

Intelligent Investment

Impact and Outlook of the Real Estate Market
after the 22nd National Assembly:

Real estate market unlikely to be affected by opposition victory in National Assembly elections

VIEWPOINT

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Introduction

Last month's legislative elections in Korea were widely seen as a referendum on the current government. The main opposition Democratic Party of Korea (DP) won 175 seats, securing about 60% of the National Assembly, followed by the ruling People's Power Party (PPP), with 108 seats. The DP's victory was widely expected and the 22nd National Assembly is scheduled to begin its four-year term on May 30.

Through this Viewpoint, CBRE would like to examine the impact and outlook on the commercial real estate market as the result of the 22nd general election.



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What does it mean for real estate?

As there has been no significant change in the distribution of seats between the ruling and opposition parties, the content and passing of specific bills pertaining to the real estate sector is likely to remain unchanged. However, housing market policy is likely to be affected as the DP has traditionally taken a conservative stance towards the real estate market, advocating measures such as suppressing investment sentiment through regulation and prioritising the supply of public housing over private housing.

Policies that the ruling PPP government has been pursuing will therefore become more difficult to pass through the new parliament. Efforts to boost housing supply and reform the tax system are expected to lose momentum as many such policies involve making amendments to existing laws and require the consent of the opposition.

The implementation of tax cuts for owners of luxury and multiple houses is therefore set to remain difficult for the time being, leaving multi-homeowners subject to transaction tax (acquisition tax and transfer tax) and holding tax (comprehensive real estate tax and property tax). The complexities of the tax system for multi-family landlords; the preference for the 'Jeonse' housing system¹⁾; the lack of large non-jeonse rental housing for sale; and the government's policy of suppressing institutional investors' access to the residential market in order to clamp down on speculative activity is likely to further discourage institutional investment in the sector.

The election result will also have a bearing on the real estate project financing (PF) market, leading to greater importance being attached to corporate restructuring rather than default liquidation. The ruling PPP has always favoured the latter approach, prioritising the reduction of the burden on project managers and construction companies to prevent insolvency, and minimising the economic shock caused by the insolvency of construction companies through related financial support for the normalisation of real estate PF businesses. However, the opposition has advocated for the restructuring of insolvent businesses; a policy that could potentially lead to some construction company-led economic volatility to emerge later this year, although market-wide distress is unlikely.

Bank of Korea (BoK) data show the outstanding balance of PF loans in the financial sector exceeded KRW 130 trillion at the end of last year, up from about KRW 92 trillion in 2020. Recent quarters have seen an increase in the number of development projects being put up for auction and cases of construction companies acquiring businesses in the logistics market. With restructuring expected to accelerate this year, expectations are growing for a PF non-performing loan (NPL) market to come to fruition; a prospect that is already seeing domestic and foreign institutions ready themselves for domestic real estate NPL investment. Based on government support for the stabilisation of the PF market, Korea Asset Management Corporation (KAMCO) is currently operating a PF normalisation fund of KRW 1 trillion and is supporting the NPL market by pursuing a plan to purchase NPLs from Korean Federation of Community Credit Cooperative and Savings banks this year. NH Investment & Securities, Meritz Securities, and other major domestic securities companies are also in the process of creating similar funds.

Several global institutional investors are partnering with domestic securities companies and asset management companies to invest in domestic distressed real estate and have embarked on large-scale fundraising. Others are seeking opportunities for distressed logistics centre development projects. Strategies expected to be deployed include purchasing discounted loan receivables for unfinished projects; acquiring key bridge loans at low prices; and securing the viability of a project and then receiving PF to maximise returns.

Financial authorities are preparing a plan to normalise real estate PFs for a soft landing and have held closed-door meetings with the entire financial sector to discuss various measures. Proposed steps include revising and selecting criteria for evaluating distressed projects; preventing additional losses in the financial sector; and providing incentives. The normalisation plan will be unveiled in May, with full-scale normalisation work to commence in the second half of the year. This will help establish a clearer target for NPL fund purchases, with selective bidding to occur based on the potential business viability of the assets, should many non-performing assets be put up for auction simultaneously.

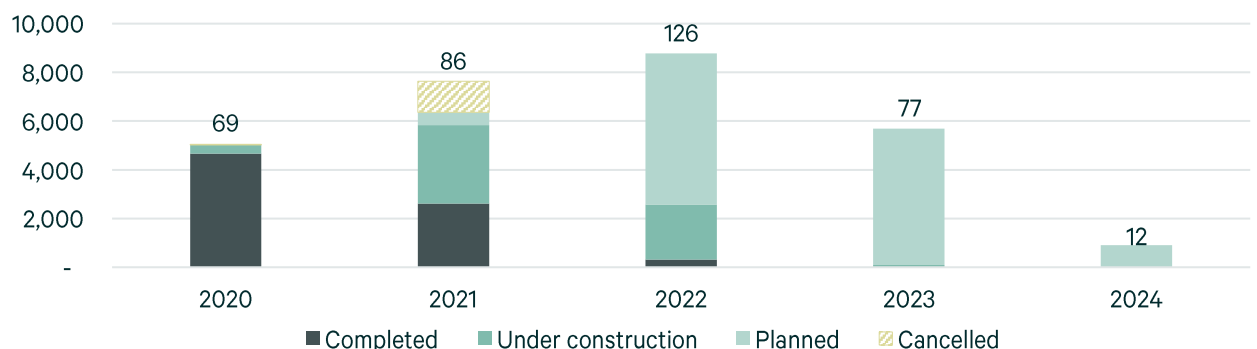
However, CBRE expects a gap to persist between the minimum asking price of a project and a potential buyers' willingness to pay, which could hinder the completion of transactions. In addition, the Ministry of Land, Infrastructure and Transport recently announced that it will support residential PF businesses using the REIT method.

In conclusion, the outcome of the National Assembly elections will have little short-term impact on the real estate market. Investors will seek out NPL investment opportunities this year, with heightened expectations for price adjustment. Prospects for opportunistic investment are expected to increase, centered on bridge loan PFs that have not been able to transfer land purchased at high prices during the real estate boom to their own PFs due to lack of viability, especially in the logistics market.

CBRE data show the number of new logistics development permits in Greater Seoul has been on a downward trend since reaching a peak in 2022. Of the 126 new development permits awarded in 2022, 70% had not started construction as of the end of last year due to a combination of difficulties including the state of the PF market, high interest rates, rising construction costs, and mounting vacancy, especially in the cold storage segment.

Figure 1: Annual development permits of Grade A logistics centre in Greater Seoul

Unit: sq. m., Thousands



Source: CBRE Research, April 2024

Due to the decrease in the ruling party's influence in the National Assembly, the office sector may see slower decision-making, particularly regarding expansion and redevelopment. This is expected to affect ongoing redevelopment projects in Seoul, meaning that a resolution to the office market supply shortage may be delayed in the long term.

Institutional investor interest in alternative sectors such as co-living and senior housing will remain upbeat, backed by the increase in single-person households and Korea's ageing population. Many buyers will seek new investment opportunities by purchasing discontinued residential projects or older properties at low prices.

Amidst expectations for the stabilization of the PF market ahead of the financial authorities' real estate PF normalization plan, concerns within the financial sector over the recovery of creditors' principal are also growing. Meanwhile, the expansion of the NPL market in the domestic commercial real estate market facing liquidity constraints is expected to present some opportunities for overseas investors. The proportion of foreign inbound funds in the Seoul commercial real estate market last year was around 20%.

CBRE expects commercial real estate investment activity to pick up by around 5-10% y-o-y in 2024, underpinned by improved transactions in the office sector. While logistics registered the strongest growth in investment volume last year, activity will fall slightly in 2024 as buyers turn more selective. However, the anticipated closing of pre-purchased assets is expected to boost overall transaction volume, while purchases of logistics development sites that have not been transferred to PFs are expected to increase.

November's U.S. presidential election is expected to have a general impact on Korea's economy. With the first Fed rate cut having been pushed back amid stubborn inflation in the U.S., uncertainty around the future timing of domestic interest rate cuts in H2 2024 will be the biggest variable impacting the Korean commercial real estate market in the second half of the year.

¹⁾Jeonse (전세) is a distinctive housing rental system prevalent in Korea, characterized by tenants paying a lump sum deposit, typically equivalent to 50-80% of the property's value, instead of monthly rent. This substantial deposit, known as "key money," serves as a security deposit for the landlord and eliminates the need for regular monthly rent payments. Upon the expiration of the lease agreement, the key money is returned to the tenant, minus any deductions for damages or unpaid utilities.

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