The Real Estate Law Review

Fifth Edition

Editor
John Nevin

Law Business Research

The Real Estate Law Review

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Fifth Edition

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CONTENTS

Editor's Preface vii
John Nevin

Chapter 1 AUSTRIA 1
Peter Oberlechner

Chapter 2 BELGIUM 14
Yves Delacroix and Alexandre Emond

Chapter 3 BOSNIA & HERZEGOVINA 28
Muamer Suljić and Ana Terzić

Chapter 4 BRAZIL 38
Marcelo José Lomba Valença and Tamiris Micheletti Britzki

Chapter 5 CAMBODIA 49
Sophealeak Ing

Chapter 6 CAYMAN ISLANDS 61
George Loutas

Chapter 7 CHINA 70
Alex Wang and Edward Hsu

Chapter 8 CROATIA 83
Ana-Marija Skoko

Chapter 9 CYPRUS 95
Nicolas Th Papaconstantinou

Chapter 10 DENMARK 108
Torben Mauritzen

Chapter 11 ENGLAND & WALES 120
John Nevin

Chapter 12 FRANCE 135
Pierre Gebarowski and Guillaume Rossignol

Chapter 13 GERMANY 150
Ingo Klöcker

Chapter 14 GREECE 161
Nikos A Vouhiounis and Christina C Zakopoulou

Chapter 15 INDONESIA 174
Luky I Walalangi, Miriam Andreta, Fiesta Victoria and T Anggra Syah Reza

Chapter 16 ITALY 185
Alessandro Balp

Chapter 17 JAPAN 197
Norio Maeda, Naoko Katakami, Yasuo Asami and Toshiyuki Yamamoto

Chapter 18 JERSEY 211
Christopher Philpott and Will Whitehead

Chapter 19 KOREA 223
Kyung Don Lee, Robert C Young and Thak-Hwan Kim

Chapter 20 MEXICO 242
Enrique Iglesias Elizondo, José G Pozas de la Vega and David Páez Gonzalez

Chapter 21 MONTENEGRO 252
Mihajlo Matković

Chapter 22 NETHERLANDS 262
Annemieke Wessels, Maarten Tinnemans and Max van Drunen

Chapter 23 NIGERIA 274
Gbolahan Elias, Lynda Chinweokwu and Pelumi Asiwaju

Chapter 24 NORWAY 282
Thorvald Nyquist

Chapter 25 POLAND 293
Janusz Siekański and Radosław Waszkiewicz

Chapter 26 PORTUGAL 304
Pedro Ferreirinha

Chapter 27 QATAR 316
Seem Maleh

Chapter 28 RUSSIA 329
Sergey Kolobov and Margarita Slavina

Chapter 29 SERBIA 340
Marija Marošan and Đorđe Popović

Chapter 30 SINGAPORE 349
Jennifer Chia, Priscilla Lim and Alicea Tan

Chapter 31 SLOVAKIA 367
Tomáš Zárecký and Laura Ogurčáková

Chapter 32 SLOVENIA 383
Uroš Bogša, Mojca Fakin and Saša Sodja

Chapter 33 SPAIN 393
Diego Armero and Rodrigo Peruyero

Chapter 34 SWITZERLAND 404
Cécile Berger Meyer and Andreas Rötheli

Chapter 35 TAIWAN 416
Yi-Jiun Su and Yi-Li Kuo

Chapter 36 TURKEY 428
Barlas Balcıoğlu and Ali Can Gören

Chapter 37 UNITED ARAB EMIRATES 439
Ibrahim Elsadig and Joe Carroll

Chapter 38 UNITED STATES 451
Meredith J Kane

Appendix 1 ABOUT THE AUTHORS 467

Appendix 2 CONTRIBUTING LAW FIRMS' CONTACT DETAILS .. 487

EDITOR'S PREFACE

I am honoured to have been invited to take over from David Waterfield as editor of *The Real Estate Law Review* and I would like to take this opportunity to personally thank David for his invaluable help and support over the years and, on behalf of *The Real Estate Law Review*, for his vital role in its success since the first edition back in 2012.

Building on the success of the previous editions of the *Review*, the fifth edition now extends to some 38 jurisdictions, and we are delighted to welcome new contributors from important jurisdictions around the world. Each contributor is a distinguished legal practitioner in his or her jurisdiction with an in-depth understanding of both his or her own domestic market and the wider global real estate market. Each chapter offers an essential guide to real estate practice in the relevant jurisdiction together with an invaluable focus on market activity, important legal and practical developments over the preceding 12 months and the outlook for 2016. Together, the chapters offer real estate practitioners and their clients an immediate and accessible overview of international real estate.

Real estate is a truly global industry and it is no longer possible to look at domestic markets in isolation. It has become essential to develop an understanding of the needs and expectations of overseas investors, and of how domestic markets are affected by legal, economic, political and social events and trends throughout the world. International economic and political instability continue to have a significant effect on the international real estate market and this is reflected in investors' pursuit of value and security. The United Kingdom (and London in particular) continues to be seen as a safe haven for capital from around the world, and the outlook here remains buoyant in both the commercial and residential sectors.

I wish to express my gratitude to all the distinguished practitioners from across the globe who have contributed to this fifth edition, and thereby to the continued

success of *The Real Estate Law Review*. I would also like to take this opportunity to thank Gideon Roberton and his team for their sterling efforts in coordinating the contributions and compiling this edition.

John Nevin
Slaughter and May
London
February 2016

Chapter 19

KOREA

Kyung Don Lee, Robert C Young and Thak-Hwan Kim[1]

I INTRODUCTION TO THE LEGAL FRAMEWORK

i Ownership of real estate

The Korean legal system is based on civil (codified) law similar to that of Germany, France and Japan, with some influence from the American legal system in certain areas such as the Korean bankruptcy and rehabilitation laws. Ownership under Korean law is based on complete ownership (similar to fee simple absolute under common law), which entitles the owner to do whatever he or she wishes with the property, including the right to exclusive possession, use, encumber and transfer. Korean law does not recognise any other possessory real property interests such as a defeasible fee simple estate, fee tail, life estate or future interest in land. Real estate can also be owned by one or more parties in Korea. Generally, co-ownerships are held under the form of a *gong-yu*, *hap-yu* or *chong-yu*,[2] and in cases of any purchase of property that are held under co-ownership, the purchaser should be careful that the seller (or sellers) has, or has otherwise secured, the authority to dispose of the property or his or her interest therein.

---

1 Kyung Don Lee and Thak-Hwan Kim are partners and Robert C Young is a senior foreign attorney at Shin & Kim.

2 The most common form of co-ownership in Korea is the *gong-yu*, which is similar to the common law concept of tenancy in common where two or more persons are owners of undivided (in some cases, divided) interests in the property (such interests are indicated as ratios to the whole property), with each co-owner holding an estate in the property by separate and distinct titles but with unity in the possession, use and right to the whole property in proportion to their respective interest in the property. *Hap-yu* is ownership of property through a partnership that is not recognised as a legal entity, but is rarely used. *Chong-yu* is ownership by members of a group (which is not a recognised legal entity), such as a religious organisation.

Under Korean law, real property consists of land and buildings, which are considered separate real property. The relevant units used to measure ownership of land and buildings are *pil-gee* and *dong* (which is equivalent to one building structures), respectively. In principle, potential buyers are not allowed to acquire interests that are smaller than one *pil-gee* or one *dong* unless a building is deemed an aggregate building[3] and the *dong* has been divided into several sections that are subject to independent use or ownership.

ii System of registration

Korea has a dual registration system for real property consisting of a land registry and a building registry. Ownership interests must be registered under the applicable registries, because land and buildings thereon are considered separate real property.

If a person wishes to acquire an ownership interest or establish a security interest, that person must register the relevant documents with the appropriate registry office to perfect the transfer of title (except where it arises by operation of law) or to establish a security interest. The priority order of the security rights established on the real property will depend on the order of the registration date.

The registration system is governed by the courts and managed by the registration division of the court administration department at the Supreme Court. The registry may be viewed on, and printed from, the Supreme Court website. An entry is made in the register after administrative procedures are completed. To avoid fraud or abuse, the entry procedure is guarded by certain protective measures, such as only holders of the relevant property identification number and password being allowed to enter any change in information. However, unlike in other jurisdictions that have adopted a more strict system, there is no strict formality, such as executing a sales or transfer deed before a notary public, to transfer title or make any other type of entry into the register. As such, while registration in the real property registry creates a strong presumptive evidence of valid ownership, it is not conclusive.[4]

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3 An aggregate building is a building that is structurally divided so that the divided sections (strata titles) can be independently used or owned (Article 1 of the Act on the Ownership and Management of Aggregate Buildings). The aggregate building and its divided sections must be separately registered before any transactions involving its use or ownership can be legally effected.

4 Under Korean law, registration in the real property registry is strong presumptive evidence of ownership. However, there are some inherent limitations to verifying ownership under the Korean recording system, and should there be any material defect in the chain of title for a certain parcel of real property, the right of the current title holder may be challenged. To avoid purchasing a property with a defect in the chain of title, the entire chain of title needs to be checked. Even if there is a defect in the chain of title of the property, anyone who has been registered as an owner of the property for at least 10 years, and who has openly and uninterruptedly occupied that property for at least 10 years in a way that a real owner would occupy its property, will be deemed to have had valid title to the property under the Korean Civil Code.

iii Choice of law

The main bodies of law that govern real estate transactions are the Civil Code, the Commercial Code, the Act on the Ownership and Management of Aggregate Buildings, and the Real Estate Registration Act. Depending on the nature and circumstances of the transaction, laws that govern permits, zoning and approvals, such as the Building Act and the National Land Planning Act, or laws that govern qualifications of the buyer, such as the Foreigner's Land Acquisition Act, the Foreign Investment Promotion Act and the Foreign Exchange Act, may also apply.

In special cases, the real estate transaction may be subject to the Industrial Complex Act, the Act on Free Economic Zones, the Protection of Military Bases and Installations Act, and the Farmland Act.

II OVERVIEW OF REAL ESTATE ACTIVITY

i Real estate funds (REFs)

In 2004, REFs were introduced in Korea as an investment vehicle after certain amendments were made to the Indirect Investment Asset Management Business Act. Many investors embraced the concept of REFs and began widely using them as investment vehicles for real estate transactions. Private REFs were especially popular, since only two or more persons were required for the formation of the REF.

The table below shows that the total number of REFs has been steadily increasing for the past five years, largely because of the increase in private REFs.

	December 2010	*December 2011*	*December 2012*	*December 2013*	*December 2014*	*December 2015*
Public offer (100 million won)	8,915	8,512	10,484	10,935	11,723	11,296
Private offer (100 million won)	132,398	155,783	188,529	231,551	270,969	325,756
Total (100 million won)	141,313	164,294	199,012	242,486	282,692	337,051
Number of REFs (Private REFs)	317 (308)	342 (334)	408 (394)	492 (476)	583 (562)	699 (679)

Source: Korea Financial Investment Association.

However, the amended Financial Investment Services and Capital Markets Act, effective as of 25 October 2015 (the Amended FSCMA, with the previous version to the amendment referred to as the Former FSCMA), no longer differentiates private collective investment vehicles (CIVs, or individually CIV) based on investment targets[5] but classifies

5 Under the Former FSCMA, CIVs were classified into four types based on the types of primary investment target (such as securities, real estate and special assets) and a CIV was required to invest at least 50 per cent of its assets in the primary investment target.

CIVs into two types: (1) management participation-type private CIVs, which invest in equity or securities or participate in management for the purpose of improving business structure or corporate governance (management participation-type private CIVs); and (2) qualified investment-type private CIVs (i.e., all other CIVs that are not management participation-type private CIVs), which may invest in any investment assets including real estate and securities (qualified investment-type private CIVs) (for further details, see Section VII.i, *infra*). As a result, following the effectiveness of the Amended FSCMA, REFs have been established in the form of qualified investment-type private CIVs.

ii Real estate investment trusts (REITs)

REITs[6] have become one of the more widely used real estate investment vehicles, as shown in the table below. Recently, REITs have become particularly popular in projects involving the development of officetels (multipurpose buildings with residential and commercial units), developments, hotels, supermarkets, department stores, and retail and discount stores. In the first half of 2013, nine REITs were established in Korea for the purpose of investing in department stores, office buildings, hotels, educational institutions and residential units.

In the first half of 2014, 39 REITs invested in office buildings and 15 REITs invested in supermarkets, department stores, and retail and discount stores. In addition, a number of REITs invested in residences (15), factories (four), hotels (10) and other types of properties (three). In the second half of 2014, for the first time in Korea, REITs were established for the purpose of investing in the leasehold rights (not the ownership rights) of residences.

As of September 2015, the total number of REITs has increased by 24 (13 of which invested in houses, seven in logistics facilities, two in office buildings and the remaining two in commercial facilities). These REITs were backed by government investments as part of the government's initiative to promote REITs and investments in the real estate market.

	September 2010	*February 2011*	*May 2012*	*December 2013*	*July 2014*	*September 2015*
Total capital (100 million won)	35,912	39,832	41,799	–*	–*	–*
Total assets (100 million won)	72,565	74,106	82,339	123,000	123,000	164,000
Number of REITs	42	65	75	80	84	118

Source: Ministry of Land, Infrastructure and Transport (MOLIT); *MOLIT did not disclose the total capital and total assets amount in its report.

6 Although the name 'trust' is used, the REIT is actually not a trust but a stock corporation.

iii Project financing vehicles (PFVs)

PFVs are one of the most common forms of investment vehicle used for real estate development projects. However, it is difficult to ascertain accurate data and information relating to PFVs, as PFVs are not governed by a central agency, such as the National Tax Office, but are governed separately by the relevant local tax office.

iv Foreign real estate transactions

After the steady increase seen in foreign investments in Korean real estate following the 1997 Asian financial crisis, because of, *inter alia*, changes in laws that permitted foreigners to directly own property in Korea and the increase in the amount of real estate for sale, the 2008 global financial crisis brought a decline in this investment. While the level of impact of the global financial crisis has been limited in Korea, it had an impact on the traditional foreign real estate players, including many of the American and European financial institutions and real estate funds. However, we have seen foreign investors returning to the Korean real estate market and in particular with respect to office buildings, hotels, retail malls, logistics and other value-adding investments. One of the more noticeable foreign investment trends in Korea has been Chinese investments in Jeju Island. As shown in the table below, within the past five years, Chinese ownership of real estate property in Jeju Island has jumped 300 per cent and continues to increase each year.

	2010	*2011*	*2012*	*2013*	*2014*	*2015**
Land (m2)	11.130 million	9.904 million	10.605 million	12.839 million	14.954 million	15.869 million
Buildings (m2)	679,000	697,000	805,000	730,000	–	–

Source: MOLIT; * until October 2015.

III FOREIGN INVESTMENT

Under the Foreigner's Land Acquisition Act (FLAA), a foreigner wanting to acquire land in Korea must file a report or obtain an approval (in some exceptional cases such as acquisition of land located in military facilities protection areas, cultural relics protection areas, etc.). A foreigner is defined under the FLAA as:

a a person of foreign nationality (foreign national);

b a corporation or organisation established in accordance with the laws of the foreign country (foreign corporation);

c a corporation or organisation established in Korea where 50 per cent or more of its shareholders and members are foreign nationals; and

d a corporation or organisation established in Korea where 50 per cent or more of its capital or voting rights are held by a foreign national or a foreign corporation.

i Acquisition of land by a foreigner

Prior to 26 June 2009, a foreigner was required to report the acquisition of land in accordance with the procedures set forth in the FLAA. However, following amendments to the FLAA, any foreigner who acquires land on or after 26 June 2009 may be exempt

from filing a land acquisition report as long as he or she elects to file the simpler real estate transaction report with the relevant mayor's office, regional office or local district office in accordance with the Act on Certified Broker's Business and Real Estate Transaction Report. In the event that a non-resident foreigner wishes to acquire land, in addition to filing a land acquisition report or a real estate transaction report, the non-resident foreigner must file a real estate acquisition report under the Foreign Exchange Transaction Act for the inflow of foreign currency.

ii Acquisition of land by a foreign-invested Korean corporation

The Foreign Investment Promotion Act governs the registration by a Korean corporation as a foreign-invested corporation where it meets a certain percentage of investment level by foreigners, and offers certain taxation and procedural benefits. These Korean corporations, as corporations duly established under the laws of Korea, would ordinarily acquire land in the same manner as any other Korean national or corporation. However, as the FLAA defines certain corporations as foreigners, and in such cases applies the same rules applicable to foreigners, a foreign-invested Korean corporation regarded as a foreigner under the FLAA must also complete the land acquisition notice or the real estate transaction notice.

iii Certain benefits available to foreign-invested companies

Certain tax and non-tax benefits are available to foreign-invested companies. For example, a foreign-invested company may be eligible for incentives or exemptions from acquisition tax, registration tax and property tax (reduced to as low as zero and for up to 15 years) for the acquisition of land in a designated foreign investment zone, or if the foreign-invested company provides certain qualified high-level technology that supports the competitiveness of Korea.

Moreover, as the government continues to foster foreign direct investment, some municipalities have provided opportunities to foreign-invested companies to purchase land at a lower than market price (but not lower than appraisal value) and without going through a bidding process. Despite certain formalities and restrictions that apply to such transactions, the attractive price and ability to acquire the property without undergoing a bidding process means that many municipalities are currently involved in development projects in which land has been supplied to foreign-invested companies. The Audit Board of Korea, however, has recently warned against abuses of the system, with foreign financing being disguised as an equity investment (for instance, an equity investment with a guaranteed yield and put option) so that a domestic company can acquire property from a municipality at lower than market price and without going through a bidding process. Legislation to further restrict such abuse is also being considered.

IV STRUCTURING THE INVESTMENT

Since 2000, the government has introduced new indirect investment vehicles in an attempt to stimulate and attract investor activity in the Korean real estate market. The most widely used investment vehicles in practice are as follows.

i REITs

A REIT is essentially a joint-stock company that has been established by investors for the purpose of earning (e.g., rent, gain on sale or development) and distributing profits. The establishment and operation of REITs are regulated by the Real Estate Investment Company Act.

REITs are subject to the following measures under the Real Estate Investment Company Act (some investors consider such measures to be too restrictive and prefer the use of the more flexible REF):

a the REIT shall offer at least 30 per cent of its shares to the general public within six months of obtaining business approval;

b the REIT shall not have any single shareholder that owns more than 30 per cent (in the case of self-managed REITs (SM-REITs)) or 40 per cent (in the case of consigned-management REITs) of the shares in the REIT;

c the REIT shall become a listed company if it meets the qualifications of a listed company under the Financial Investment Services and Capital Markets Act;

d the REIT shall distribute not less than 90 per cent of its maximum dividend limit of the relevant year to its shareholders (the REIT shall receive a corporate tax deduction if it distributes 90 per cent or more in dividends); and

e the REIT shall not dispose of its newly acquired real estate within one year (three years for housing) unless the real estate was created or built pursuant to a real estate development project.

The Real Estate Investment Company Act recognises three different types of REIT: SM-REITs, consigned-management REITs and corporate-restructuring REITs (CR-REITs). Since their introduction, CR-REITs have been popular among investors (in 2015, 33 out of 118 REITs were CR-REITs). This is because, unlike the other REITs, CR-REITs are:

a exempt from the public offering requirement;

b not subject to a cap on the maximum ownership by a single shareholder;

c not subject to the restriction on disposing of acquired real estate within one year; and

d entitled to a corporate tax deduction if they distribute 90 per cent or more in dividends to shareholders.

CR-REITs, however, are not suitable for most real estate transactions, because at least 70 per cent of the total assets of the CR-REIT must be invested into real estate for corporate restructuring purposes and the seller must meet certain requirements.

SM-REITs are unique in that shareholders are allowed to participate directly in investment and management decisions of the REIT through shareholder or board meetings. However, SM-REITs are rarely used by investors because they are deemed 'corporations', and are not only required to operate like corporations (i.e., hire full-time staff and employees), but also are not entitled to receive the corporate tax exemptions available to the other REITs (as of September 2015, out of a total of 118 REITs, there were only nine SM-REITs).

The amended Real Estate Investment Company Act, effective as of 23 October 2015, provides for more relaxed regulation with respect to REITs, key details of which are set forth below:

a if a REIT supplies 70 per cent or more of the total floor area of a building to be held or developed by the REIT as rental housing units, then the REIT shall be exempted from the obligation of public offering and dispersion of stocks;

b development REITs are abolished and, instead, a REIT's investment in development projects shall be determined by a special resolution of the general meeting of shareholders, and as such the REIT shall be solely responsible for its decision on investment in a development project; and

c REITs may borrow funds more conveniently as they are no longer required to set a record date for their borrowing of funds and issuance of bonds.

ii REFs and qualified investment-type private CIVs

Under the Former FSCMA, REFs were collective investment vehicles that invest more than 50 per cent of their equity interests in real estate. However, pursuant to the Amended FSCMA, REFs need to be established as qualified investment-type private CIVs. Unlike REFs under the Former FSCMA, qualified investment-type private CIVs are no longer required to invest 50 per cent or more of their collective investment assets in real estate. However, a non-professional investor who intends to invest in a qualified investment-type private CIV is required to make an investment of 100 million won or more (for further details, see Section VII.i, *infra*).

A qualified investment-type private CIV is not subject to the various requirements that apply to REITs – such as public offering, listing, dividend distribution, capital contribution limits and maximum ownership caps on single investors – and it may, at its discretion, invest all of its assets in a real estate development project. In addition, qualified investment-type private CIVs may be structured in the form of a trust or a corporation or association (the trust type has been more popular in the past, but the use of the corporate type has been increasing). One of the drawbacks of the qualified investment-type private CIV is the limited investor participation in investment decisions, as the investors are meant to be passive; however, REITs such as consignment-REITs and CR-REITs are also subject to similar limitations.

iii PFVs

A PFV is a joint-stock company established for the purpose of engaging in the business of 'facility investment, social indirect capital facility investment, development of resources or any other specially designated business that requires a considerable investment of time and capital and distribution of earnings to its shareholders'. The PFV is basically a paper company, and shall not have any employees or persons serving as officers or full-time directors. Although the PFV is governed by the Commercial Code as a special purpose company, it is privy to certain tax benefits under the Corporate Income Tax Law of Korea, such as exemption from acquisition tax and corporate income tax (i.e., if it distributes 90 per cent or more in dividends).

PFVs have been widely embraced by investors, and are commonly used in real estate transactions over REITs. The key advantages of PFVs are as follows:

a easy establishment process (REITs require approval from MOLIT, while PFVs only require a report to the relevant tax office);
b no mandatory categorisation of business (unlike REITs, PFVs do not need to indicate in their corporate name their business as a real estate investment vehicle);
c no reporting requirements (REITs are required to submit a quarterly business report to MOLIT, while PFVs are not subject to reporting requirements to any authorities);
d no public offering or listing requirements;
e no in-kind contribution caps; and
f no dividend requirements (even though they may enjoy certain tax benefits if they are distributing 90 per cent or more dividends).

In addition to the many advantages, PFVs are particularly attractive among investors as they are also allowed to participate in the decision-making process of investments.

The drawbacks of PFVs are that they are real estate investment vehicles, mostly reserved for large development projects; they are paper companies, established to meet temporary milestones; and the qualifications for being recognised as a PFV are still unclear.

iv Asset-backed securitisation

An asset-backed securitisation company (ABS company) is a limited liability company that acquires real property and, based on this underlying asset, issues ABS securities (i.e., senior bonds, junior bonds, equity) to the bondholders and equity owners. ABS companies are regulated under the Asset-backed Securitisation Act.

To be recognised as an ABS company, a party must establish a limited liability company or register itself as a trust with the Financial Services Commission and submit information to the Financial Service Commission, including the name of the company or trust, the assets under ownership, the expected duration of ownership, and a business plan outlining the management, operation and disposition of the assets. While the amount of information required and the strict approval process may seem cumbersome to certain investors, ABS companies are among the more popular investment vehicles, as they provide numerous tax benefits. For the past few years, ABS companies have not been used as a vehicle for acquisitions of real estate because the Financial Supervisory Service is very reluctant to grant approval.

V REAL ESTATE OWNERSHIP

i Planning and zoning

The main body of law that governs the use and development of real estate is the National Land Planning and Utilisation Act. According to this Law, the relevant offices of each metropolitan city (e.g., Seoul, Busan), city (e.g., Suwon, Pyung-taek) and county (e.g., Go-seong) shall devise a general use and management plan for their respective domains. Included in the general use and management plans are designated zoning areas (e.g., residential, industrial, farming), designated zoning districts (e.g., scenic districts, fire prevention districts, preservation districts) and designated zoning sections

(e.g., green belt sections, city park sections). In some cases, a parcel of land may be subject to multiple designations (e.g., land designated for farming may also be deemed a preservation district). While the general use and management plan also regulates the type of buildings and structures that may be constructed and used on the land (e.g., purpose, lot coverage, height), it is the Building Act that regulates and approves the actual construction, re-modelling and expansion of the building on the land.

The Act on the Maintenance and Improvement of Urban Areas and Dwelling Conditions for Residents primarily focuses on providing systemic and regular services to improve and develop the quality of life of residents in outdated and run-down urban areas. According to this Act, the city shall evaluate areas that require maintenance and improvement, and reflect those areas in the general maintenance and improvement plan for urban and residential areas, which is produced every 10 years. Areas that are designated for maintenance and improvement will receive necessary services once qualified contractors are approved by the city.

For urban projects that are much larger in scale (i.e., the re-zoning of an entire city), the planning and execution thereof are governed by the Urban Development Act. Once a city is qualified to undergo urban development, an area will be designated as a 'development area', and the central government, municipal government and landowners will form a consortium and become the general contractors of the project.

Real estate transactions that involve the development and use of storage and logistical facilities are regulated under the Act on the Development and Management of Logistics Facilities. This Act was enacted by the government to implement highly efficient and competitive logistical infrastructure within Korea. For this purpose, the Minister of Land, Transport and Maritime Affairs must publish an overall plan detailing its agenda every five years, and persons who wish to operate multipurpose logistical terminals (i.e., a terminal capable of supporting more than two transportation modes) must register with the Minister and submit a construction plan that includes the details of the structure and facilities to be built. The Minister has the authority to designate logistics facilities, and any developer that wishes to engage in the development and management of logistics facilities must be appointed by the Minister as the general contractor, and may commence construction after submission and receipt of approval of a development plan of logistics facilities.

ii Environment

The Framework Act on Environmental Policy provides that the central government has the duty to work in concert with municipal governments and public agencies to preserve and protect the environment from pollution by using preventive, restorative and punitive means. Individuals or businesses that are guilty of polluting the environment are subject to responsibility and shall, at their own cost, fully clean up and restore the environment to its original condition, subject to approval by the central government.

Soil contamination has long been a serious environmental issue in Korea. According to the Soil Environment Conservation Act, a party responsible for causing soil contamination must clean up and restore the contaminated areas. If multiple parties are involved, and it is unclear which party caused the contamination, the parties are jointly responsible for restoring the damages incurred. It should be noted that owners and their

successors, and the operators of facilities that cause soil contamination, are responsible for any damages that may arise; however, the successor shall not be liable if the results of an environmental due diligence conducted prior to the transfer of ownership did not reveal that the facility was at risk of causing contamination.

Owners of facilities that are categorised as public use facilities must maintain a minimum air quality standard for their patrons. The air quality must be measured by the owner or a person qualified under the Code of the Ministry of Environment, and recorded for inspection purposes.

iii Tax

A person who acquires real estate is typically subject to an acquisition tax at a rate of 4.6 per cent. However, if the real estate is located in an area designated as an 'overpopulation control area' under the Seoul Metropolitan Area Readjustment Planning Act and is acquired by the purchaser's main office or branch office, within five years of that office's establishment in the overpopulation control area, the purchaser will be subject to acquisition tax at a rate of 9.4 per cent. Certain investment vehicles, such as the above-mentioned REF, CR-REIT, ABS and PFV, are not subject to the heavy amount of acquisition tax applied to an overpopulation control area, and are subject only to the 4.6 per cent rate of acquisition tax. See Section VII.i, *infra*, for further details about qualified investment-type private CIVs.

iv Finance and security

The most common forms of security interest used by debtors and creditors in a real estate transaction are a mortgage and mortgage trust. A brief summary of both is provided below.

Mortgage

The debtor maintains ownership of the real property while the creditor is granted a security interest on the debtor's real property for providing a loan. The mortgage interest must be registered in the relevant title registry. If the debtor fails to pay back the loan, the creditor may enforce its security rights by requesting the court to auction the real property and, upon foreclosure, the creditor shall receive its relevant share of the auction proceeds subject to the creditor's priority rights.

Mortgage trust

The debtor's real property is transferred into a trust, whereby the trustee holds ownership of that property and the creditor is granted a priority interest on the trust proceeds. If the debtor fails to make the required loan payments, a public offering of the real estate shall be made available by the trustee, and the sale proceeds will be distributed to the creditors subject to their priority interests.

With respect to real estate development projects, various security measures, such as a pledge on shares issued by the general contractor, an agreement to transfer or relinquish the general contractor's development rights, the general contractor's joint liability, a pledge on insurance payments, and an agreement to transfer or assign general contractor's rights under the development contract, are also available to lenders.

VI LEASES OF BUSINESS PREMISES

The lease of business premises is permitted in Korea, and the leasehold rights of the landlord and tenant are governed by the Commercial Building Lease Protection Act. A common leasehold right that is often used in Korea is a unique leasehold right called a *jeonse*. In the case of a *jeonse*, the landlord receives a large key money deposit from the tenant (in lieu of no or small monthly lease payments) and, in return, the landlord allows the tenant to use the property for the period stated in the applicable lease contract. Upon the expiration or early termination of the lease term, the landlord must return the key money deposit to the tenant.

To secure the leasehold right and return of the key money deposit, a *jeonse-kwon* must be registered with the court having jurisdiction over the real property in question. In such a case, if the landlord does not return the key-money deposit to the tenant upon the expiration or termination of the lease term, the tenant may take action to foreclose on the property, regardless of whether the tenant holds a first priority security interest over the property, without securing a court judgment on the merits of the case. Upon completion of foreclosure proceedings, if auction proceeds resulting from such foreclosure proceedings were insufficient to pay the entire amount of the key money deposit to the tenant, the tenant will continue to have an unsecured claim against the landlord for the remaining balance of the key money deposit. Further, notwithstanding the foreclosure proceedings, the tenant must continue to pay monthly rent (if any) and management fees to the landlord until the tenant surrenders the premises and restores the premises to its original state.

According to the Civil Code, a lease is an agreement between a landlord and tenant. While the lessee may use the leased premises upon making certain lease payments (in some cases, security deposits equal to 10 times the amount of monthly rent are provided) to the lessor, if the lease is not recorded in the applicable registry, the lessee shall not have grounds to challenge the validity of such a lease against a subsequent landlord (i.e., the subsequent landlord does not automatically assume the existing lease). Moreover, in the event the leased premises become subject to foreclosure, if the lease is not registered, the security deposit shall not be returned automatically to the lessee, as the lessee is deemed a general unsecured creditor, and the auction proceeds will be distributed to the creditors subject to their priority rights.

Unlike the Civil Code, if the leased premises comprise a commercial building and it is deemed that a lease exists according to the Commercial Building Lease Protection Act, lessees are entitled to special protections, as subsequent landlords must assume existing leases and lessees are granted first priority rights for the return of their security deposits to a certain limited extent permitted by the Commercial Building Lease Protection Act.

VII DEVELOPMENTS IN PRACTICE

i Financial Investment Services and Capital Markets Act

The Amended FSCMA is causing significant changes to the regulatory framework for private CIVs and substantial deregulation relating to the entry, establishment,

management and sales of private CIVs. In particular, REFs under the Former FSCMA will be established in the form of qualified investment-type private CIVs under the Amended FSCMA, with various changes expected to take place in relation to the establishment and management of private CIVs.

Regulatory framework for private CIVs

Pre-amendment	*Post-amendment*
General private CIVs Qualified private CIVs (hedge funds) PEFs Corporate financial stability PEFs	Qualified investment-type private CIVs Management participation-type private CIVs

Changes to the regulatory framework for private CIVs

One of the major amendments to the regulatory framework for private CIVs is the combining of four categories of private CIVs – general private CIVs, qualified private CIVs (hedge funds), private equity funds (PEFs) and corporate financial stability PEFs – into two categories: qualified investment-type private CIVs and management participation-type private CIVs. Accordingly, the general private CIVs (including REFs) and the qualified private CIVs under the Former FSCMA are integrated into and regulated as qualified investment-type private CIVs under the Amended FSCMA. Moreover, where under the Former FSCMA funds needed to be established separately for each type of investment target, such as real estate or special assets, it is now possible under the Amended FSCMA, with the elimination of this limitation, to incorporate various types of investment target into a single qualified investment-type private CIV.

Limitations on investment in private CIVs by non-professional investors

As the regulations with respect to the establishment and management of qualified investment-type private CIVs have been relaxed under the Amended FSCMA, and given that the CIVs are more likely to be exposed to higher risks under the relaxed regulations, only qualified investors are permitted to make direct investments in such CIVs. By qualified investor is meant a professional investor or a non-professional investor with an investment amount exceeding a certain threshold (either 100 million won or 300 million won depending on the ratio of loans, etc.[7] of the relevant CIV) (Article 249-2 of the Amended FSCMA and Article 271 of the Enforcement Decree thereof). Therefore, individual investors and non-listed corporations whose investment amounts fall below the relevant threshold are no longer permitted to make direct investments in CIVs.

7 100 million won if the sum of (1) the appraised value at risk relating to derivative instruments, (2) the amount of debt guarantee or value of collateral provided and (3) the total amount of loan does not exceed 200 per cent of the total net assets of the CIV, or 300 million won if otherwise.

Deregulation of entry, establishment and sale of private CIVs

A collective investment manager was formerly required to obtain authorisation from the Financial Services Commission (FSC) to conduct collective investment business; however, the Amended FSCMA, has newly introduced the concept of qualified private collective investment business and one only has to register to manage such investment (Article 249-3(1) of the Amended FSCMA).

Under the Former FSCMA, the set-up or establishment of a general private CIV (including REFs) required registration with the FSC. Under the Amended FSCMA, however, qualified investment-type private CIVs only need to be reported to the FSC within two weeks of being set-up or established, substantially easing regulations related to the establishment of CIVs (Article 249-6(2) of the Amended FSCMA).

Under the Former FSCMA, the selling of collective investment securities was only possible through investment traders or investment brokers. Under the Amended FSCMA, however, qualified private collective investment managers are permitted to make direct sales with respect to the qualified investment-type private CIV that they manage (Article 249-8(8) of the Amended FSCMA). Also, when selling qualified investment-type private collective investment securities, the principle of adequacy shall not be applied, which means that it shall not be required to obtain information about the investment purpose, status of property, experience in investment, etc. of the non-professional investors unless the non-professional investors request otherwise (Article 249-4(2) of the Amended FSCMA).

Deregulation of asset management

Investment targets and ratio of investment

Under the Former FSCMA, REFs were required to invest 50 per cent or more of their assets in real estate (including real estate securities and other real estate-related properties). However, under the Amended FSCMA, qualified investment-type private CIVs are permitted to make investments freely without being restricted to investing only in certain types of properties and in certain ratios (Article 249-8 of the Amended FSCMA excludes Article 299 from application). This takes deregulation a step further than is the case for REITs, where 70 per cent or more of total assets should be real estate.

Borrowing or debt guarantee and provision of collateral

The REFs were prohibited from borrowing money on their own account in principle under the Former FSCMA, provided that exceptions applied when borrowing was needed for (1) making payments for redemption or (2) acquiring real estate properties with the funds' assets. Also, under the Former FSCMA, debt guarantee and provision of collateral for anyone other than the relevant CIV were prohibited.

Under the Amended FSCMA, qualified investment-type private CIVs are permitted to (1) invest in derivative securities, (2) guarantee debt or provide collateral and (3) borrow money up to 400 per cent of net assets in principle. However, no exceptional cases were provided to allow borrowing in excess of statutory borrowing limits based on a resolution by the general meeting of collective investors (Article 249-7(1) of the Amended FSCMA and Article 271-10(1) of the Enforcement Decree thereof).

Property retention period

Under the Former FSCMA, REFs shall not, in principle, (1) acquire a domestic real estate property only to dispose of it within one year from the acquisition (in the event of acquiring an unsold house, within the period specified under the collective investment agreement), or (2) dispose of land without any building or other structure erected thereupon before implementing a real estate development project in respect of such land. The restriction relating to the property retention period also applies to qualified investment-type private CIVs under the Amended FSCMA, albeit under a different provision.

Loans

Under the Former FSCMA, collective investment managers of REFs were prohibited from providing any loans while managing collective investment assets unless such a loan was provided (1) to a certain financial institution for a short term not exceeding 30 days or (2) to a corporation related to real estate development (Articles 83(4) and 94(2) of the Former FSCMA).

The qualified investment-type private CIVs under the Amended FSCMA are expressly exempted from the application of this restriction and are not otherwise prohibited from lending by any other provisions. On the other hand, the Amended FSCMA does not provide any separate provision that affirmatively permits qualified investment-type private CIVs to lend either. Therefore, there may be two conflicting views with respect to the possibility of lending by qualified investment-type private CIVs under the framework of the Amended FSCMA. One view is that under the Act on Registration of Credit Business, Etc. and Protection of Finance Users, money-lending business may be carried out only by those who have been registered for credit business, except credit financial institutions otherwise permitted and authorised under other applicable laws. Pursuant to such a view, given that qualified investment-type private CIVs are not expressly permitted to lend money, the qualified investment-type private CIVs would still be prohibited from engaging in money-lending. The other view is that the Amended FSCMA should be construed as permitting qualified investment-type private CIVs to lend money since the specific restriction on money-lending under the Former FSCMA no longer applies to qualified investment-type private CIVs, and the Amended FSCMA does not otherwise prohibit them from lending in any provision.

In relation to this, notwithstanding the absence of any express language prohibiting qualified investment-type private CIVs from lending, the Korean financial authority appears to be of opinion that the Amended FSCMA may not be construed as permitting qualified investment-type private CIVs to lend money. The Korean financial authority's conservative interpretation seems to be concerned with potential problems that may arise from the management and supervision of lending business conducted by qualified investment-type private CIVs, and possible resistance from various stakeholders, including banks, credit financial institutions and credit service providers.

Issuance of beneficiary certificates with differential rights and redemption

The beneficiary interest in investment trusts was required to be issued equally under the Former FSCMA; however, qualified investment-type private CIVs under the Amended

FSCMA may issue beneficiary certificates with different rights in respect of repayment of trust principal and distribution of profits, etc. (Article 249-8(1) of the Amended FSCMA excludes Article 189(2) from application).

Furthermore, under the Former FSCMA REFs were established as closed-end funds, but qualified investment-type private CIVs under the Amended FSCMA are not subject to this restriction (Article 249-8(1) of the Amended FSCMA excludes Article 230 from application).

Additional funding of existing real estate private funds

A collective investment manager who has managed real estate private funds prior to the date of enforcement of the Amended FSCMA (25 October 2015) may continue to set up and establish real estate private funds pursuant to the Former FSCMA for a period of up to three years from the date of enforcement of the Amended FSCMA (Article 4(1) of the Addenda of the Amended FSCMA). However, the term of existence of the real estate private funds so set-up and established shall not exceed four years from the date of enforcement of the Amended FSCMA, on condition that new or additional collective investment securities may be issued by the collective investment manager to the extent of the sum of collective investment properties of the real estate private funds that are liquidated or dissolved after the date of enforcement of the Amended FSCMA (the Upper Limit) among the collective investment properties held by the real estate private funds under management at the time of the enforcement of the Amended FSCMA (Paragraphs 2 and 3 of Article 4 of the Addenda of the Amended FSCMA).

However, the Upper Limit does not apply if collective investment securities are issued to, and subscribed by, an investor after 25 October 2015 (1) pursuant to a capital call agreement whereby the investor has agreed to subscribe collective investment securities upon receipt of the request for such subscription of the collective investment securities; (2) for the purpose of distributing dividends upon closing of accounts of an existing real estate private fund; or (3) for the purpose of complying with an agreement that is executed by an existing real estate private fund to hedge against foreign exchange risks.

Tax issues

REFs under the Former FSCMA enjoyed certain tax benefits provided under special tax provisions, as set forth below. However, notwithstanding the introduction of qualified investment-type private CIVs under the Amended FSCMA, some of these special tax provisions have not been amended to be applicable to qualified investment-type private CIVs. On the basis of contextual interpretation, therefore, the special tax provisions that have not been amended are construed as not being applicable to qualified investment-type private CIVs. Compared with the existing REFs, therefore, the qualified investment-type private CIVs are entitled to tax benefits to a much lesser extent, unless the tax provisions are otherwise further amended.

Tax benefits for existing REFs

a Article 87-6 of the Restriction of Special Taxation Act: this article provides for special tax treatment for dividend incomes paid in respect of beneficiary certificates of real estate funds investing 50 per cent or more of their assets in rental housing.

b Article 180-2 of the Restriction of Special Local Taxation Act: this article includes special tax provisions that the properties acquired as collective investment properties of a real estate fund under Article 229-2 of the Former FSCMA are not subject to heavy local tax rates until 31 December 2015 (these articles will be extended to 31 December 2018 according to the amendment to the Restriction of Special Local Taxation Act, which was passed by the National Assembly on 9 December 2015). However, such heavy local tax rates would not be imposed unconditionally only because this provision is not readily applicable to qualified investment-type private CIVs; rather, it would depend on a number of factors including whether five years had elapsed from the establishment of the trustee of the qualified investment-type private CIV in a metropolitan city and whether the target real property is located in an overpopulation control area. According to the amendment to the Restriction of Special Local Taxation Act, the properties acquired by qualified investment-type private CIVs that invest more than 80 per cent of their assets in real properties will not be subject to heavy local tax rates until 31 December 2018.

c Article 106 of the Local Tax Act: this article excludes any land that corresponds to Article 106(1)2 of the same Act among the land owned by a REF from the target of aggregate real estate tax by classifying such land as separately taxable land (Article 106(1)3(E) of the Local Tax Act and Article 102(5)23 of the Enforcement Decree thereof).

ii Real Estate Investment Company Act

The amended Real Estate Investment Company Act, effective as of 23 October 2015, provides for significantly relaxed regulation of the investment in real-estate development projects by REITs.

Under the former Real Estate Investment Company Act a REIT was required to be authorised as a development REIT by MOLIT to invest in real-estate development projects, whereas the amended Real Estate Investment Company Act abolished all relevant provisions regarding development REITs, and provides that a REIT may invest in real-estate development projects regardless of its type so long as it determines, by a special resolution of the general meeting of shareholders, the proportion of its investment assets in such projects in relation to its total assets.

Furthermore, in line with government policy to stimulate the rental housing unit market, the amended Real Estate Investment Company Act provides that the obligation of public offering or the maximum shareholding limit on one shareholder shall not be applicable where the REIT supplies as rental housing units 70 per cent or more of the total floor area of a building held or developed by it.

iii Commercial Building Lease Protection Act

The amended Commercial Building Lease Protection Act, effective as of 13 May 2015, provides for greater protection of lessees of commercial buildings.

In principle, the Commercial Building Lease Protection Act shall apply to the lease in a commercial building where its converted lease security deposit (i.e., lease security deposit plus monthly rent multiplied by 100) is at or lower than the threshold amount set by the region (in the case of Seoul, 400 million won), but some provisions of the amended Commercial Building Lease Protection Act apply to the lease in a commercial building even if its converted lease security deposit exceeds such a threshold amount. In particular, with respect to the lease in a commercial building executed or renewed after the enforcement of the amended Commercial Building Lease Protection Act, and regardless of the amount of its converted lease security deposit, if the leased premises is delivered to the lessee and then the lessee files an application for business registration under the relevant tax laws, the lessee may claim his or her leasehold against a third party without regard to registration of the leasehold right.

While it was difficult for the lessee of a commercial building who increased the business value of the leased premises by investing his or her capital therein to recover such increased value upon the termination of the lease under the former Commercial Building Lease Protection Act, the amended Commercial Building Lease Protection Act provides that the lessor shall protect the opportunity for the lessee to recover an amount equivalent to the business value of the leased premises (premium) from a new lessee three months prior to the expiration of the lease.

Furthermore, under the amended Commercial Building Lease Protection Act, the lessor may terminate the lease agreement upon the lessee's failure to pay rents only if the rent in arrears at the time of such termination equals the aggregate amount of the rents for three rental periods.

VIII OUTLOOK AND CONCLUSIONS

There were sweeping changes to real estate-related laws in 2015, which are already having a major impact on the market. The overhaul of the FSCMA and the Real Estate Investment Company Act, for instance, is causing significant changes to the regulatory framework for private CIVs and REITs, and has resulted in substantial deregulation relating to the use of private CIVs and REITs. The amended Commercial Building Lease Protection Act, however, has created some difficulties as it increased the rights of all commercial tenants (and not only small commercial tenants), and owners and prospective investors need to consider more carefully the potential implications of tenants rights in determining value-adding and long-term strategies.

Following a trend of divestments in Korea by foreign financial investors and real estate funds, in part because of the impact of the global financial crisis in their home countries, foreign investors started to return to the country in 2014 and 2015; in particular, they started to acquire trophy assets in the Seoul Central Business District and to invest in hotel, retail and logistics development projects. The trend that developed in 2015 and is likely continue in 2016 is value-adding investments (such as acquiring an office building and converting it to mixed use with retail components).

Acquisitions of overseas properties in major cities around the world (including Atlanta, Chicago, London, Los Angeles, Montreal, New York, Paris, San Francisco and Washington, DC, and in Australia and Germany) by Korean investors, including pension funds, financial institutions and real estate funds, have continued to increase, and we expect this trend to continue in 2016. We note, however, that Korean investors are now looking more to invest in mezzanine loans and instruments, which offer a slightly higher yield.

Appendix 1

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Kyung Don Lee is a partner and co-head of the real estate and real estate finance practice group. He is one of the leading experts in the field of real estate law in Korea and has been involved in many of the largest real estate transactions in Korea. He also specialises in construction and development and project financing in connection with real estate transactions. Mr Lee graduated from Seoul National University with a BA and completed his LLM at Columbia Law School. He has worked at Shin & Kim and Winthrop, Stimson, Putnam & Roberts in New York. He has represented many REFs in the acquisition, financing, operation and disposition of real estate assets, as well as financial institutions and project financing funds in connection with loans to various real estate investors, including developers.

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Robert C Young, a senior US attorney, has been with Shin & Kim since January 1998. The focus of his practice is real estate, financing and mergers and acquisitions. He has been involved in a multitude of real estate projects, including representing foreign and domestic funds and companies in the acquisition and sale of existing commercial properties and development projects, and senior and mezzanine financing. Mr Young also has extensive experience with sale and leaseback transactions, as well as on general leasing matters. He received his JD from the University of California, Hastings College of the Law, and clerked at the Hawaii Supreme Court.

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