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Housing and Real Estate Market Development – Worldwide Experience and Options for Vietnam

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Housing Industry Issues for the Sustainable Urban Development in South Korea

November 26, 2010

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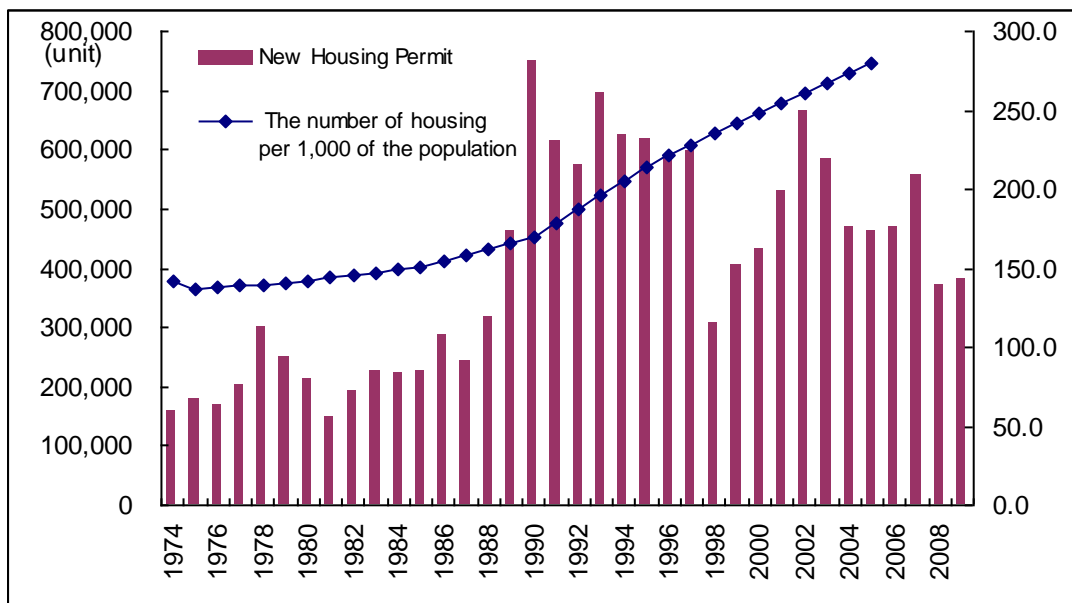
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1. Status of the Housing Market in South Korea

South Korea is the 3rd most densely populated country in the world with a population of 49,044,790 (in 2007). Only 5.8% of her terrain is urban land area. Almost half of the populations (48.3%, 22,770,000 people) lives in Metropolitan area which only occupied 11.8% of South Korea (2005). This situation has also been a source of social, economic, urban, and housing problems in South Korea for the past 40 years.

<Trend of new housing construction volume and the number of houses per 1000 people >



(Source: Ministry of Land, Transport and Maritime Affairs)

“The 1st Economic Development Plan” started in the early 1960. This started the migration of people from rural area to major cities. Continued migration into the cities has sharply raised the demand for housing. However, as the Korean government had no financial resources to spare toward a housing industry investment, the housing supply by the private sector were minimal, and only housing construction by individual owners were taking place. The supplying of housing began on a full scale starting with “The 1st New Town of Metropolitan area” development which was led by the public sector in 1989.

Before that time, the volume of the annual housing supply in Korea was only 250,000 units, but the development of new town caused it to more double to 550,000~600,000 unit. For the first time, the housing construction industry had started to grow in large leaps.

During this era, absolutely lack in total housing supply combined with the domestic economic growth accompanied by various local and infrastructure development had caused a sharp increase in the land price. On top of this, South Korea had experienced

rapid economic growth in 1970s, low interest rate, exchange rate, and increasing liquidity in 1980s. This in turn had caused repeated pattern of sharp rises in real estate prices in 10-year cycles.

However, the sharp rise of the real estate prices has not been closely connected with financial markets until 1990s. But since then, the Korean real estate market began to be closely linked to the financial market due to the opening up of the capital markets and structural transformations of the financial markets in 1998. Korean real estate prices were also hit hard by the 2007 global financial crisis that bulged out of the US subprime mortgage crisis. But interestingly, the size of the South Korea's down fall in housing price was much smaller compared to the major countries' downward trend. Major advanced countries had to restructure their debt but in Korea, loan volume related to real estate even increased a little. At the end of 2009, the current amount of real estate related PF reached about KRW101,000,000,000,000, and housing mortgage loans of households reached KRW265,000,000,000,000. This showed an increase of 16.5% and 20.3% compared to 2007 level before the subprime mortgage loan crisis.

2. Characteristics and Evaluation of Korean Housing Policy

Based on the abundant supply of the economic growth and high population growth, housing and real estate market in Korea focused on supplying the needed quantity of housing and development of new buildings for last 30 years. About 13,000,000 houses were newly built during the 36 years, of which 66% were large scale New-town development that started in the late 1980s.

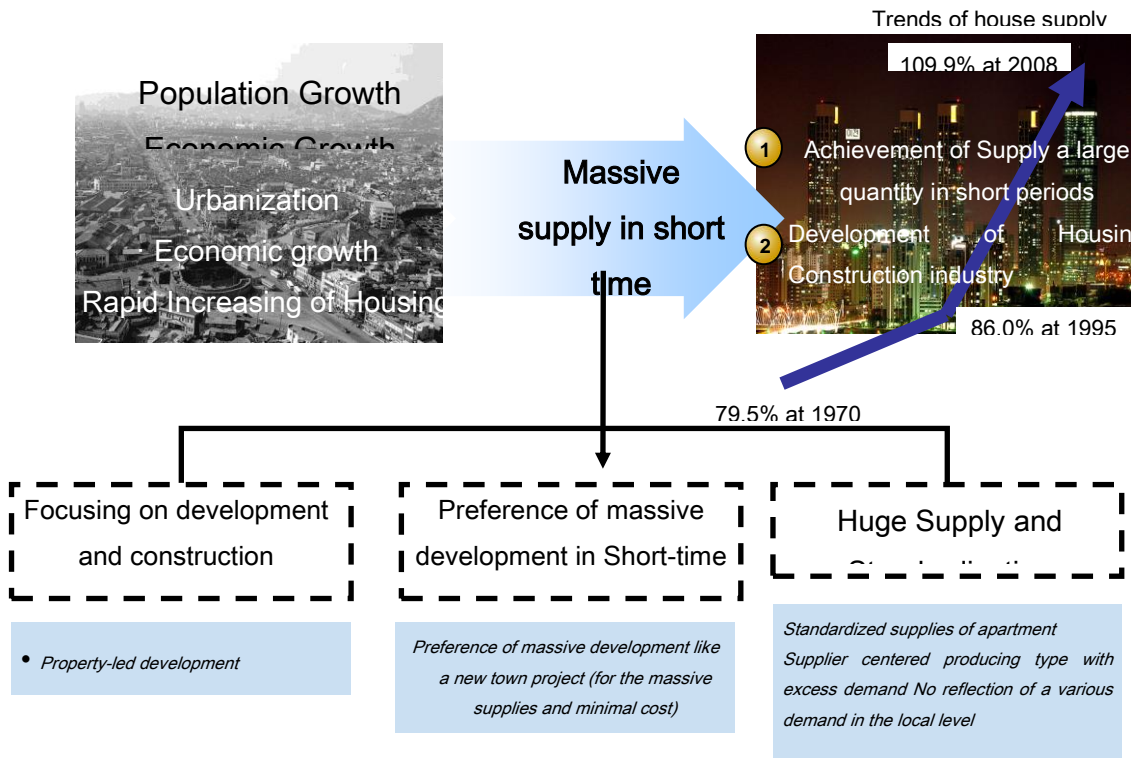
Housing construction in Korea has really been in full implementation for only 20 years. In 1970, the living space per person was 6.8m², which had been increased to 23m² (3.4 times more) by 2006

There were amazing improvements in physical housing environment. The water supply ratio, kitchen and flush toilet supply ratio has reached 95% of population by 2008. However, there also were some undesirable side effects.

Housing and real estate related industry had been focused on development and had not expanded to maintenance, financing and other service businesses. The goal of increasing large volume of housing supply in short time led to building monotonous type of apartment housing.

70-80 percent of newly constructed housing is apartments (15~20 story high rise residential building complex), and apartments represent 55 percent of total Korean housing inventory. The large scale of housing production method resulted in not only monotonous housing type but also many social problem caused in the development process such as land speculation with massive expropriation, deprivation of original residency rights.

<picture1> The Result of Korean housing and real estate market for the last 20 years.



Above all, the real estate market focusing on housing development and construction brought about continuous increase in land price and capital gains which were causes of property-led development industry structure expecting continuous rise of land and housing price.

Looking back, real estate market seemed to have pattern of sharp ups and downs of 10 year-cycles, and there were many repeated patterns of government policy changes between regulating and allowing real estate speculation. Since the 2008 global economic crisis, Korean real estate market also has experienced a serious market depression, even though the size of the impact has been relatively small compared with other advanced countries, the reasons for which I will explain in a later section. This has led to the unavoidable construction industry-wide reorganization. On reflection, one can see the seed of the construction companies' industry-wide reorganization in the supply led business model that no longer matched the reality of the market. The supply focused business model worked well for over 20 years as long as the housing supply was in a catch-up mode to the dynamically increased demand due to demographic change on top of prospering economic development.

3. Environmental Changes and Paradigm Shift in the Real Estate Market

In the next decade, Korean real estate markets are expected to experience huge social and economic changes with declining growth momentum. First of all, the fundamental factors in the change of the supply and demand dynamic are low-growth economy, low population growth.

In population aspect, Korean population is expected to decline from 2019 caused by the low birthrate. Korea is also expected to enter the aging society faster than any other advanced countries.

In the next 10 years, the highest ratio of age population is the 40s who have high homeownership rate and high prospective home buyers but also feel high pressure for retirement savings.

In the survey of experts (by the Construction & Economy Research Institute of Korea: CERIK on Feb. 2010), the housing demand by the over 40s group has high interest in the residential convenience, energy saving and the liquidity of their real estate holdings. On the other hand, the structural changes in total housing needs also demands change in housing supply strategy. Housing market which is now moving out of the absolute lack in housing supply state requires changes in the large scale housing supply system that was appropriate in the past.

Preference of apartment housing is still high, but monotonous product will be difficult to satisfy desires of trade-up buyers. What is now required is a shift to more customer-oriented, made to order housing in small quantities and various types.

The second change factor is the change in consumption behavior and pattern due to the changes in household structure.

Until now, 1-2 person household has meant mainly young age group or a small part of the old age group. But 1-2 person households will increase in all age groups from now on. Especially for the young age group and the old age group, higher demand is expected for rental housing and retirement housing. Accordingly, the housing industry will have to shift its focus of production from 4 person owner occupied housing for the 30s-40s household to products and services for 1-2 person household in all age groups.

■ Collapsing of Housing Bubble in Developed Countries..... Will it be repeated in Korea?

Looking at the next 10 year prospect for Korea, there is a high interest on the question of “Will Korea also experiences a burst of housing bubble?” This interest is due to the expensive lessons learned from the early 1990s land bubble burst in Japan and 2007 subprime mortgage crisis of the housing market in the USA.

There are similarities between the situations just before the bubble burst of the above 2 countries and apparent situation in Korean housing price rises and increase of the housing mortgages since the middle of 2000.

Therefore, as the recent inactivity of the real estate market continues, South Korea is highly concerned whether it would follow after the two countries and fall into a long term stagnation as the result of collapsing of the real estate prices.

Skyrocketing housing price rises with a low interest and an excessive liquidity in the countries like Japan and the US led to financial crisis and resulted in the collapse of real estate bubble.

In Korea, the increasing consumer debt and the fact that the retirement of the baby boomers in Korea would begin in 2010 have increased similar concern for housing bubble burst in Korea. However, the situation in Korea is different from US and Japan examples countries, and the out fold would depend on how the market responds from now on as to whether the bubble would burst or not.

One of the differences is that the Korean housing market has passed the 100% housing supply rate in 2002, which is only 5 years before the time of the recent global crisis. Korean housing market is only now approaching a “full” housing supply rate as experienced by the advanced countries. Also the government had been tightly regulating on the loan-to-value(LTV) and debt-to-income ratio (DTI) since 2004, before the subprime mortgage crisis, so that the concerns about the lending banks becoming insolvent with downfalls in housing prices is not high.

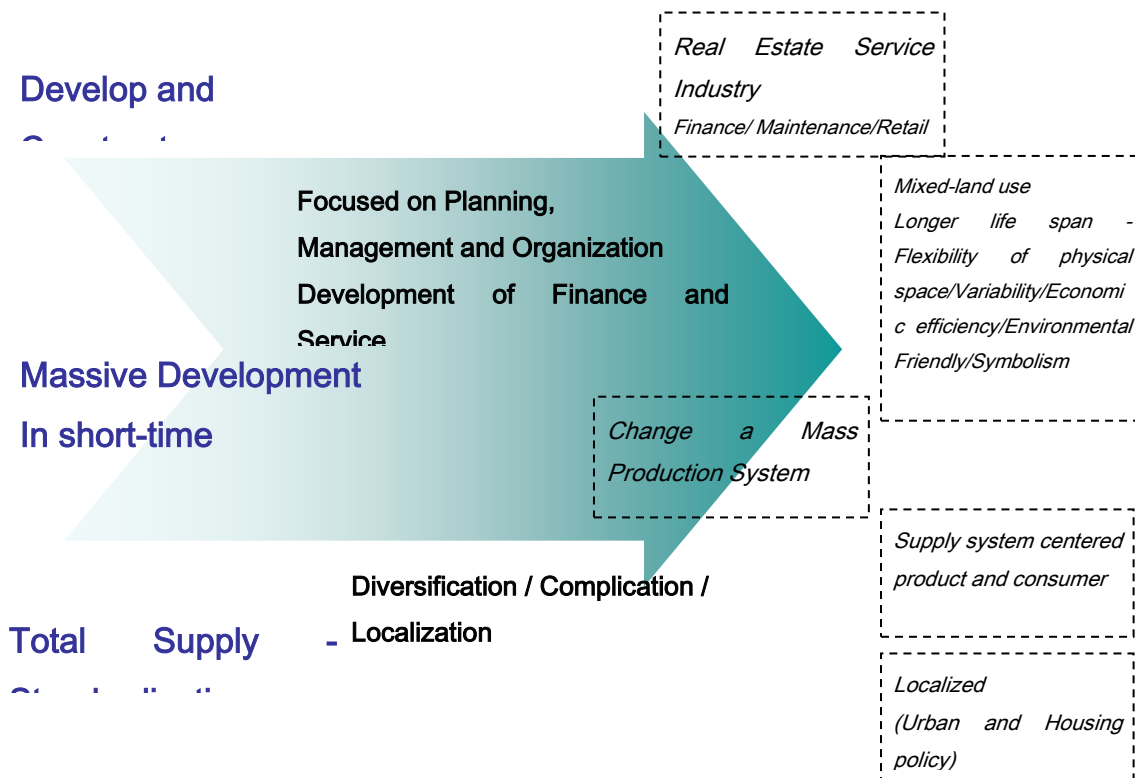
Another reason is that according to increase of the household income, the housing market still has additional demand such as second houses or upgrade replacement purchase. Especially, there are still other chances for the additional housing buyer and replacement housing buyer in the 40s as a core age group in the population.

The housing market will also depend on the possibility of the increase of the population through the aggressive immigration policies or unification of the South and North Korea.

In spite of population decrease, there will be opportunities to create new markets like green housing and green construction as changes occur in global construction standards and global cooperation agreements relating to green energy and environment. These changes will create new requirements for construction technology and manufacturing innovations.

One growing area of opportunity that exists for the Korean housing industry would be the close application of Korea's high-tech IT technology into the housing industry. This also may open doors for export opportunities in the advanced countries for the Smart Home markets.

<Picture2> the change that the Korean real estate market should accept for the next 10 years



■ Proper responses to the changes are the sustainable industry policy and business strategy.

The coming trend in market the domestic housing suppliers must adapt in order to thrive is meeting the demand for customization for demographic needs and location specific needs and toward more mixed- use development.

It will be inevitable that the housing industry would have to move away from the industrial system focusing on the large scale development and construction.

Even though the total volume of housing demand will decrease, the housing market focused on service market has enough potential demand. Also a growing trend toward mixed-use and conversion of urban function can be another main driver for the new demand.

Both horizontal and vertical mixed-use will become very active, and the complexity and

conversion of urban functions will be rapidly progressed.

A global trend that is increasingly becoming a new requirement and opportunity for the housing industry is the 'Framework Convention on Climate Change (FCCC)'. This would create a market demand for innovations in technology and production and distribution system in the housing market. Therefore, 'environmentally friendly housing' and 'urban regeneration' will also be key words for growth in the housing industry.

The 'urban regeneration' trend has already been observed in some advanced countries where the population of the suburbs is coming back to urban areas as the society becomes an aging society. In the advanced countries, the energy savings from the urban regeneration and the ensuing shorter commuting hours are recognized as an important social issue. However, Korea's awareness and the ensuing actions in regulations and development of technology for climate-changes friendly housing are relatively behind.

Specially, the preferred housing location is predicted to move towards downtown areas rather than suburbs, but the heights and cubic dimension policy of urban land use which is still rigid. For example, the 2nd New-Towns are being developed, but they are all 40km away from Seoul. They are too far away. This situation requires a supplemental plan.

The financial sector also has a lot of issues remaining as well. The elderly household with large real estate asset desperately needs liquidity of their held real estate assets. Reverse mortgage or property securitization product is needed in order to support such liquidity needs.

Project financing for housing supplier also has not gotten out of the form of a requiring guaranteed mortgages by construction companies.

An excessive surety obligation of construction companies has already become a social problem. As international financial reporting standards (IFRS) shall come into force in the next year, the surety obligation condition can not be maintained any more.

Therefore, it is high time to develop proper project financing and the various financial products for the housing suppliers.

Finally, I would like to address the necessary mindset changes regarding the housing and real estate markets. An interest toward housing for the high income investment product aimed at capital gains is already going down.

However, the interest in an income producing real estate generating cash flow is increasing. This means that there is greater interest in product category of real estate with stable rental income.

4. Future Issues

Even though the social circumstances have gone through many changes in Korea, the real estate industry and policy have remained in the past.

The current housing supply system and technology must be changed to support the expansion of new housing products such as energy saving and long-life span. The Korean housing industry is at an inflection point of industry wide transformation. The current housing industry depression has structural issues at its source. This no longer fit the reality of the market nor the society. To transform the Korean housing industry to become a viable market driven industry, two structural changes must accure in concert. Government needs to abolish the now excess protection or regulation. The housing supplier must shift from “If we build, they will buy” mentality and become new product development and innovation driven supplier focusing on the dynamic needs of the customer.

Simply stated, the hardware of housing supply such as construction technology and IT application is at a competitive level on a global basis. However, the software of housing supply such as sales process and distribution channel of housing units is still at industrial-age, as an analogy, and needs to be updated to fit the knowledge-age.

In addition, left over from the period of excessive policy intervention that was intentioned to hold down speculation during the rapid rising period of housing prices have led to treating multiple house owners as speculators rather than rental-housing providers. However, Korean housing industry has successively gone through transformation in establishing a realistic real estate assessment standard and requiring stricter reporting and providing various statistics and thus has crafted a foundation for the market to become transparent. Therefore, the government policy makers need to be assured of the fact that the speculation on real estate which was possible in the past is now almost impossible to be repeated in the future.

In the past, the domestic housing and real estate industry had been focusing on supplying a large volume of housing in short periods and the housing welfare had been focused on quantity rather than quality of life. However, the welfare of future generation will be fulfilled in the hierarchical housing welfare suitable for each grouping of customers including low-income people and the middle income people and focus on efficient movement in and out of housing and pursue improvements of housing standard, etc.

The roles and responsibilities should be such that the government takes care of the housing needs of low-income class and the market provides the housing welfare needs of the middle class.

In conclusion, the goal of the advancement of the Korean housing industry and the government can be summarized into three key elements.

First, supply-driven housing market should and will be changed into demand-driven market.

Second, Eco-friendly green construction must be promoted as a new growth engine for domestic economic development.

Lastly, housing welfare for all the people must ultimately be promoted.