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FOREIGN INVESTORS IN SEOUL REAL ESTATE

Increasing Inbound Investment Volume of Foreign Investors in Seoul



Summary & Recommendations

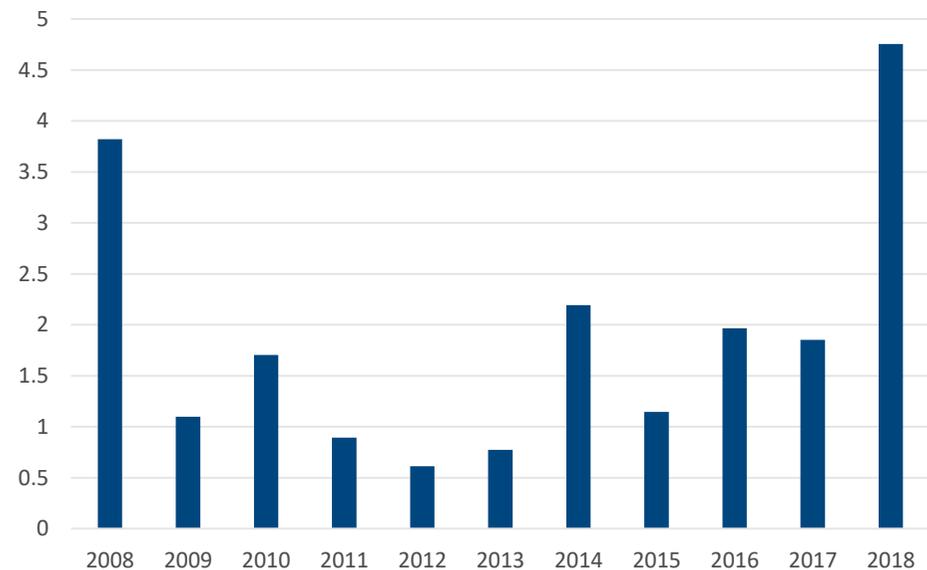
Real estate investment funds are increasingly targeting Asia, and investors' interest in the Seoul property market has been rising, partly because other developed urban markets in the region such as Tokyo and Hong Kong are very competitive.

- > The impact of US private equity on the Korean real estate market has been expanding with the recent creation of large-scale Asian-focused real estate investment funds.
- > Rising US interest rates are an opportunity for the Korean and Japanese real estate markets, as interest rates are comparatively low. Global investors will likely seek to continue diversifying their portfolio by increasing their investments in Korea.
- > Foreign investors are more aggressive in pursuing value-added and opportunistic strategies than Korean investors. They are also actively expanding their local network among domestic asset management companies to enhance their ability to source deals.

The net value of acquisitions made by foreign investors, including land development sites, has risen sharply over the last year. Foreign investors' interest in Seoul properties continues to grow, and this report contains an analysis of the Seoul real estate assets bought by foreign investors over the past five years, along with investment trends.

We expect the influence of US private equity funds on the Korean commercial real estate market to increase as the amount of global private equity capital increases. The easing of political tensions on the Korean peninsula is another factor likely to encourage interest in the Korean property market. In addition, we expect an increase in the number of real estate investors looking to diversify their portfolios in the Asia Pacific region.

Foreign investor net acquisition value (USD billion)



Source: Colliers International, RCA

Note: All property types over the most recent seven years; USD1 = KRW1,114.

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RANKING OF FOREIGN INVESTORS

Private equity and global institutional investors

Over the past five years, KKR, one of the world's largest private equity firms, has been the top foreign investor in Korea by transaction volume. K-Twin Tower, the first investment in Korea real estate by KKR in 2014, was sold to Samsung SRA asset management at the beginning of 2018, and at the time recorded the highest unit sales price in Seoul's CBD.

KKR decided to invest KRW2.1 trillion (USD1.9 billion) in the redevelopment project of the Renaissance Hotel with IGIS Asset Management and the Korean National Pension Service through its private equity fund, KKR Asian Fund III in 2018. This is KKR's third real estate investment in Korea.

Meanwhile, in 2016, Blackstone, a global private equity firm, acquired Capital Tower for about KRW450 billion (USD403 million) using a share deal structure. Since then, Blackstone has been expected to invest further in the Korean real estate market. Morgan Stanley acquired Susong Tower and is currently looking for assets to invest in as part of its Asian Core Fund.

In addition, the Hong Kong-based private equity firm Pacific Alliance Group (PAG) recently raised funds to invest in the Asian real estate market. In 2017, PAG purchased POBA Gangnam Tower through a share deal structure, its first investment in Korea.

Nomurarifa Asset Management was the most active investor in Korea over the last five years based on the number of assets. This firm is actively investing in not only core but also small and medium-sized buildings.

M&G Real Estate, which has partnered with a number of Korean pension funds, has purchased Centropolis Tower in Seoul for KRW1.2 trillion (USD1 billion) in 2018. The deal was the single largest real estate transaction in the Korean capital market. Centropolis Tower is a new prime office building in the CBD. According to industry news, M&G Real Estate has been aiming to diversify its portfolio in the Asia Pacific region and is looking for particular assets including retail and logistics properties.

Deutsche Bank recently invested in the Kumho Asiana headquarters, partnering with GIC, and is actively reviewing opportunities to acquire logistics assets.

Top 10 foreign investors USD million (2014-2018)

Rank	Company Name	Country	Vol (m USD)	# Props
1	KKR	United States	2,326	3
2	CIC	China	2,238	3
	Brookfield AM	Canada	2,238	3
3	Prudential plc (M&G)	United Kingdom	1,558	6
4	Deutsche Bank	Germany	1,171	6
5	GIC	Singapore	1,050	6
6	AEW Global	United States	700	6
7	CPP Investment Board	Canada	685	3
8	Keppel Capital	Singapore	652	2
9	Morgan Stanley	United States	515	3
10	Blackstone	United States	479	3

Top 10 foreign investors by number of transactions (2014-2018)

Rank	Company Name	Country	Vol (m USD)	# Props
1	Nomura Holdings	Japan	410	8
2	Prudential plc (M&G)	United Kingdom	1,558	6
3	Deutsche Bank	Germany	1,171	6
4	GIC	Singapore	1,051	6
5	AEW Global	United States	700	6
6	Ascendas-Singbridge	Singapore	428	4
7	SC Capital Partners	Singapore	426	4
8	Landing Holding Group	China	335	4
9	KKR	United States	2,326	3
10	CIC	China	2,238	3

Source: Colliers International, RCA

Note: Survey data includes all property types over the last five years

FOREIGN INVESTMENT STATUS

Country distribution and investment type

Over the last five years, the United States has been the primary source of foreign investment capital in the Korean real estate market.

China's Sovereign Wealth Fund (SWF), China Investment Corporation (CIC), is the first Chinese entity to own a Korean prime office asset. CIC is also the foreign investor with the second largest investment under management in Korea. CIC acquired International Finance Center Seoul, in a joint-venture agreement with Brookfield in 2016. This deal include three office towers, the Conrad Seoul Hotel, and IFC Mall.

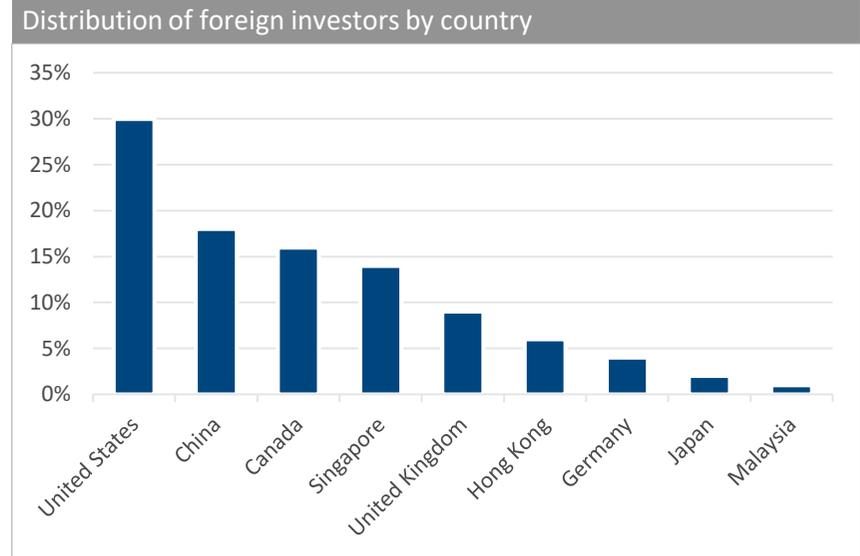
In addition, SWFs such as GIC, the Canada Pension Plan Investment Board (CPPIB) and the Malaysian Employees Provident Fund (EPF) are actively investing in Korea real estate market.

The EPF, which has recently invested in the Korean property, is expanding its investment portfolio in domestic logistics properties, cooperating with Korean distributors.

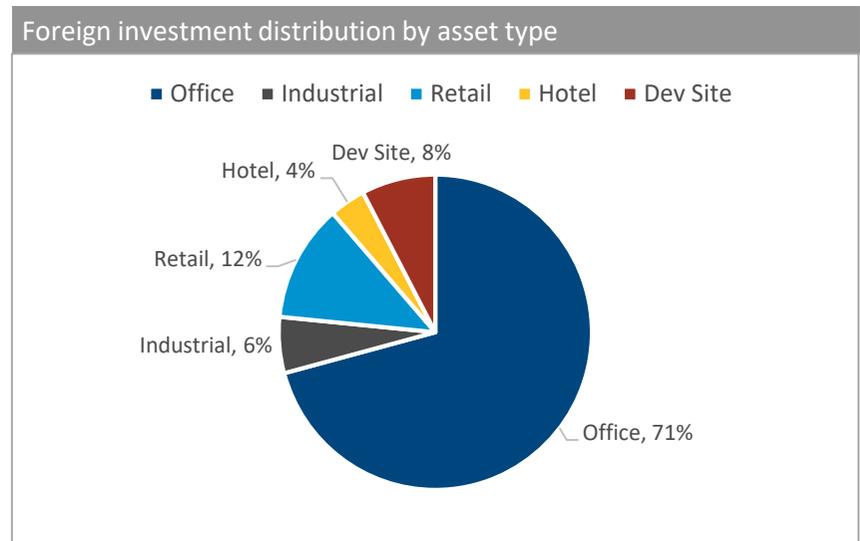
Over the past five years, the type of investment assets acquired in Korea by foreign investors have been concentrated in office properties. For instance, GIC has acquired major prime office properties, including Gangnam Finance Center (GFC) and Seoul Finance Center (SFC) as part of its long-term investment portfolio.

The Abu Dhabi Investment Authority (AIDA) of the United Arab Emirates, the largest SWF in the Middle East, bought State Tower Namsan in 2014 for KRW503 billion (USD451 million), which is currently on the market for sale.

Foreign investors are struggling to find opportunities to invest in core office buildings due to competition with domestic institutional investors, and we expect them to expand their investment strategies by investing in value-added opportunities and logistics centres for higher-yield properties.



Source: Colliers International, RCA
 Note: All property types over the last five years



Source: Colliers International, RCA
 Note: All property types over the last five years

FOREIGN INVESTORS' INVESTMENT ASSETS

Increased value added transactions

Unlike local institutional investors who mostly consider properties with stable operating revenues as part of their investment portfolio, foreign investors are more likely to invest not only in core and core-plus assets, but also riskier value-added investments as well.

Angelo Gordon, a US-based investment company, purchased the KB Kookmin Bank's headquarters in Myeong Dong, using its Asia Opportunity Fund in 2017. The company plans to redevelop the property into retail and hotels.

At the same time, AEW Capital acquired the Hana Card Building through Pabblestone Asset Management's investment vehicle. AEW is also likely to implement a value-added strategy to convert the lower stories into commercial retail space.

Invesco has also been actively investing in the Korean real estate market, acquiring assets such as Donggyo-dong building and Majestar City buildings.

In addition, some Hong Kong based investment companies, such as Orion Partners, Gaw Capital and PGIM, have been steadily investing in the Korean Real Estate market. We expect PGIM to increase its investment in the Korean market through its Asia Property Fund III by using a value-added strategy. Meanwhile, according to industry news article, Ascendas, a Singapore-based investor, plans to invest in the Janggyo 12 District project once construction is completed.

Examples of major foreign investment (2017-2018)

Property Name	Vol (m USD)	Owner/buyer
Daor E&C SK Mixed-use Development 2018	1,873	KKR, NPS, IGIS
Centropolis	1,070	KTCU, POBA, M&G Real Estate, LB AMC
POBA Gangnam Tower	308	PAG (ASIA)
Kumho Asiana HQ Bldg	418	GIC, CPPIB , Deutsche AWM
Susong Tower	383	Morgan Stanley, IGIS

Foreign investment in value added transactions (2017-2018)

Property Name	Vol (m USD)	Owner/buyer
Hana Card Building	65	AEW Capital, Pebblestone
Kookmin Bank Building HQ	214	Angelo Gordon, Mastern Investment Management
Metro Tower	214	Tongyang Life Insurance, ANDA AMC
Janggyo 12 District	n/a	Ascendas-Singbridge
City Plaza	78	JP Morgan, IGIS
T Tower	166	PGIM, IGIS

Source: Colliers International , RCA

Note: All property types over the last two years

ONGOING FOREIGN INVESTMENT DEALS

<i>Seoul Square</i>	
Address	416, Hangang-daero, Jung-gu, Seoul
GFA	132,809sqm (40,175 py)
Floor	B2 ~ 23F
Completion	2009 Renovation
Efficiency Ratio	55.62%
Ownership	Alpha Investment



Source: Colliers International , RCA



<i>Jongro Tower</i>	
Address	51, Jong-ro, Jongno-gu, Seoul
GFA	60,654sqm (18,348 py)
Floor	B6 ~ 24F
Completion	1999
Efficiency Ratio	50.97%
Ownership	Alpha Investment

<i>State Tower Namsan</i>	
Address	100, Toegye-ro, Jung-gu
GFA	66,799sqm (20,207 py)
Floor	B5 ~ 20F
Completion	2011
Efficiency Ratio	57.27%
Ownership	ADIA



INBOUND INVESTMENT OUTLOOK

Asia target funds expected to increase

We expect that the influence of global institutional investors, including KKR, PAG and Gaw Capital, for example, on Korean real estate investment will rise due to the recent opening of large-scale Asian real estate investment funds.

Higher return than other Asian cities

The gross yield on Grade A office properties in Seoul averages about 4.3%, which is higher than that of Tokyo (3.6%) and twice that of Hong Kong (2.3%).

The short-term interest rate has been frozen at 1.5% since November 2017. The Bank of Korea has raised its benchmark interest rate by 25 basis points to 1.75%. The cap rate of prime office properties in Korea is 4-5%, as the interest rate is unlikely to change due to concerns over economic slowdown.

The five year Korean treasury bond yield is 1.9% as of 8 January 2018. The spread between the cap rate and the five year Korean treasury bond yield is 240 basis points. As the yield spread is higher in Seoul than in other Asian developed cities (except Tokyo, which is a very competitive market), we expect investors will continue to seek commercial real estate assets in Seoul.

Higher potential return in Korea due to lower rates

Increasing interest rates in the US provide an opportunity for the Asian real estate market. Due to the low interest rates compared to the US, foreign investors will likely continue to seek out Korean properties to diversify their portfolios. When investing in prime office properties, the five year fixed interest rate for the senior debt is around 3.5%. Korea's interest rate is lower than the Federal funds rate.

Alternative investments for portfolio reorganization

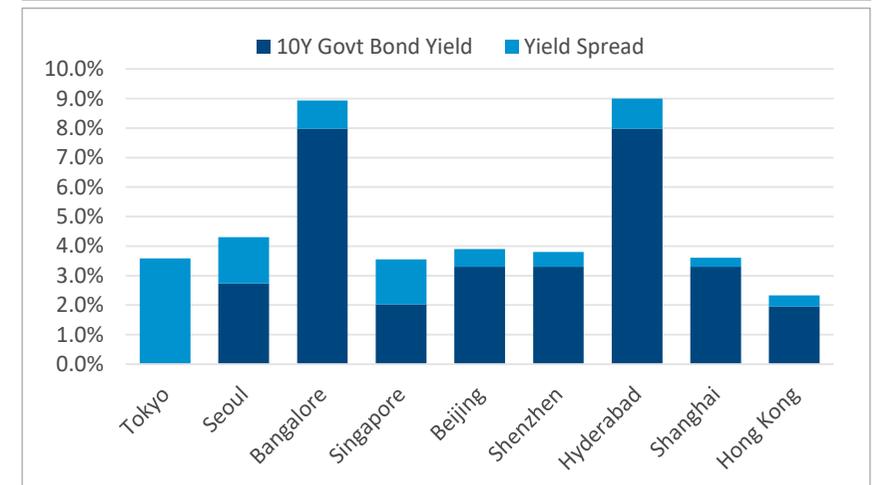
Most global investors consider office properties in Korea still undervalued. Korea remains as one of the places to invest for portfolio diversification, as the Japanese and Australian markets are very competitive. In addition, we expect that the preference for safe assets like real estate will continue even after Korean interest rates are increased.

Office Market Forecasting

Seoul's office building transaction market was active in 2018 due to the major deals closed in this year. The estimated total of KRW 10.7 trillion (USD9.5 billion) represents a sharp increase from the previous year, as a number of prime office buildings including Centro Polis building, Gangnam N Tower and Samsung C&T Corporation's Headquarter were closed.

Seoul Square, Jongro Tower and Namsan State Tower are currently being put on the market. We expect that these deals will ensure that transaction volume increases further in 2019. If the expected transactions of prime location buildings are successfully concluded in 2019, the aggregate transaction value will again exceed KRW10 trillion (USD8.5 billion).

Office yields and yield spread vs. 10-year bonds for nine Asian cities (%)



Source: Colliers International, Bloomberg

STRATEGIES FOR FOREIGN INVESTORS

Increase in the use of share deals

Foreign investors are using the share deal transactions of real estate funds to purchase real estate assets rather than owning them directly, and this trend is likely to increase in the future. Under a share deal, the purchase retains the REIT or Fund which owns the office and takes ownership of the REIT or Fund.

This investment method is convenient because investors are exempt from paying acquisition tax, and local real estate asset managers can continue to operate by extending the funds' expiration period. For example, Morgan Stanley purchased Gwanghwamun's Susong Square Building and Blackstone purchased Yeoksam-dong Capital Tower as share transaction deals in 2016.

Value-added investment strategy

Institutional investors in Korea prefer to invest in stable real estate assets with high-quality tenants that will likely provide higher returns than bonds.

Foreign investors, on the other hand, prefer to invest in properties where they can add value, raising the rate of return with tactical strategies to reduce high vacancy rates or increase rental rates, while avoiding pricey competition with domestic institutional investors.

Foreign investors should invest in various types of investments, including value-added and opportunistic strategies, not only to avoid competition with domestic institutions, but also to increase the potential for profits.

Joint venture partnership strategy

The typical investment strategy of overseas pension funds and sovereign wealth funds (SWFs) is to secure stable, long-term profitable assets rather than risky assets. Therefore, conservative global investors like SWFs should make a joint venture deal partnering with the local institutional investors with similar investment criteria.

Target sector for investment

Seoul's office building transaction market was remarkably active in 2018. Office is still a very attractive sector due to a low interest rate for institutional investors who have been seeking alternative investment tools. However, if the buildings are vacant due to the increased vacancy rates (a result of the difficulties in finding tenants), funding is likely to remain challenging.

As foreign capital has accounted for a growing proportion of recent property sales, competition for trophy asset is growing fiercely between both domestic and overseas investors. The GBD in particular is a highly sought-after office market for investors due to its favourable leasing market.

In light of Korea economic concerns and uncertainty, investors will seek safe properties with long-term leases amid concerns of worsening occupancy rates. Apart from core office buildings, more investors are adopting value-added strategies to overcome decreased returns as increased interest rates begin to affect returns negatively. In addition, we expect investment take-up rates in industrial properties to rise as a target sector for investment.

Active partnerships with domestic companies

Due to their limited ability to source deals, we recommend that foreign investors should more actively seek closely tied partnerships with local asset management companies.

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