Judy Jang
Associate Director | Research | Korea
+822 6325 1918
judy.jang@colliers.com

THE RISE OF KOREA'S REITS

Real estate investment trusts (REITs) are surging in popularity among Korean investors

Summary & Recommendations

- The Korean REIT market will likely expand with governmental support and the currently low interest rate environment in Korea.
- Asset managers and securities firms need to continue educating themselves about REITs, including even recruiting REITs specialists to prepare for a full-fledged expansion of the REITs market.
- Currently office REITs offer the greatest opportunity, but AMCs and existing REITs should find a variety of real estate to develop into publicly listed REITs.
- To take advantage of government subsidies, we recommend AMCs pool existing real estate funds into indirect REITs.

KRW47.8 trillion

As of September 2019, the number of REITs in Korea is 232 and the total investment size is about KRW47.8 trillion. We expect this to grow to KRW60 trillion next year, with 13 new REITs scheduled to be registered in Q4 2019.

Dividend yield of 11.1%

In 2018, the average annual dividend yield for Korean REITs overall was about 4.4 percent. However, the yield of listed REITs was 11.1 percent. The recently listed Lotte REIT aims for a 6% rate of return.

7 Listed REITs

As of December 2019,the Korean stock market has seven REITs, including Shinhan Alpha REIT and E-REITs Kocref. More REITs are moving to be listed on the nation's stock market. The asset size is about KRW2.2 trillion, accounting for about 4% of the overall REIT market.

Largest REIT is KRW1 trillion

Lotte REIT, listed on the country's Kospi market, is the country's biggest real estate investment trust in terms of assets under management.

Source: Korea REITs Association, Colliers International. Note: USD1 = KRW1,191.

Recently, large-scale REITs like NH prime REIT and Lotte REITs were listed in an initial public offering (IPO). Various investment companies and asset management companies (AMCs) are considering offering new REITs, not only as classic REITs, but also as funds of funds (FoF).

REITs are largely divided into public offerings and private equity. Although the REIT market has been dominated by private equity, the government has recently announced plans to boost public offerings of Real Estate Indirect Investments, creating a major shift to the paradigm of the Korean REIT market. While Investors in private equity REITs were limited to institutional investors, with an increasing number of public REITs, ordinary individuals can diversify into this market.

The REIT market is becoming more attractive, with low interest rates, governmental support and an increase in the number of public REITs. This is pushing more securities firms, real estate trusts and AMCs, to advance into the public REIT market. We expect the REIT market to see rapid growth in 2020 with a diverse array REITs.

REIT OUTLOOK AND STRATEGY

Increased participation of various financial institutions

Not only are financial institutions such as banks and securities companies looking to enter the REIT market, but also construction companies. Previously the REIT market was dominated by management and trust companies.

Shinhan Bank aims to increase its operating assets allocated to REITs to KRW1 trillion (USD840 million) by utilizing Shinhan REITs Management AMC. NH Prime REIT Co., a real estate investment trust of South Korea's Nonghyup Financial Group, listed its NH Prime REIT, which includes prime offices such as Seoul Square and Gangnam N Tower. In addition, Hana Bank and KB Bank are expanding their presence in the REIT market through Hana Asset Trust and KB Real Estate Trust, respectively.

As widely reported, Securites firm such as Mirae Asset Daewoo, KB Securities, Daishin Securities and Shinyoung Securities, as well as asset management firms like IGIS Asset Management plan to expand market.

Due to the sluggish domestic housing market, Korean real estate developers Daelim Industrial Co., HDC Hyundai Industrial Development Co., Daewoo, POSCO and Lotte Engineering & Construction Co. are also planning to diversify their business models through REITs.

Status of major listed REITs in Korea

REIT	Asset Management Company (AMC)	Underlying Asset	IPO Scale (KRW)	Estimated dividend yield
Shinhan Alpa REITs	Shinhan REIT management	Pankyo Krafton Tower, Yongsan The Prime	114 billion	4% or less
Lotte REIT	Lotte AMC	4 Lotte department stores, 4 Lotte Marts and 2 outlet malls	429 billion	6% or less
NH prime REIT	NH REIT management	Seoul Square, Samsung C&T's Seocho office, Gangnam N Tower, Jamsil SDS Tower	68 billion	5%~6%

Source: Colliers International

Emergence of large-scale REITs

Homeplus Co., a South Korean hypermarket operator, plans to re-enter the REIT market in the next year, after having canceled their planned KRW1.7 trillion (USD1.4 billion) REIT IPO in March 2019. If the Homeplus REIT does launch, it would be the largest real estate investment trust by market cap.

Expanding and diversifying REIT investment sectors

As of Q3 2019, there were 121 residential REITs, 55 office, 27 retail, and 14 logistics REITs. Additionally, there were nine multi-sector and six hotel REITs. Despite accounting for the largest number of REITs, residential REITs offer relatively lower yields compared to other sectors. Thus, the development of the public residential REIT market has been slow.

Over the next three years, with the expansion of the publicly traded REIT market, we expect the REIT sector will diversify into the infrastructure, data center, and housing sectors.

REIT Investment Strategy

AMCs and securities firms that have until now only invested directly into funds should focus on sourcing appropriate real estate which could be used in a REIT instead of being held privately. In addition, with the diversification of the REIT market, existing office and retail focused REITs should considering diversifying, developing various property types such as student housing and data centers.

We expect that the scale of overseas real estate investment listings to increase. In addition, AMCs and securities companies should prepare to attract foreign institutional investors to their REITs products. Previously, REITs in Korea did not have the scale to attract foreign institutional investors, however, if the Homeplus REITs successfully launches, we expect its scale to put Korean REITs on the radar for these investors.

Recently, REIT sponsors have been establishing indirect REITs (by pooling existing real estate funds or by using REITs beneficiary certificates) rather than directly investing in real estate. We expect the Korea REIT market will expand further, as AMCs convert existing real estate funds to indirect REITs.

REASONS FOR THE REIT BOOM

Low interest rate trend

With sluggish economic growth, Korean interest rates have been declining. The Bank of Korea has recently cut its base interest rate to 1.25%, marking the lowest rate ever. Under this trend, investors are turning to real estate to offset the meagre returns from savings accounts or the stock market. In particular, the REIT market, with more FoFs and public REITs, is attracting increasing attention from the general public, who due to the capital requirements often find it difficult to invest directly in real estate.

Government's policy to support public REITs

By introducing "comprehensive measure[s] to revitalize [the] REITs," the government is boosting the REIT market and expanding opportunities to acquire high-quality assets by:

- expanding the supply of public buildings and land
- easing location regulations, and
- easing restrictions on mutual investment between REITs and funds.

In addition, the government is pushing to encourage private investment by promoting publicly listed REITs. This measure allows pension funds to invest in listed REITs, as well as simplifying the process of publicly listing REITs. In addition, these publicly listed REIT shares, which can now only be sold by securities firms, are planned to also be sold at banks. We expect these factors, along with the lower tax rate on the dividend income from REITs, to support the growth of the REIT market.

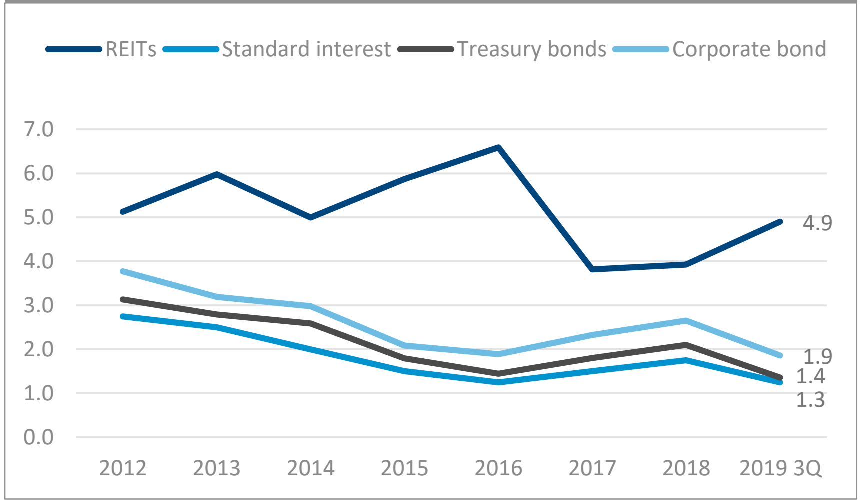
Expanding the REIT market into the retail sector

Due in part to the rise of ecommerce, Korean retail giants such as Lotte and Shinsegae are seeking to secure liquidity by cashing in their real estate-bound funds through the sale of their real estate. Recently, Lotte AMC launched a Lotte REIT with an asset base of four Lotte department stores, four Lotte Marts and two Lotte outlet malls. Over the next three years, we expect that the REIT market will expand as each retailer expanded its REITs to secure funds for investment in its online business.

Attractive dividend yield

The return on the REITs consists of capital gains after liquidation and periodic dividends. Dividend income of 5 ~ 6% per year and yields of 7 ~ 9% can be earned from the 2 to 3% annual gains in capital values. This level of dividend income far exceeds bank deposit rates (about 1.4%) and three-year Korean government bond yields (also about 1.4%).

Rate of return comparison



Source: The Bank Of Korea, REITs Information System

Stability against other financial products

To take advantage of tax benefits, REITs commonly pay out dividends of more than 90% of their profits. These regular dividends offer investors an stable return comparable to direct real estate investment, while offering the liquidity of a listed security. These stable returns contrast with the stock market , which can experience large variations due to its inherent volatility and prevailing economic conditions.

Primary Author:

Judy Jang
Associate Director | Research | Korea
+82 2 6325 1918
judy.jang@colliers.com

For further information, please contact:

Kichoon Jung
Managing Director | Korea
+82 2 6325 1901
kichoon.jung@colliers.com

Andrew Haskins
Executive Director | Research | Asia
+852 2822 0511
andrew.haskins@colliers.com

Joon Lee
Senior Director | CMIS | Korea
+82 2 6325 1907
joon.lee@colliers.com

Jay Cho
Director | Office Services| Korea
+82 2 6325 1905
jay.cho@colliers.com

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