

## Real Estate Strategic Outlook: South Korea

### Short-term challenges, longer-term chances

The base rate has been cut from 3.5% to 3.0% in late 2024, with potential further reductions anticipated in 2025.

Real GDP growth in South Korea is forecast to be moderate, at 2.2% in 2024 and 1.9% in 2025. Export activities have contracted due to the slowdown in the Chinese economy and global trade activity, while the recovery in investment is expected to support GDP in the next few quarters with modest consumption growth.

With rising household debt and higher real interest rates exerting downward pressure on economic growth and inflation, the Bank of Korea initiated its rate-cutting cycle with a 50 basis points cut in late 2024. The bank is expected to gradually reduce its policy rate to the mid-2% level by the end of 2025.

The brief martial law imposed on 3<sup>rd</sup> December was soon lifted and had limited impacts on the country's economy and capital market. However, political uncertainty is likely to continue to be a risk to the economy until there is more clarity.

### Capital values expected to bottom out in 2025

Logistics and office sectors could see yield spreads turning positive from 2025 onwards

The price correction phase for South Korea's office and logistics sectors is expected to end by 2024, with a modest recovery starting in 2025. The logistics sector experienced a larger price correction of 15-20% for core stabilized assets from its peak valuation two years ago, compared to 8-13% in the office sector, due to differing leasing market fundamentals.

Current negative spreads between cap rates and borrowing costs could gradually turn positive by 2025-2026, as borrowing costs fell from 6.5-8% at the end of 2022 to 4.5% by the end of 2024, potentially dropping further to low 4% levels by 2025. This decrease is driven by a decline of 60 bps in long-term bond yields and narrowing lenders' margins from 290 bps to 150 bps, reflecting increased lender confidence in stabilized assets.

Positive yield spreads are expected for logistics and office sectors from 2025 and 2026, boosting investment demand in both sectors.

### Logistics: Construction cost rises to limit new supply from late 2025

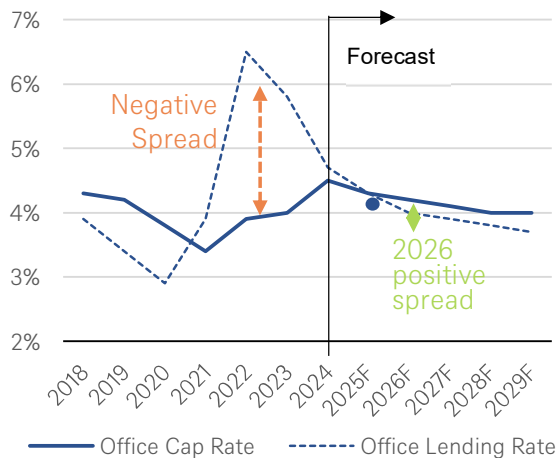
Surging financing and construction costs have become significant obstacles for logistics developments, pushing breakeven rents for new development projects 30-40% above current market rents. This is expected to limit new supply from the second half of 2025 onwards. If the logistics vacancy rate in Greater Seoul stabilizes from its elevated level of above 10% in 2024, strong rental growth beyond 2026 could materialise.

### Office: Healthy fundamentals with limited supply.

The Seoul office occupier market remained the world's most vibrant location, despite office vacancy rising modestly from around 2% in 2023 to 3.5% in Q3 2024. Leasing momentum has slightly softened due to companies relocating their headquarters to decentralized areas and reduced hiring by large corporations amid economic slowdown concerns.

However, rising construction costs and delays in construction plans are expected to limit future office supply until at least 2028, keeping vacancy rates tight in major office districts for the foreseeable future.

### Cap Rates and Lending Rates in Office Sector



Source DWS, December 2024. Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses, which might prove inaccurate or incorrect.

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