

Real Estate Strategic Outlook: South Korea

Short-term challenges, longer-term opportunity

The base rate remains at 3.5%, with a potential cut in 2024.

Amidst surging interest rates and weakening external demand, South Korea's real GDP growth was expected to have fallen below 1% in 2023, while a slight growth recovery of 1.3% is expected in 2024.

Along with the price growth of energy and service products, the country's CPI moderated from 6.3% in July 2022 to 3.3% in November 2023, significantly relieving the pressure for further interest rate hikes. Since January 2023, The Bank of Korea has cautiously kept the base rate unchanged at 3.5%, while current market expectations are for rate cuts as early as 2024, with looming concerns over an economic slowdown and high domestic household debt levels.

CRE capital values remain under further pressure before potentially bottoming out in 2024.

An attractive investment window for alternative lenders.

Negative spreads between commercial real estate cap rates and borrowing costs remain wide, at around -100 to -150 basis points in September 2023, creating a significant pricing gap between sellers and potential buyers. Core investors should look out for repricing opportunities in real estate equity investments, with the bid-ask price gap eventually leading to price corrections and more reasonable entry points, especially in the Seoul office market and regional logistics markets underpinned by a higher entry yield, strong market fundamentals, and the potential for yield compression when inflation wanes.

Investors with more strategic flexibility may also look out for real estate debt, as asset-based lending yields have reached attractive levels. The lending yields for core stabilized assets and construction loans continued to escalate to around 5-8% and 8-18%, respectively. The maturing real estate debt amount is expected to peak in 2024 with an immediate need

for new lenders to step in and ease constraints in the credit markets.

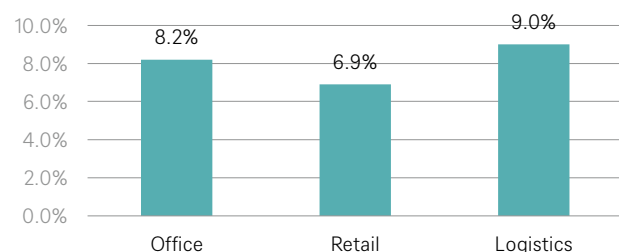
Logistics: Short-term market disruption and limited future supply

The average modern logistics vacancy rate in Greater Seoul increased from 3.0% in 2019 to 5.7% in the second quarter of 2023, and will likely rise to nearly 6% in 2024 due to ongoing strong supply. Surging financing and construction costs have become critical stumbling blocks for logistics developments, resulting in approximately 50-60% of planned projects being canceled or put on hold, which should relieve concerns over oversupply in the coming years.

Office: Healthy fundamentals with limited supply.

Amid widespread global office woes with permanent working-from-home arrangements, the Seoul office market stood out as the world's most vibrant office leasing market with a tight vacancy rate of 2.8% in the third quarter of 2023. Given the limited supply and healthy space expansion by IT and tech office tenants, office vacancy rates in major office districts should remain tight in the foreseeable future, while the strong leasing momentum could slightly moderate with looming concerns over the potential economic downturn in the coming quarters.

Total Return Forecast in South Korea, 2024-2033f, p.a.



Source: DWS, January 2024

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