

Korea Real Estate Recovery

A lot of talk and media coverage of a real estate recovery in the States. The people in Korea are hoping the optimism will transfer overseas and spur the local real estate market. Korea is unique. I was talking to a Vice President at an international asset management firm yesterday related to the local real estate market and he gave a great synopsis of the current situation.

He provided a background of the real estate development in Seoul. During the late '80s, the Korean government decided to build out 4 MM units in the periphery circle around Seoul, since the city was overpopulated. These outskirts districts include Bundang (분당), Ilsan (일산), Pyeongchon (평촌), and the like. They are now about 30 years old. The Korean government allows reconstruction of the apartment buildings when they are 40 years old. As a result, the investors are in limbo, as they need to wait another 10 years to live in a newly constructed building if they purchase now, or have to wait 10 years using key money, or jeonse (전세), which is similar to the purchase price.

As a result, nobody is buying. A lot of young buyers are in jeonse. Even the jeonse is not a "park the money" scheme any longer, as the jeonse, at least in Seoul, average around 200-300K USD. Since, they don't have that money, they borrow money from the bank at 4% interest, so the average Korean, who makes 2000-3000 USD, is paying out 1000 USD to banks.

Koreans are not oblivious to the US recovery and Chinese real estate bubble. They understand buying is better than paying interest to banks. What they are scared of is losing money on an investment should the real estate market stale for a few more years under President Park's administration. Also, the Japanese economy is unstable as well and should Japan implode, it will take Korea with it. So, they have been playing it safe by holding on to cash and borrowing at low rates.

However, like Buffett said, when everyone else is scared to invest, that is the time to buy. So keen investors have been picking up smaller units, which cost less such as officetels. Officetels, which are small units, are very similar to studio condos in Los Angeles. The officetels are located in buildings where the 1st floor are retail shops and the next few floors are offices, and the top are condos. Less burden for the investors, and a larger market demand with new homeowners, single workers and newly weds.

In the US, a lot of focus on inventory. How is inventory in Korea? In Seoul, construction is very limited. It's an island situation and there is no more room to build large apartment complexes, so they have been constructing a lot in the periphery circle. Some are very far from Seoul central i.e. Dongtan (동탄), which is near Suwon and by metro, it takes 1.5 hrs each way, which is a tiring commute. A lot of young, new homebuyers are flocking there since Seoul is too expensive and the other established pockets like Bundang, Ilsan is also pricey. We believe Seoul central (i.e. Gangnam, Gangbuk) will rise in price and the periphery areas will rise less, as new inventory in the vicinity places a downward pressure on pricing.