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Asia Market Watch

SOUTH KOREAN REAL ESTATE INVESTORS TURN TO CENTRAL EUROPE

South Korean institutional real estate investors have increased their focus on Europe, demonstrating a material shift away from their traditional U.S. equity and debt allocations. This trend is expected to gather momentum, with more than 75% of cross-border investment activity anticipated to be directed to Europe – a nearly complete reversal of the usual European/U.S. real estate investment split in past years.

South Korean institutions, much like Singaporean insurance companies and pension funds, have sought to diversify their portfolios as domestic real estate investments are not offering investors sufficient size, yields and geographic diversification. Singapore has overtaken China to become the biggest source of outbound real estate capital in the Asia-Pacific region and South Korean investors are becoming increasingly important players across Europe.

The notable increase in South Korean real estate investment in Europe comes amidst a marked slow-down in Chinese investments and only the earliest stages of interest from Japanese institutional investors. China, once Asia's biggest source of outbound real estate capital, has recorded a more than 80% drop in investment volume in the 12 months ending 31 March 2019.

Increasing real estate capital flows from South Korea are a welcome relief to many European markets which are broadly experiencing a more than 10% drop in investment volumes in 2019 compared to last year due to pricing, supply challenges, and political uncertainty.

South Korean Real Estate Investors Expand Eastward in Europe

The vast majority of South Korean overseas real estate investment in 2018 went into Europe — up from 59% in 2017.

In fact, 2018 set a record for South Korean investment in Europe's' commercial real estate markets, with volumes rising nearly six-fold over the past five years to €7.3 billion. London was the favorite target of South Korean investors last year, followed by other European gateway cities such as Frankfurt, Brussels, and Paris. Notably, 40% of South Korean real estate investments in Europe were in the U.K. last year.

However, South Korean real estate has been increasingly expanding into other European locations outside of the UK and France, including Amsterdam, Madrid, Lisbon, Brussels, Dublin, Copenhagen, Vienna, and Helsinki. South Korean investments in the U.K. have also slowed in the face of growing concerns over a "no-deal" Brexit, resulting in a surge of interest in secondary markets such as Central and Eastern Europe. South Korean investors are attracted to Central Europe by accommodative financing, attractive yields, and currency hedging premiums, as well as the region's proximity to Germany and relatively strong domestic economic growth.

Strong investment flows into Central and Eastern European real estate worth €4.8 billion in Q4 2018 lifted the total volumes in the region for the year to a record high of €13.8 billion. Poland remained the driver of the 5% rise in CEE real estate investment flows in 2018, as its volume increased 41% from 2017.

While virtually all South Korean real estate investments in CEE have been in Warsaw or Prague, South Korean investors are beginning to look at major secondary cities in Poland and other CEE jurisdictions. For example, Valesco and AIP Asset Management reportedly paid €120 million for an office building in the Slovakian capital city of Bratislava on behalf of a consortium of Korean investors.

Of all the Asian capital flows into the CEE region, Poland is by far the most favored target with over €1 bn in Asian cross-border investment in 2018, compared to a fraction of that amount in Hungary and the Czech Republic — the next most desired CEE countries for Asian investors. Real estate investors from South Korea as well as Singapore and Malaysia have been increasingly active in CEE markets while Chinese investment has fallen dramatically.

In addition to office and logistics projects favored by South Korean investors, a number of South Korean manufacturing companies have built factories in Central and Eastern Europe — most notably in battery technology for the automotive sector. Manufacturing companies active in CEE include: Hanon Systems, LG Chem, and SK Innovation.

Focus on Poland

Poland is the leading economic power in Central Europe.

With a population of 38.5 million and impressive GDP growth in excess of 5%, the Polish market offers real estate investors a diversified economic base and multiple major population centers including: Warsaw (1,702,139), Lodz (768,755), Krakow (755,000), Katowice (294,510) and Gdansk (227,306).

The Polish real estate investment market —which saw about €7.2 billion traded in 2019 (an all-time record) — continued to grow for the fourth consecutive year. The Polish investment market's 2018 year-end result represented nearly half of the total volume in the CEE region. The Polish real estate market in 2018 was unique for many reasons:

- There were almost 100 transactions concluded throughout the year including the biggest retail portfolio sale in the history of the Polish market.
- It has the largest number of portfolio transactions traded in a single year in the industrial sector (7).
- It had the highest investment volumes reported in the main real estate sectors: office (€2.75 billion), retail (€2.47 billion), and industrial (€1.84 billion). In addition, around €120 million was traded in the hotel sector.

Notably, the share of Asian capital in overall real estate transaction volumes in Poland reached 20% in 2018.

Conclusion

> *South Korean investment in Central and Eastern Europe is set to grow significantly in the coming year, with more than a dozen major projects reportedly in the 2019 pipeline.*

While investment will continue to be concentrated in the office sector in Warsaw and Prague, there is a growing interest in the logistics sector and exploration of secondary cities in Poland, as well as in other CEE jurisdictions outside of Poland and the Czech Republic, such as Slovakia, and potentially Hungary.

Before South Korean investors enter new CEE Real Estate markets, sellers will need to assist South Korean real estate investment managers in understanding alternative market fundamentals and answer questions about specific sovereign risks, market liquidity, leasing supply, and other more granular local market dynamics.

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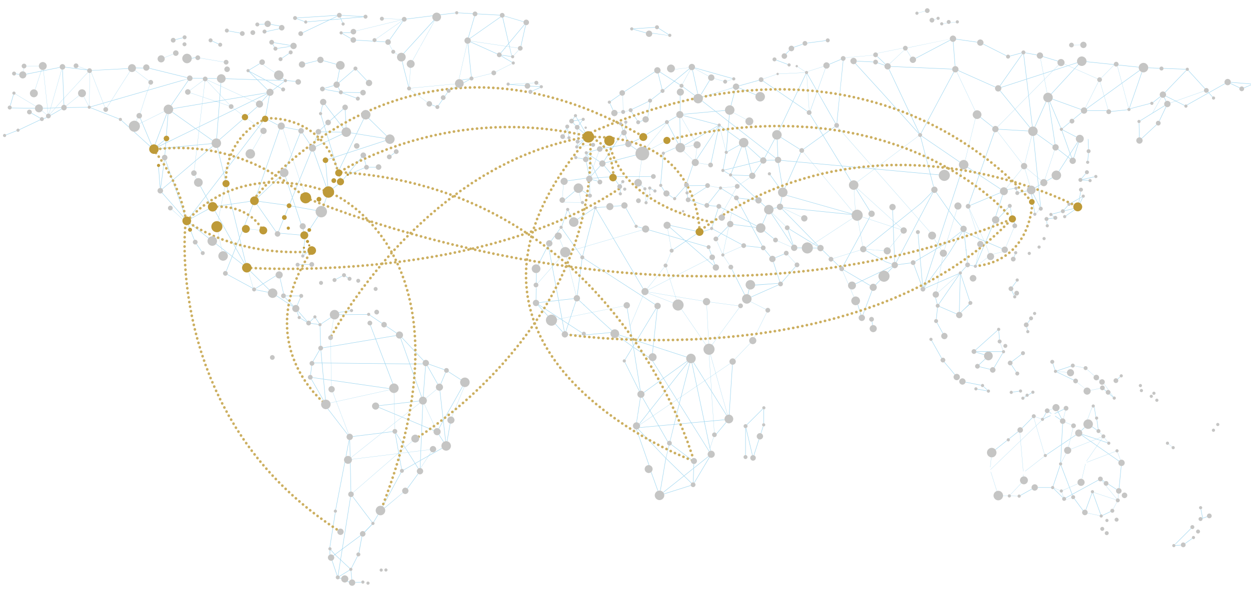
Greenberg Traurig: Real Estate Beyond Borders



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GT's Asia Real Estate Team

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GT's Global Real Estate Team

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