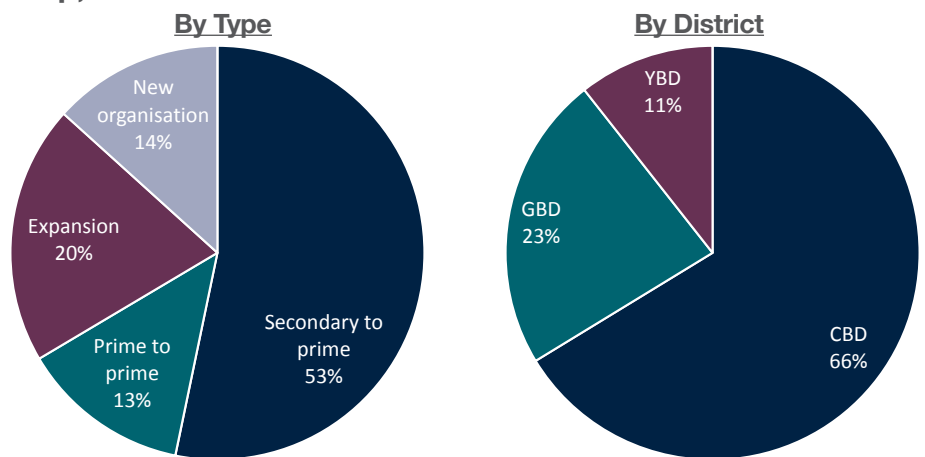
In GBD, the vacancy rate rose 0.4 ppt

QoQ to 9.5%. Descente, the anchor tenant of Arc Place (former Capital Tower), relocated to Lotte World Tower in Jamsil, pushing up the vacancy rate in the GBD. Pernod Ricard left A+ Asset Tower (former Nara Building) for Seoul Square in the CBD, creating some vacancy in the building. Dell International, after its merger with EMC, moved to EMC's office in Gangnam Finance Center, thus reducing the occupancy rate of Prudential Tower. Meanwhile, some vacancies in the GBD were filled by tenants relocating within the district, via secondary to prime buildings upgrades, including Fluke, a test and measurement tools company, and Orix Capital. Office expansions

included CJ E&M (Parnas Tower), Meritz's affiliates (Meritz Tower) and Posco's affiliates (Posco Center). Moreover, co-working space company, Fast Five leased two floors of Meritz Tower which is its 9th location.

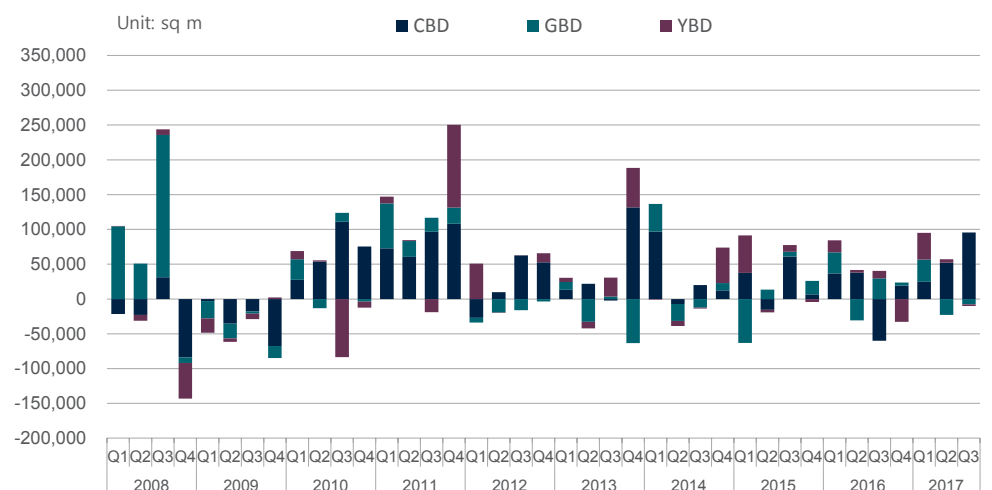
The vacancy rate in the YBD rose 0.2 ppt from the previous quarter to 16.9%. Some tenants such as S-1, LKMS and Asset One (PineBridge Asset Management) moved from the CBD to the YBD, to both Three IFC and Hana Financial Investment Building respectively. However, HPE, which was spun out from HP Korea, moved from the HP Building to SK Securities Building and downsized,

GRAPH 3 **Take-up, Q3/2017**



Source: Savills Korea

GRAPH 4 **Net absorption, Q1/2008–Q3/2017**



Source: Savills Korea

→ negatively impacting on the YBD's vacancy.

Rent rates

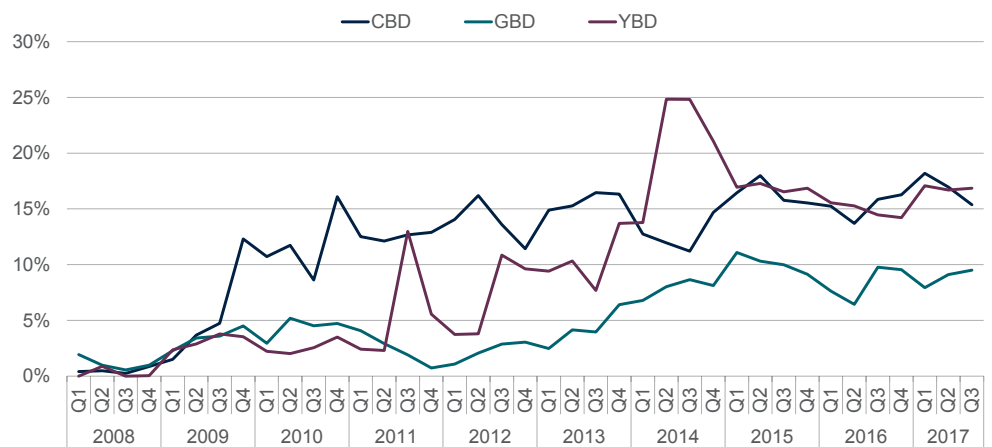
The face rent of Seoul prime office buildings averaged KRW 94,400/3.3 sq m in Q3/2017, up 1.3 ppts from the same period last year. By district, the CBD saw a 2.1 ppts increase as Booyoung Taepyeong Building raised its quoting rent. In the GBD, the average rent rose 1.2 ppts due to an upward rent adjustment by Arc Place, which is undergoing a significant refurbishment program. Meanwhile, the YBD recorded a 0.4 ppt decrease in rent, following Two IFC lowering its marketing face rents.

Outlook

The new prime office buildings planned for completion in the major office districts in 2017 have all been delivered. In non-major office districts, Amore Pacific's new building in Yongsan is scheduled to complete in Q4/2017, with a GFA area of 188,800 sq m (22 FL/B7). Amore Pacific and its affiliates will leave Signature Tower to occupy 19 floors in the newly completed HQ. The remaining office space will be leased out to Samil PWC which will relocate from Yongsan LS Tower.

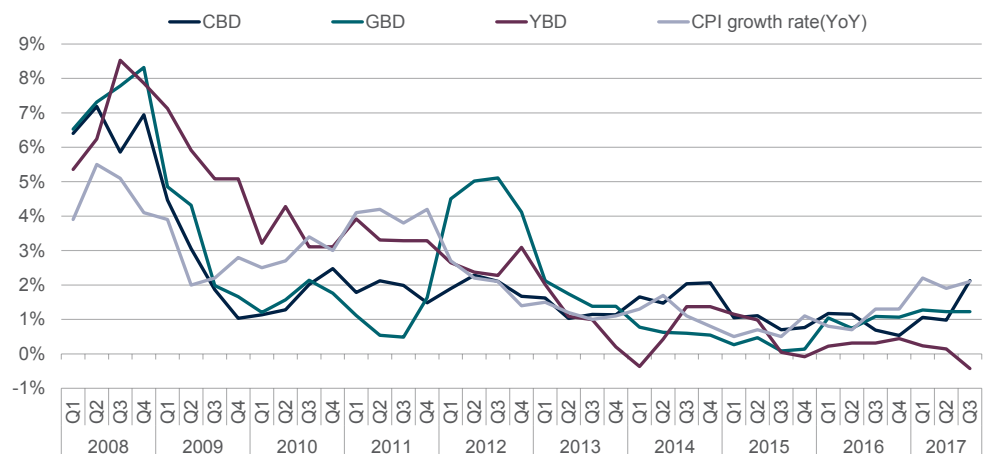
The CBD will continue to see relocations. However, such relocations will be mostly prime-to-prime and thus will not result in a material change to the vacancy rate. Shinhan Card plans to vacate its space in Post Tower, to lease Pine Avenue A from November 2017, and will fill 58% of the entire building's vacancy. Japanese pharmaceutical company Daiichi Sankyo will relocate from SC Bank's HQ building to occupy one floor in Center1. In addition, the European Chamber of Commerce in Korea will contribute to net absorption in the area through its relocation from S Tower to Seoul Square. In the case of KDB Life Tower, Dongbu Corp. will downsize, however, this will be offset by Booking.com (2 floors) and CJ Olive

GRAPH 5 Seoul prime office vacancy rate, Q1/2008 – Q3/2017



Source: Savills Korea

GRAPH 6 YoY rental increase rate by district, Q1/2008 – Q3/2017



Source: Savills Korea, Bank of Korea

Networks (1 floor) moving in, leaving a vacancy rate of approximately 5%, and further lowering the vacancy rate in the Seoul Station area. Overall the Q4/2017 vacancy rate is expected to edge down in the CBD. However, relocations by Amore Pacific (as aforementioned) and the Korea Institute for Curriculum and Evaluation (moving to outside Seoul), both planned for Q1/2018, are likely to put upward pressure on the vacancy rate.

The GBD is expected to witness a drop in vacancy as large tenants move in to pre-committed areas in Q4. Parnas Tower will fill all of its vacancy as tenants, who have already signed lease contracts take occupation.

Tenants, including law firm Yulchon and game company Blizzard, will complete their relocations to Parnas Tower in Q4/2017, from Korea Textile Center and Cheongdam-dong respectively. Meritz Tower signed a for lease two floors to Ericson-LG which are relocating from Anyang. The vacancy rate for ASEM Tower will decline to 2% with Gucci Korea's relocation from Cheongdam-dong and law firm Hwawoo's office expansion. In Arc Place, WeWork will open its fourth location in Seoul and expect to expand further cross each of business districts.

The YBD is highly likely to suffer further vacancy rate as LG's affiliates plan to leave the area. With the LG

→ affiliates' relocation to LG's R&D Center in Magok scheduled for Q4/2017, LG Electronics, LG CNS and Farm Hannong will all vacate their YBD offices in both Two IFC and FKI Tower. However, Yeouido Post Office organizations and beauty product importer Illumina Korea, will occupy some of the vacancy in the KTB Building in Q4 due to the demolition of the Yeouido Post Office for reconstruction.

Transactions and Investment market

Despite slightly heightened volatility in the financial markets due to geopolitical risks, abundant liquidity resulted in an active prime office transaction market in Seoul. Buildings that changed hands in Q3/2017 included; Majestar City Tower 2 (Seocho-dong); V-PLEX (Samseong-dong); City Plaza (Yeouido); Bundang Square and M

Tower (both in Bundang). The office building transaction volume for Q3 was around KRW 1.5 trillion, which pushed the total transaction volume for the first three quarters around KRW 6.3 trillion. The majority of assets that remain under transaction this year are forecast to conclude in Q1/2018. These deals include Hyundai Group's office building in Yeonji-dong, Hana Bank's annex building in Euljiro and two office buildings in Myeong-dong, owned by KEB Hana Bank and Kookmin Bank.

Koramco REITs & Trust was the purchaser of Majestar City Tower 2 for KRW 205.5 billion, in a deal that was completed at the end of June. It is reported that Korea Investment Management will acquire and resell a share in the building, in the form of an equity commitment worth KRW 75 billion. With the exception of the residential component and part of

the retail that sold to individuals under strata titles, the conclusion of the Tower 2 deal, means Majestar City has mostly been acquired by institutional investors (Office Tower 1 previously sold to IGIS Asset Management c/o INVESCO). Currently 80% of Office Tower 1 is leased out, whilst Tower 2 has attracted tenants for 50% of its office space, including the area master-leased by the seller. The retail portion, currently leased to Lotte Mart, previously sold to Ryukyung PSG Asset Management.

IGIS Asset Management acquired V-PLEX (former NC Tower 2) from NC Soft for KRW 177 billion; backed by investments from NPS' blind fund and other institutional investors. IGIS Asset Management attracted Fast Five, a shared office service provider, to fill part of the vacancy created by the exit of former anchor tenant

TABLE 3 Major tenant relocations, Q3/2017

District	To			From	
	Building	Tenant	Area (sq m)	District	Building
CBD	Seoul Square	SK Planet	24,900	CBD, Non-core	KCCI, Nongshim Seongmugwan Bldg
	T Tower	SK Communications	8,100	Seodaemun	NH Life Insurance Bldg (former Imkwang Bldg)
	Twin City Namsan	CJ Olive Networks	7,500	CBD	CJ Namsan HQ, T Tower
	Seoul Square	MSD Korea	7,200	Mapo	Seoul Credit Guarantee Foundation Bldg
	Booyoung Taepyeong Building	Shinhan Bank	6,700	Non-core	Shinhan Bank Ilsan IT Center
	Booyoung Taepyeong Building	Lotte Card	3,500	CBD	Lotte Insurance Building
	Gran Seoul	Spaces	3,400	NEW	
	Seoul City Tower	SK Planet	3,200	Non-core	KSCFC Bldg (Sindaebang-dong)
	Seoul Square	Pernod Ricard Korea	2,800	GBD	A+ Asset Tower (former Nara Bldg)
	Booyoung Taepyeong Building	Booyoung	2,300	NEW	
GBD	KAIT Tower	ORIX Capital	3,700	GBD	Donghoon Tower
	Meritz Tower	Fast Five	3,600	NEW	
	Hanhwa Life Insurance Seocho HQ	Dreamplus Gangnam Center	2,700	NEW	
	ASEM Tower	Fluke	2,400	GBD	Ilsong Building
YBD	SK Securities Building	HPE	7,200	YBD	HP Bldg
	Three IFC	S-1 Corporation	1,200	CBD	S-1 Bldg
	Hana Financial Investment Building	Asset One Asset Management	600	CBD	Shinil Building

Source: Savills Korea

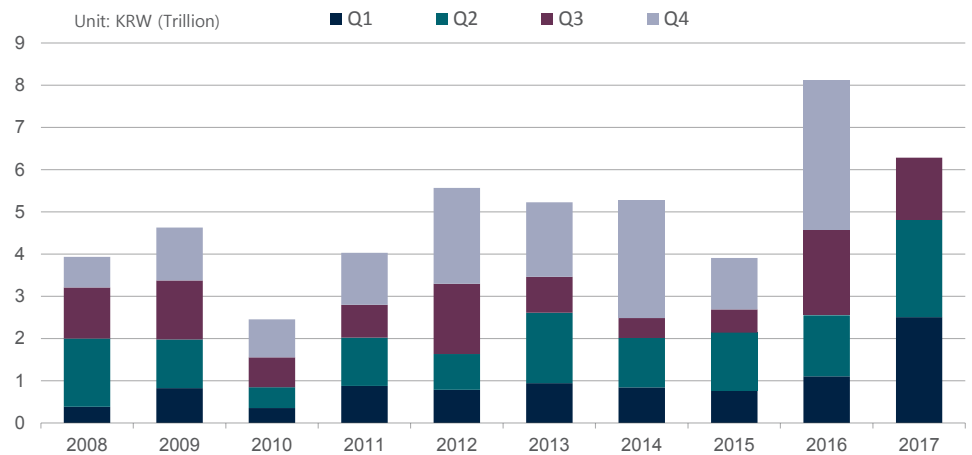
➔ Coupang. V-PLEX is earmarked for a value-add strategy via a large-scale remodeling and further lease up.

The Bundang area recently saw its vacancy rate stabilize with tenants overflowing from Pangyo. The 3rd quarter saw two major office buildings in the area change hands. Koramco Asset Management is reported to have purchased Bundang Square's office section and the Vision World parkade for KRW 100 billion; via its blind fund and investment from the Korea Fire Officials Credit Union. Naver's affiliate, Line, is a major tenant in Bundang Square, which currently enjoys a low vacancy rate of 6%. Bundang M Tower, which is located near Ori Station and rented to Naver and Samsung Welstory, sold to Kclavis Asset Management for KRW 100 billion.

AEW sold its beneficiary certificates issued for City Plaza in Yeouido to JP Morgan in July 2017. AEW, after acquiring the property in Q4/2015, converted the lower floors (1F-3F) of the building into retail space and attracted the F&B company Sikgaekchon under a master-lease. AEW also successfully lowered the vacancy rate of the office section to sub 2% as part of their value-add asset management strategy.

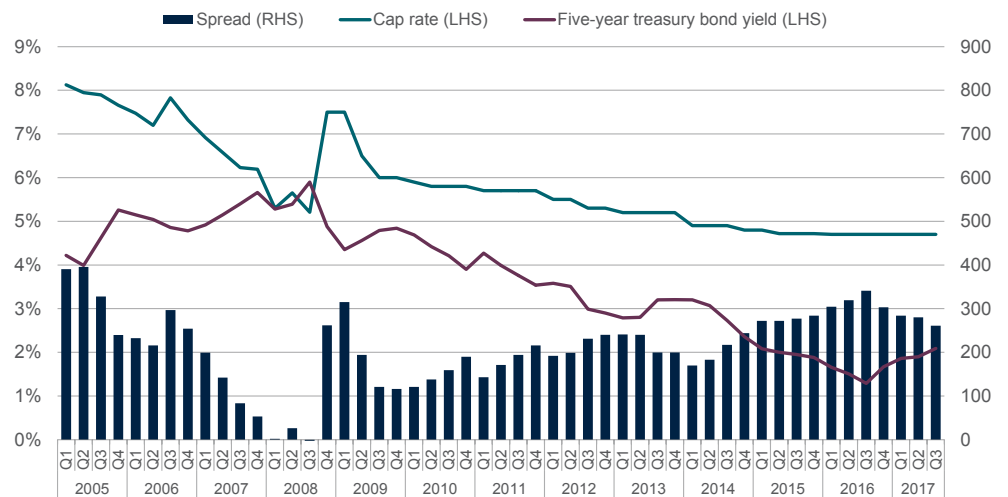
Based on a long-term historical occupancy of 90% and current asking rents, the market average cap-rate for Q3/2017 stood at 4.7%. However, given rent-free periods and tenant incentives, effective rents are estimated to put actual net initial yields in the low 4% range. As of the end of September, the yield on the five-year government bonds increased to 2.09%, posting a spread of approximately 260bps. In general, typical LTVs in the Korean investment market remain around 55%. ■

GRAPH 7 Office transaction volumes, Q1/2008 – Q3/2017



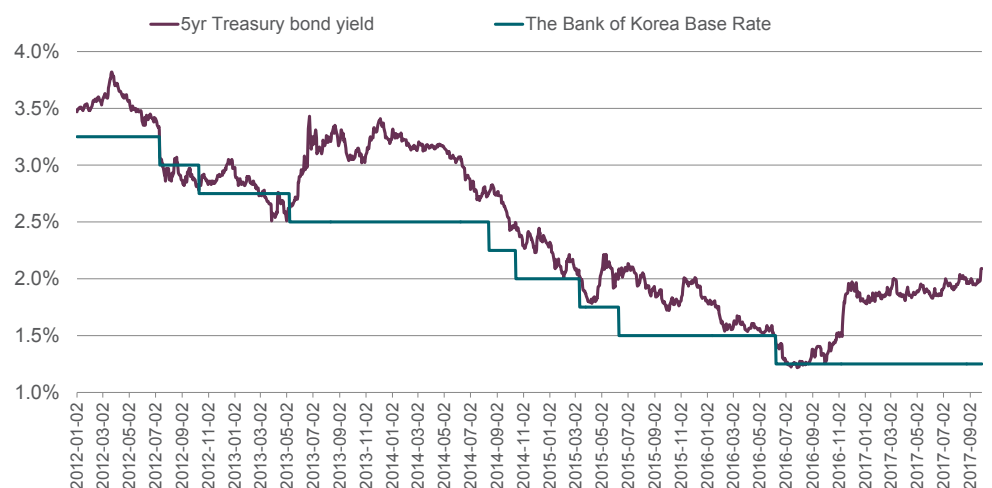
Source: Savills Korea

GRAPH 8 Prime office building cap rate trends, Q1/2005 – Q3/2017



Source: Savills Korea, Bank of Korea

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



Source: Bank of Korea

TABLE 4 Major investment transactions, Q3/2017

District	Building Name	Seller	Buyer	Transacted area (sq m)	Transaction Price (KRW bil)
YBD	City Plaza	IGIS AMC (AEW Capital)	IGIS AMC (JP Morgan)	14,861	approx. 90.0
GBD	V-PLEX (former NC Tower 2)	NC Soft	IGIS AMC	26,839	177.0
	Mitaa Building	Mitaa Wilshire Investment LLC	Tong Yang AMC (Orion Partners)	15,074	74.0
Seocho	Majestar City Tower 2	M Square PFV	Koramco AMC	36,189	205.5
Dogok	EBS Gangnam HQ	EBS	Hanwell	18,492	73.3
BBD	Bunadang Square	Vestas AMC (Invesco)	Koramco AMC	47,692	100.0
	Bundang M Tower	Shinhan BNP AMC (Blackstone)	Kclavis AMC	46,125	100.0

Source : Savills Korea

Please contact us for further information

Savills Korea



K.D. Jeon
CEO
Savills Korea
+82 2 2124 4101
kdjeon@savills.co.kr



Crystal Lee
Senior Director
Investment Advisory
+82 2 2124 4163
csjlee@savills.co.kr



Seunghan Lee
Senior Director
Leasing & Marketing
+82 2 2124 4253
seunghanlee@savills.co.kr



Hyunseok Jhee
Director
PM Services
+82 2 2124 4204
hsjhee@savills.co.kr



JoAnn Hong
Director
Korea
+82 2 2124 4182
jhong@savills.co.kr



Simon Smith
Senior Director
Asia Pacific
+852 2842 4573
ssmith@savills.com.hk



Miah Yang
Senior Director
Retail Service
+82 2 2124 4270
mayang@savills.co.kr

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Appendix

Overview of the Seoul office market and Savills Korea office survey

TABLE 5
Summary of surveyed buildings, Sep. 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	21	19	9	49
	Average GFA (sq m)	53,000	47,000	45,000	50,000
	Average year of completion	2004	1999	1996	2000
Total number of buildings		44	31	18	93
Total area (sq m)		3,070,000	2,080,000	1,310,000	6,460,000

Source: Savills Research & Consultancy

Close to 61.8% of large office buildings (30,000 sq m or more) in Seoul are located in three major business districts – the CBD (31.9%), GBD (17.0%) and YBD (12.9%). 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 121 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.