

Chapter 16

The Korean Housing Market: Its Characteristics and Policy Responses



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1 Recent Housing Market Developments

1.1 Housing Price Trends

Korea experienced only a limited drop in housing prices after the global financial crisis, unlike advanced economies that experienced sharp price declines (Fig. 16.1a). Prices began to recover in 2014 when the government eased real estate regulations, and have since then remained on an upswing. From the first quarter of 2014 to the second quarter of 2017 the rise in housing prices (10.5%) was concentrated primarily in the capital area (the SMA¹), similar to the cases in other advanced countries such as the Netherlands and Australia. Figure 16.1b shows that the gap in the rates of housing price increases in Seoul and in the nation as a whole was 6.9 percentage points (pp) during this period.

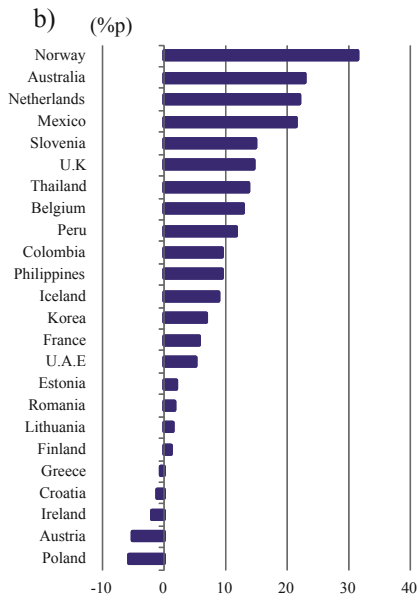
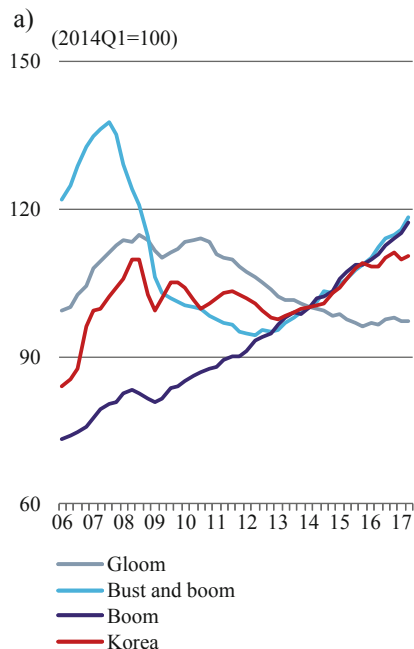
Apartments account for 60% of all housing in Korea,² and since 2014 apartment prices in the SMA have risen far faster than those in the NSMA (Fig. 16.1c). In

¹The SMA includes Seoul, Incheon and Gyeonggi (GG). The non-SMA region, NSMA, consists of five major cities and eight provinces. The five major cities are Busan, Daegu, Daejeon, Gwangju and Ulsan, and the eight provinces Gangwon (GW), Chungbuk (CB), Chungnam (CN), Jeonbuk (JB), Jeonnam (JN), Gyeongbuk (GB), Gyeongnam (GN) and Jeju (JJ).

²In Korea, apartments refer to five or more story residential buildings. Most apartment complexes have facilities nearby such as supermarkets, schools and district offices as well as easy access to public transport.

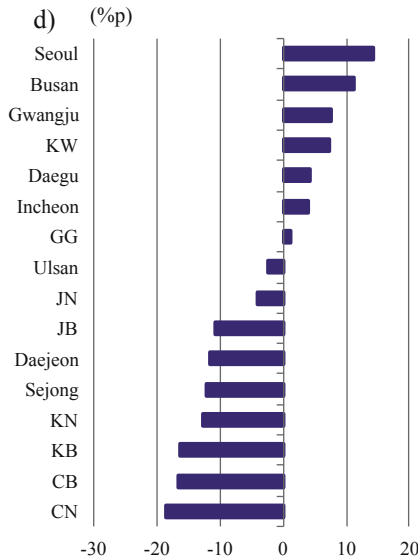
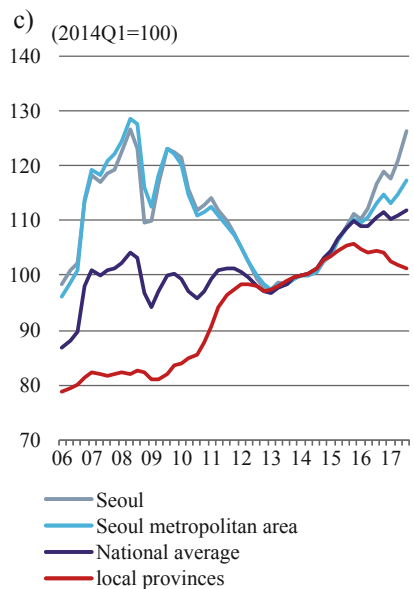
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Sources: BIS (2018), Korea Appraisal Board (2018)

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Source: Korea Appraisal Board (2018)

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Fig. 16.1 (a) Real housing price index. Note: Gloom: Netherlands, China, etc; bust and boom: US, UK, etc; boom: Australia, Canada, etc. The classification is from IMF (2017). (b) Gaps in real housing price growth between capital cities and nations overall. Note: From Q1 2014 to Q2 2017.

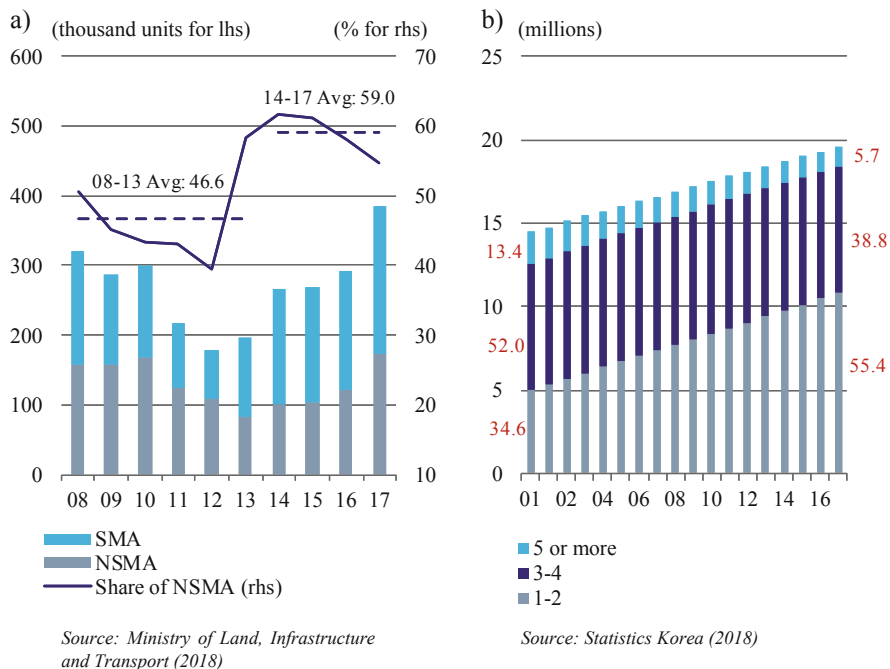


Fig. 16.2 (a) Number of apartments constructed. Note: SMA is the Seoul metropolitan area and NSMA is the rest of the country. (b) Number of households by household size. Note: Figures are the percentage proportions

particular, the growth rate in Seoul from the first quarter of 2014 to the fourth quarter of 2017 (31.2%) exceeded the national average (12.6%) by 18.7pp (Fig. 16.1d).

1.2 Supply and Demand

Housing supply, which had fallen amid the post-crisis housing market slump, began to increase with the real estate deregulation in 2014, led by the NSMA. The quantity of new apartments completed in 2017 stood at 385,000 units, greatly exceeding the 6-year average (2008–2013) of 250,000 (Fig. 16.2a). The supply in the NSMA accounted for 59.0% of all new apartments between 2014 and 2017, sharply up from 46.6% between 2008 and 2013.

The demand for housing has grown with the rise in the number of one- and two-person households (Fig. 16.2b) as a result of, for example, shrinking household size in the course of population aging (Oh et al. 2017). In particular, the annual rate

Fig. 16.1 (continued) (c) Regional real apartment price index in Korea. (d) Gaps between regional and national real apartment price growth rates. Note: From Q1 2014 to Q4 2017

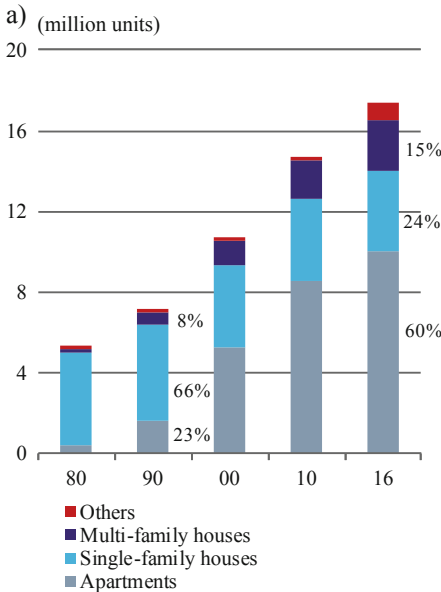
of growth in the number of households is higher in the SMA (2.1%, 2000–2017) than the national average (1.8%), due to the faster growth in one- and two-person households there.

2 Structural Characteristics of the Korean Housing Market

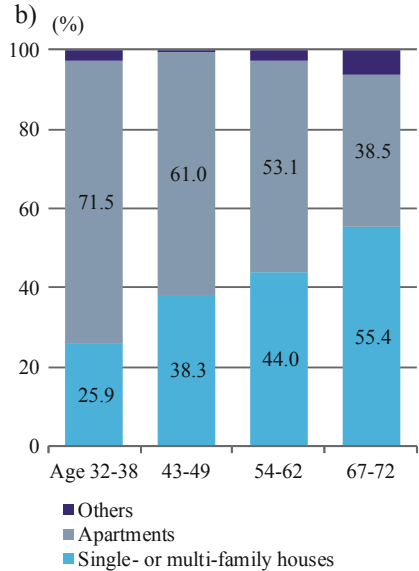
The Korean housing market is characterized by the dominance of apartments among housing types, by considerable demand for housing for investment purposes, and by household-led supply of rental housing.

2.1 Apartments as a Dominant Form of Housing

As of 2016, apartments accounted for 60% of all housing units in Korea (Fig. 16.3a). On the supply side, apartments came to predominate because they could be more effectively supplied and managed than other types of housing in response to the growing overpopulation of the SMA and other large cities during the past periods of industrialization and urbanization.

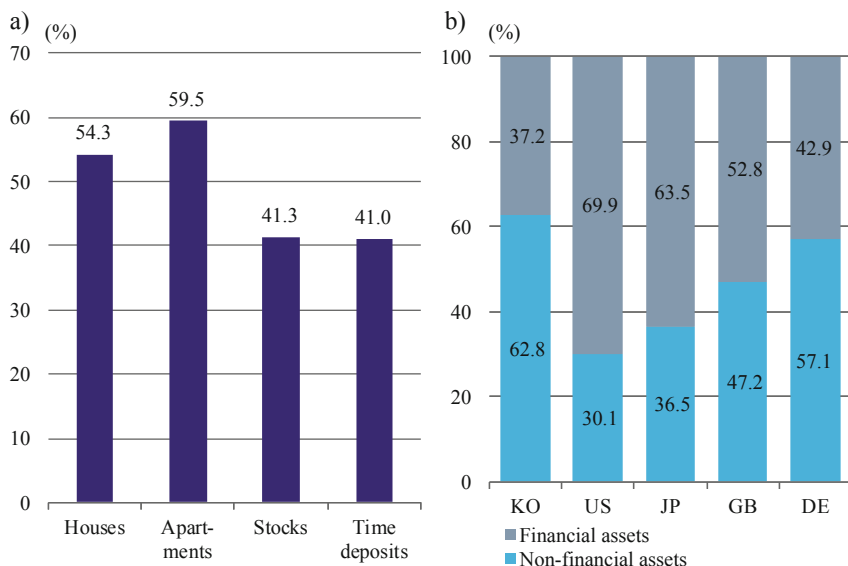


Source: Statistics Korea (2018)



Source: Ministry of Land, Infrastructure and Transport (2018)

Fig. 16.3 (a) Number of houses by type. Note: Figures are the percentage. (b) Housing preferences by generation. Note: 2016 survey



Sources: Author's calculation based on data from KB Kookmin Bank, Bank of Korea (2017)

Sources: Bank of Korea (2017)

Fig. 16.4 (a) Cumulated returns by asset type. Note: Between 2007 and 2016 figures for houses and apartments are based on samples from KB Kookmin Bank, and time deposits are based on one-year maturity. (b) Compositions of household assets in major countries. Note: Figures for Korea and the US are based on the national balance sheets in 2016 (and those for other countries on their national balance sheets in 2015)

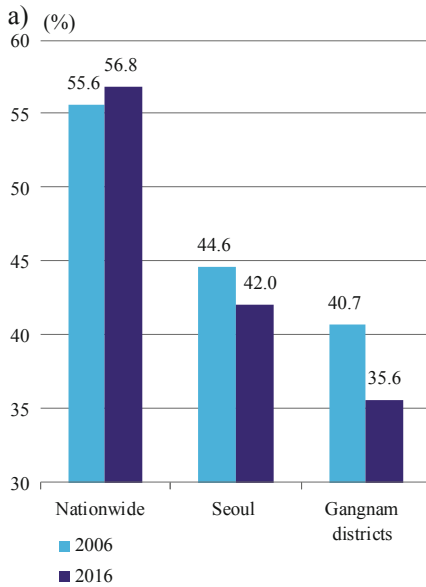
On the demand side, the younger generations prefer apartments, as do the middle-aged because of apartments' high liquidity (Fig. 16.3b). They can cash in their property assets after retirement. The proportion of apartments is considerably higher in the SMA (63.2%) and other large cities (63.9%) than in the rest of the country (57.5%).³

2.2 Demand for Housing as an Investment

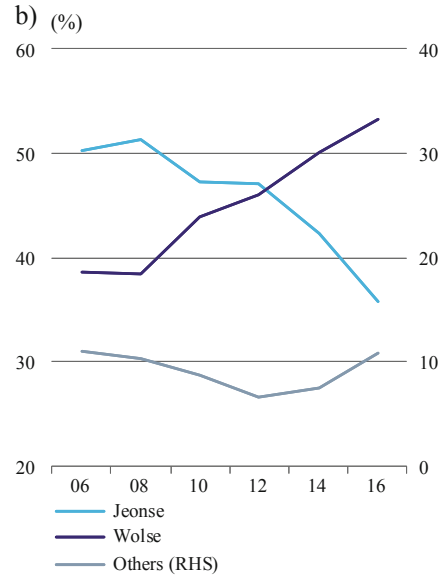
Korean households have a strong tendency to own houses not only for residential but for investment purposes as well. Apartments in Korea are highly preferred as an investment because they yield high and stable profits, and are highly liquid⁴ (Fig. 16.4a). As a result, non-financial assets, such as homes and commercial

³The large cities include Seoul and six major cities (Incheon, Busan, Daegu, Daejeon, Gwangju and Ulsan).

⁴Since apartments in Korea are standardized, they have advantages in terms of being sold and leased out.



Source: Statistics Korea (2018)



Source: Ministry of Land, Infrastructure and Transport (2018)

Fig. 16.5 (a) Shares of owner-occupiers by region. Note: The Gangnam districts include three districts in southern Seoul (Seocho, Gangnam and Songpa). (b) Shares by rental housing type. Note: Wolse is a rental contract based on a deposit plus the payment of monthly rent

buildings, accounted for 62.8% of total household assets in Korea at the end of 2016, far exceeding the figures seen in other major advanced countries (Fig. 16.4b).

Meanwhile, the popularity of jeonse,⁵ a leasehold deposit system unique to Korea, tends to make it easy to purchase homes for investment purposes through so-called gap investment. It allows home buyers to easily finance a sizeable portion of the purchase price in the form of the deposits they receive for leasing the housing out. The amount of deposit is referred to as jeonse price.⁶

Demand for housing as an investment is more concentrated in Seoul. As of 2016, housing units held by multi-home owners (households owning two or more homes) accounted for 53% of total housing units in Seoul, a proportion higher than the national average (49.9%). In reflection of this, the share of owner-occupiers in Seoul stood at 42.0%, well below the national average (56.8%) (Fig. 16.5a). Nationwide, the share rose from 55.6% in 2006 to 56.8% in 2016, while in Seoul it has been falling from 44.6% to 42.0% over the same period.

⁵Under this system, a homeowner rents a housing unit upon receiving a certain leasehold deposit from the tenant, and returns the deposit once the contract period ends.

⁶In 2017 the national average jeonse-to-sales price ratio for apartments was 74.6%.

2.3 Household-Led Supply of Rental Housing

The Korean rental housing market differs from those in other major countries in that the household sector, more so than the public or corporate sectors, plays the main rental housing supplier role. Korean households supplied 78.9% of total rental housing at the end of 2015 (compared to 13.7% by the public sector, and 7.4% by the corporate sector), well above the figures in major countries such as the US (56.3%), the UK (53.1%), Germany (64.1%), and Japan (66.5%).

Meanwhile, jeonse tenancies, which do not occur in other major countries, accounted for 35.9% of the total rental housing supplied by households in 2016 (Fig. 16.5b). The share of jeonse is also much higher in Seoul (45.3%) and the SMA (42.0%, regional average) than in the NSMA (25.0%).

3 Recent Buoyancy in the SMA Housing Market

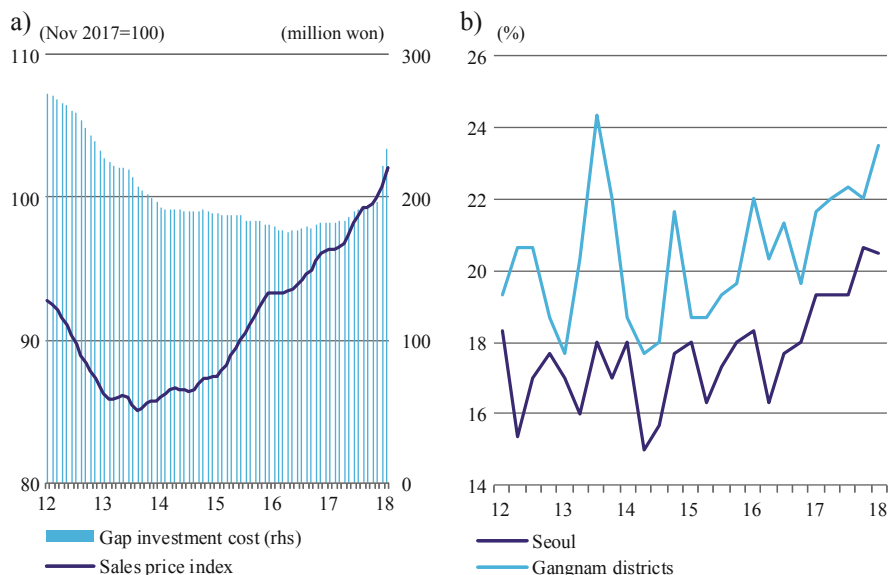
The buoyancy of the housing market in recent years, particularly in the SMA, has been driven by three factors—the persistently low interest rates, the easing of real estate regulations, and the stronger incentives for financial institutions to supply mortgage loans.

3.1 Persistently Low Interest Rates

With low interest rates having continued for a prolonged period of time, demand for investment in housing has increased. This demand has particularly increased in the SMA, as expectations of housing price growth have spread there. Housing purchases in the form of gap investment⁷ have been on the rise (Fig. 16.6a), particularly in the SMA where rental demand is higher than in other areas due to the favorable educational and cultural conditions. Figure 16.6b shows how the investment in housing in Seoul by non-Seoul residents has also grown since 2014.

Meanwhile, as jeonse prices for homes have increased faster than their sales prices, and borrowing costs have become lower, demand from households switching from rental to ownership of housing has also grown. The proportion of jeonse tenants purchasing their own units rose from 7.4% in 2013 to 10.4% in 2016.

⁷When the gap between the housing sales and jeonse prices is small, investors purchase homes by only investing this difference (gap). They then lease the homes and later gain profits by selling them when their sales prices rise.



Source: Korea Appraisal Board (2018)

Source: Korea Appraisal Board (2018)

Fig. 16.6 (a) Apartment sales price and gap investment cost in Seoul. Note: The gap investment cost is the difference between the housing sales and jeonse prices. (b) Proportion of housing purchases in Seoul by non-residents

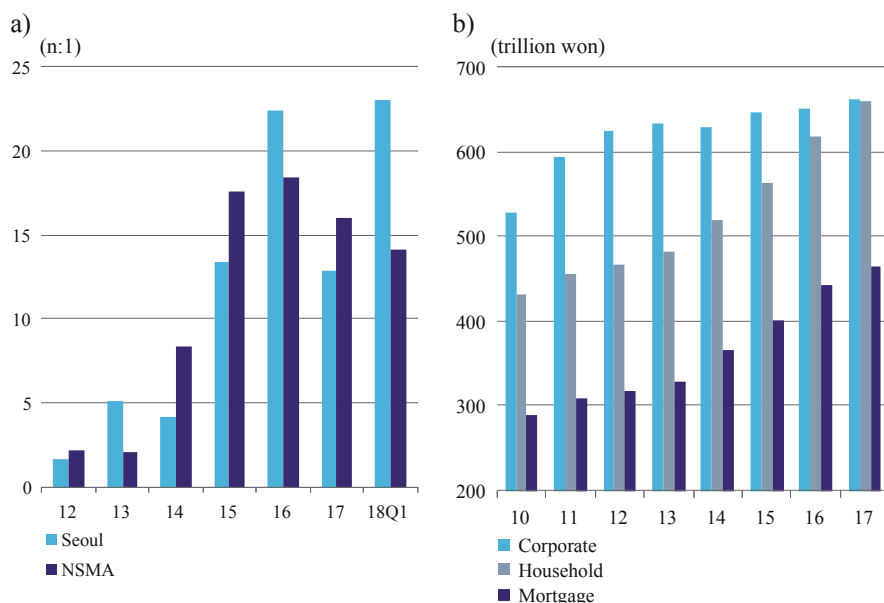
3.2 Easing of Real Estate Regulations

In an effort to boost the real estate market, the Korean government eased the housing market-related regulations drastically in 2014. In the SMA the LTV and DTI ratios were raised by up to 20pp (50% → 70%) and 10pp (50% → 60%), respectively.⁸ This led to stronger expectations of housing price rises, and demand for housing purchases increased as a result. In addition, with the shortening of the years required before apartments are eligible for reconstruction,⁹ and the easing of qualifications for having first priority to bid in new apartment pre-sale markets,¹⁰ investor demand flowed into homes in Seoul scheduled for reconstruction as well as into new apartment pre-sale markets (Fig. 16.7a).

⁸Here, the debt-to-income ratio is calculated by dividing the sum of annual principal and interest payments of a mortgage and annual interest payments of other debts by annual income.

⁹Previously apartments had to be at least 40 years old to be eligible for reconstruction, but the government has eased that threshold to 30 years for apartments in the SMA and other large cities. This has significantly expanded the range of apartments eligible for reconstruction.

¹⁰In order to purchase a new apartment in Korea, one must be selected from a pool of subscribers. The qualifications for being prioritized to bid in new apartment pre-sale markets were eased to attract more demand.



Sources: Bank of Korea (2017), commercial banks' business reports

Fig. 16.7 (a) Apartment subscription rate. Note: Subscriptions by those having first priority. (b) Household and corporate lending by depository institutions

3.3 Stronger Incentives for Financial Institutions to Provide Mortgage Loans

The incentives for financial institutions to provide mortgage loans have strengthened, due largely to the low risk weights applied to household loans for BIS capital ratio purposes,¹¹ as well as to rising credit risks in the corporate sector in line with its ongoing restructuring.

These stronger incentives for financial institutions to provide mortgage loans, combined with expectations of higher housing prices, have worked as major factors contributing to the surge in household debt (Fig. 16.7b). As the supply of new homes expanded in line with the easing of real estate regulations, the related mortgage lending has also increased, leading to a sharp rise in household debt.¹²

¹¹The risk weights on household and home mortgage loans averaged 22.5% and 19.2%, respectively at the end of 2017, far below 55.5% for corporate loans.

¹²In line with the strength of the housing market since 2014, Korean household debt grew by 10.9% in 2015 (year-end basis) and by 11.6% in 2016, but the growth slowed to 8.1% in 2017 on the effects, for example of the government measures to stabilize the housing market (of August 2) and curb household debt growth (of October 24). Despite this slowdown, the pace of growth in debt still

4 Policy Responses

The Korean government has introduced comprehensive and tailored policy measures since the second half of 2017 in order to stabilize the housing market in the SMA and curb the sharp rise in household debt (FSC 2017a, b). The government's responses have been sweeping, and cover macroprudential, housing and tax policies related to household debt and the housing market. Further, in order to enhance policy effectiveness and minimize any negative side effects, the government has devised measures that vary in range and intensity depending on the target regions, the households concerned, and the types of housing demand.

4.1 *Comprehensive Measures*

Macroprudential Policies

In an attempt to manage total household debt and curb financing for speculative purposes, the government has been active in using macroprudential policies, including tightening of the regulations on all financial institutions and loans, while also developing comprehensive and systematic criteria for loan screening.

The government has tightened the LTV and DTI requirements greatly (from 70% to 40%) in August 2017, and has limited the number of home mortgage loans per household, for example from one loan per borrower to one loan per household in speculation-prone areas. To prevent any leakage from the home mortgage loan regulations, a debt service ratio (DSR) has been introduced to mandate comprehensive assessment of borrowers' debt servicing capacities for all financial institutions' loans, and will be effective from October 2018. In addition, to limit financial institutions' incentives for supplying excessive household loans several regulations have been introduced in January 2018, including an upward adjustment of the Basel risk weight from 35% to 70% for high-risk home mortgage loans with LTVs over 60%.

Housing Policies

The government has implemented policies to curb speculative demand for new apartments and for apartments scheduled for reconstruction, as that has been a main factor behind the rise in housing prices in the SMA. It has tightened the criteria for top-priority subscribers for new apartment purchasing rights, while limiting their resales by imposing a higher capital gains tax on them. The government has also tightened the requirements for apartment reconstruction, by for example revising the safety criteria for approving reconstruction projects.

outstrips that in income, and Korea's household debt-to-nominal GDP ratio (household credit statistics basis) has thus continued to increase, from 73.0% at end-2014 to 81.8% at end-2016 and 83.8% at end-2017.

Tax Policies

The taxation of housing investment has been strengthened, to curb demand for investment purposes and to heighten tax fairness. The government has raised the transfer income tax on owners of multiple homes, which became effective from April 2018, and imposed levies on excess earnings from reconstruction in January 2018. Discussions on revising the property holding tax on owners of multiple homes and expensive homes are also ongoing. This could be a more effective means of controlling housing demand for investment.

4.2 Tailored Responses

By Region

The target regions for the tighter regulations are sub-divided into speculative investment zones, overheated zones and adjustment-required zones, depending upon their respective degree of housing price rises and overheating. Each zone is subject to a different level of regulation.¹³ The Gangnam districts in Seoul were designated as speculative investment zones, and are subject to the strongest regulations. Other parts of the SMA and the provincial cities are subject to relatively relaxed regulations.

By Household

The level of regulations applied to households varies depending upon whether they own multiple homes, or have taken out home mortgage loans. Households that own multiple homes are subject to a 10–20pp transfer tax add-on. Households owning only single housing units benefit from tax exemptions only after they have lived in their homes for two or more years. When a household with an existing home mortgage loan seeks an additional loan for a housing purchase, the applicable LTV and DTI ratios will be tightened by 10pp each.¹⁴

By Housing Demand

Housing demand is categorized into demand for speculative and for residential purposes. The government strictly regulates speculative demand, while providing active support for residential demand. Speculative demand is strictly controlled through tighter screening of the financing methods involved and checking on the owner-occupancy status of the borrower. On the other hand, LTV and DTI ratios are relaxed for low-income households purchasing homes for residential purposes, in order to alleviate their financing difficulties.

¹³See appendix for a detailed explanation.

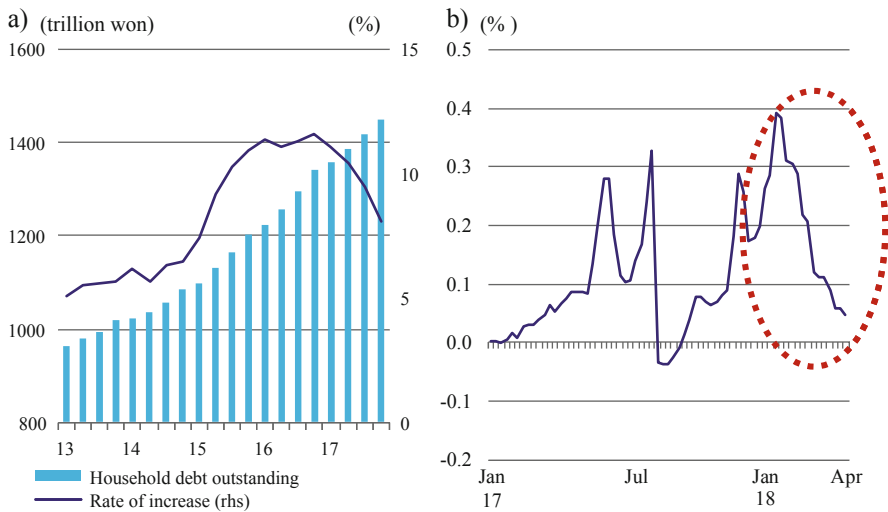
¹⁴When a home mortgage loan borrower purchases an apartment in one of the overheated regions, the borrower will be subject to tighter LTV and DTI ratios (30% instead of 40%).

5 Policy Evaluation

Thanks to the government’s comprehensive and tailored policy responses, the growth in household debt has slowed since the second half of 2017, and the housing market in the SMA has been gradually stabilizing in 2018. The rate of household debt growth was 8.1% (at year-end) in 2017, down significantly from the figures of around 10% in 2015 and 2016, in line with the tightening of the LTV and DTI limits and the other policy measures implemented in 2017 (Fig. 16.8a).

Despite the government’s announcement of its housing market stabilization plan in August 2017, and its partial implementation thereof, housing prices in the SMA continued to rise for some time. In 2018, however, they have shown slower growth as the effects of the government’s policies have begun to take hold (Fig. 16.8b).

For long-term housing market stability it should be noted, however, that demand-reduction policies alone cannot stabilize the housing market in the SMA. There is a structural imbalance between the limited supply of new housing in that area, and the continually growing demand for it.



Source: Bank of Korea (2017)

Source: Korea Appraisal Board (2018)

Fig. 16.8 (a) Volume and growth rate of household debt. Note: Quarter-end basis; year-on-year. (b) Growth rate of apartment prices in the SMA. Note: Week-on-week

Appendix

Table 16.1 Housing market regulations by region

Zones	Major regulations	Areas
Speculative investment	<ul style="list-style-type: none"> – Tighter LTV/DTI requirements (40/40%) – Limit on the number of mortgage loans – Transfer tax add-on (+10%p) 	11 districts in Seoul (including Gangnam districts), Sejong
Overheated	<ul style="list-style-type: none"> – Tighter LTV/DTI requirements (40/40%) – Tighter requirements for apartment reconstruction and top-priority subscribers for new apartment purchasing rights – Tighter screening of the financing methods 	All 25 districts in Seoul, Sejong, 1 city in Gyeonggi, 1 district in Daegu
Adjustment-required	<ul style="list-style-type: none"> – Tighter LTV/DTI requirements (60/50%) – Tighter requirements for apartment reconstruction and top-priority subscribers for new apartment purchasing rights – Transfer tax add-on (+10–20%p) 	All 25 districts in Seoul, Sejong, 7 cities in Gyeonggi, 7 districts in Busan

Note: As of May 2018; designation of speculative investment zones was repealed in April 2018 upon the introduction of transfer tax add-on in adjustment-required zones

Source: FSC 2017a, b

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