The Real Estate Law Review

Third Edition

Editor
David Waterfield

Law Business Research

The Real Estate Law Review

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Third Edition

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David Waterfield

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THE PRIVATE COMPETITION ENFORCEMENT REVIEW

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CONTENTS

Editor's Preface vii
David Waterfield

Chapter 1 AUSTRIA.................... 1
Peter Madl

Chapter 2 BELGIUM 12
Yves Delacroix

Chapter 3 BRAZIL.................... 26
Marcelo José Lomba Valença and Tamiris Micheletti Britzki

Chapter 4 CAMBODIA.................... 37
Sophealeak Ing

Chapter 5 CAYMAN ISLANDS.................... 48
George Loutas

Chapter 6 CHINA 57
Alex Wang and Edward Hsu

Chapter 7 CYPRUS 69
Nicolas Papaconstantinou

Chapter 8 CZECH REPUBLIC.................... 80
Martin Kubánek and Miroslav Dudek

Chapter 9 ENGLAND & WALES 90
David Waterfield

Chapter 10 FINLAND.................... 103
Samuli Palin and Leif Laitinen

Chapter 11 FRANCE 113
Pierre Gebarowski and Guillaume Rossignol

Chapter 12 GERMANY 127
Ingo Klöcker

Chapter 13 GREECE 138
Paraskevi A Anargyrou and Stella G Yannika

Chapter 14 HUNGARY 148
Péter Berethalmi and Kata Molnár

Chapter 15 INDONESIA 157
Eddy Marek Leks

Chapter 16 IRELAND 169
Kevin Hoy

Chapter 17 ITALY 178
Alessandro Balp

Chapter 18 JAPAN 189
Norio Maeda, Tomohiro Kandori, Naoko Katakami and Kozo Kuromatsu

Chapter 19 JERSEY 203
Christopher Philpott and Will Whitehead

Chapter 20 KOREA 214
Kyung Don Lee, Robert C Young and Eun Nyung Lee

Chapter 21 LUXEMBOURG 231
Véronique Hoffeld and Marc Meyers

Chapter 22 MEXICO 241
Benjamin C Rosen

Chapter 23 NETHERLANDS 256
Annemieke Wessels, Maarten Tinnemans and Max van Drunen

Chapter 24 NIGERIA 268
Gbolahan Elias and Lynda Chinweokwu

Chapter 25 NORWAY 275
Thorvald Nyquist

Chapter 26 POLAND 284
Agata Demuth and Michał Gruca

Chapter 27 PORTUGAL 292
Filipa Arantes Pedroso

Chapter 28 QATAR 300
Louise Wall

Chapter 29 ROMANIA 315
Silvia Opris (née Popa) and Ionuţ Sava

Chapter 30 SCOTLAND 325
Michael Henderson and Nick Ryden

Chapter 31 SLOVAKIA 340
Tomáš Zárecký

Chapter 32 SOUTH AFRICA 351
Andrew Bembridge

Chapter 33 SPAIN 360
Diego Armero and Rodrigo Peruyero

Chapter 34 SWEDEN 371
Patrick Forslund and Niclas Winnberg

Chapter 35 SWITZERLAND 380
Cécile Berger Meyer and Andreas Rötheli

Chapter 36 TAIWAN 393
Yi-Jiun Su and Doris Lin

Chapter 37 TURKEY 404
Barlas Balcıoğlu and Ali Can Gören

Chapter 38 UKRAINE 415
Vladislav Kysil

Chapter 39 UNITED ARAB EMIRATES 425
Ibrahim Elsadig and Joe Carroll

Chapter 40 UNITED STATES 437
Meredith J Kane

Appendix 1 ABOUT THE AUTHORS 451

Appendix 2 CONTRIBUTING LAW FIRMS' CONTACT DETAILS ... 471

EDITOR'S PREFACE

Building on the success of the previous editions of *The Real Estate Law Review*, the third edition now extends to some 40 jurisdictions, and we are delighted to welcome new contributors from key countries around the world. *The Real Estate Law Review* seeks to enable practitioners and clients to meet the challenge of keeping abreast of the rapidly evolving global real estate market. Each chapter offers an up-to-date and accessible summary of the key legal and practical developments in the relevant jurisdiction, and a vital snapshot of the important market drivers, trends and opportunities. Together, the chapters provide an invaluable overview of international real estate.

It is no longer possible to look at domestic markets in isolation; real estate has become a global industry, and *The Real Estate Law Review* reflects that status. An awareness of the global real estate market and an understanding of the practices and requirements of overseas investors are vital if practitioners and their clients are to take advantage of investment trends and opportunities as they develop.

The Real Estate Law Review continues to provide an overview of the state of the international real estate market, including the types of investor, the sources of funding and those assets that are in demand. In general, the focus remains on prime properties in the world's leading global cities as investors continue to seek a safe haven for their capital. Although this remains the case with London, investors are starting to see opportunities in the wider UK market, and we are generally more optimistic than at this time last year. However, positive recent news, data and forecasts must still be considered in the light of continuing economic and political challenges, including the next US fiscal cliff, uncertainty in emerging markets and the stability of the eurozone.

Once again, I wish to express my gratitude to the distinguished practitioners from across the globe who have provided invaluable contributions to this edition. As ever, I would also like to thank Gideon Roberton and his team for their sterling efforts in compiling this third edition of *The Real Estate Law Review*.

David Waterfield
Slaughter and May
London
February 2014

Chapter 20

KOREA

Kyung Don Lee, Robert C Young and Eun Nyung Lee[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 a 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 Eun Nyung Lee 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 structure), 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, such 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]

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 a 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 such 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 are especially popular, since only one or more persons are required for the formation of the REF. However, under the amended Financial Investment Services and Capital Markets Act, commencing from January 2015, at least two or more persons will be required for the establishment of the REF.

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

	Dec 2008	*Dec 2009*	*Dec 2010*	*Dec 2011*	*Dec 2012*	*Dec 2013*
Public offer (100 million won)	11,377	8,560	8,915	8,512	10,484	10,982
Private offer (100 million won)	77,525	107,028	132,398	155,783	188,529	221,008
Total (100 million won)	88,902	115,588	141,313	164,294	199,012	232,070
No. of REFs (Private REFs)	252 (238)	298 (290)	317 (308)	342 (334)	408 (394)	470 (455)

(Source: Korea Financial Investment Association)

ii Real estate investment trusts (REITs)

REITs[5] 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 (multi-purpose buildings with residential and commercial units), developments, hotels, supermarkets, department stores, and retail

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

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 addition, for the first time in Korea, a REIT was established for the purpose of investing in the leasehold rights (not the ownership rights) of real estate property. While such REIT does not have the benefit of receiving any sale proceeds that may arise at the time of dissolution of such fund, the investors would be entitled to receive a constant stream of dividends through the security right attached on the owner's right to receive rent payments from its tenants.

	Jun 2008	*Jan 2009*	*Sep 2010*	*Feb 2011*	*May 2012*	*Jul 2013*
Total capital (100 million won)	23,673	24,905	35,912	39,832	41,799	– *
Total assets (100 million won)	49,045	48,837	72,565	74,106	82,339	– *
No. of REITs	21	20	42	65	75	73

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

iii Project financing vehicles (PFVs)

PFVs are one of the most common forms of investment vehicles 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 their relevant local tax office.

iv Foreigner real estate transactions

Following the steady increase in foreign investments in Korean real estate following the 1997 Asian financial crisis due to, *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 saw foreign investment slow down. 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, as shown below, the level of foreign investment has since regained some momentum since 2009.

	2008	*2009*	*2010*	*2011*	*2012*	*2013 (until November)*
Land (m^2)	8.544 million	13.456 million	11.130 million	9.904 million	10.605 million	11.508 million
Buildings (m^2)	526,000	941,000	679,000	697,000	805,000	730,000

(Source: MOLIT)

III FOREIGN INVESTMENT

Under the Foreigner's Land Acquisition Act (the 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 that acquires land on or after 26 June 2009 may be exempt from filing a land acquisition report as long as such foreigner chooses to file the more simple 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 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 such foreign-invested company provides certain qualified high 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. It should be noted, however, that the Audit Board of Korea has recently warned against the abuse of such system where foreign financing is being disguised as an equity investment (for instance, an equity investment with a guaranteed yield and put option) for a domestic company to acquire property from the municipalities 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

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

i REITs

A REIT is essentially a joint-stock company (*chusik hoesa*) 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 of the shares in the REIT;
c the REIT shall only take in-kind contributions of up to 50 per cent of the capital of the REIT;
d 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;
e 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);
f 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; and
g the REIT shall invest only within 30 per cent of its total assets if it plans to invest in a real estate development project.

The Real Estate Investment Company Act recognises three different types of REITs: self-managed REITs (SM-REITs), consigned-management REITs and corporate-restructuring REITs (CR-REITs). Since their introduction, CR-REITs have been popular among investors (in 2013, 29 out of 73 REITs were CR-REITs). This is because, unlike the other REITs, CR-REITs are:

a exempt from the public offering requirement;
b exempt from the listing requirement;

c not subject to a cap on the maximum ownership by a single shareholder; and
d are entitled to a corporate tax deduction if it distributes 90 per cent of more in dividends to shareholders, even though it is restricted from disposing of acquired real estate within one year.

CR-REITs 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.

SM-REITs are unique in that shareholders are allowed to directly participate in investment and management decisions of the REIT through shareholder or board meetings. However, SM-REITs were rarely used by investors because they were deemed 'corporations' and were not only required to operate like corporations (i.e., hire full-time staff, employees), but were not entitled to receive corporate tax exemptions like the other REITs. In an attempt to promote further use of REITs and SM-REITs, on 13 July 2007, the Ministry of Land, Infrastructure and Transport (MOLIT) introduced development-oriented REITs that allowed investment of their entire assets into real estate development projects even prior to being listed. Under the present law, development-oriented REITs may be structured in the form of an SM-REIT, consigned-management REIT or CR-REIT. The implementation of development-oriented REITs has contributed to the growth of SM-REITs, as more investors have established development-oriented SM-REITs within the past five years than ever before (as of July 2012, there were 10).

On 31 December 2011, MOLIT introduced a new set of amendments to the Real Estate Investment Company Act intended to provide investors with more flexibility in using REITs. For example, the amendments relaxed the requirement that SM-REITs must have at least five employees with asset management expertise at the time of establishment to only three employees at the time of establishment and a total of five employees within six months of establishment; and allowed for another type of REIT structure, the parent-subsidiary real estate investment trust (parent-sub REIT), in support of institutional investors. To qualify as a parent-sub REIT, national pension plans and other similar associations stipulated in the Real Estate Investment Company Act must own more than 50 per cent of the equity interests in the parent-REIT, which in turn owns more than 50 per cent of the equity interests in the subsidiary REIT that owns real property. Unlike other REITs, parent-sub REITs are exempt from the public offering requirement, as well as the 30 per cent limitation on the maximum equity ownership by a single shareholder.

ii REFs

REFs are collective investment vehicles that invest more than 50 per cent of their equity interests in real estate. REFs are governed by the Financial Investment Services and Capital Markets Act.

Unlike REITs, REFs are not subject to requirements such as public offering, listing, dividend distribution, capital contribution limits and maximum ownership caps on single investors, and, at their own discretion, may invest all of their assets in a real estate project. In addition, REFs may be structured in the form of a trust, a corporation or an association. For these reasons, REFs are currently the most popular collective

investment vehicles used by investors in Korea. Although there are some drawbacks, such as limited investor participation in investment decisions, these are relatively minor considering that other REITs (e.g., consignment-REITs and CR-REITs) are also subject to similar limitations, and blind-type REFs (i.e., no oversight by investors) are almost non-existent in the Korean marketplace. It should be noted that investors are not allowed to repurchase or redeem their shares after investment in a REF unless the trust securities (trust-type REF) or equity securities (corporation-type REF) become listed.

In Korea, the most common type of REF formed by investors is the trust-type REF. While there are no key differences in benefits or advantages, it appears that investors prefer the relative ease of forming a trust-type REF over a corporation-type REF.

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.

Some minor drawbacks of PFVs are that they are real estate investment vehicles mostly reserved for large development projects, they are paper companies that are 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 (*yuhan hoesa*) 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.

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.

The planning and execution of much larger-scale urban projects (i.e., the re-zoning of an entire city) 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. To meet such 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 multi-purpose 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 culpable 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 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, the purchaser will be subject to an acquisition tax of 9.4 per cent within five years of such office's establishment in the overpopulation control area. Certain investment vehicles, such as the 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 acquisition tax.

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.

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 such 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 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 such 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 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 premise is 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

Amendments were made to the Financial Investment Services and Capital Markets Act on 28 May 2013, and became effective on 29 August 2013. One priority was to amend the definition of collective investment. Prior to the amendments, the term collective investment was defined as monies collected through solicitations for investment made to two or more persons; as such, regardless of actual investment, any solicitation for investment made to two or more persons was deemed a collective investment.

Under the amendments, 'collective investment' is now defined as monies collected from two or more investors, which means that, to qualify as a collective investment, there must have been an actual investment by two or more investors. As a result of this change in definition, dissolution of a collective investment scheme will now be required where the number of investors is reduced to one. However, being a single investor will not lead to dissolution of the collective investment scheme in certain exceptional cases, and a grace period of one month from the date when such collective investment scheme is established or the number of investors is reduced to one will be provided.

Although the relevant amendments will come into force as of 1 January 2015, the amendment to the definition of collective investment will not affect a collective investment scheme established prior to 1 January 2015 with only one investor (i.e., the dissolution requirement will not apply) as long as no additional collective investment certificates are newly issued by such collective investment scheme after 1 January 2015 (i.e., the effective date of the amendments). If additional certificates will be issued for capital injections (including issuance to the existing investor) after 1 January 2015, it will have to be issued to at least two investors.

ii Real Estate Investment Company Act

On 4 June 2013, amendments were made to the Real Estate Investment Company Act, which became effective on 19 June 2013. Under the amendments, if a REIT invests all of its assets in the leasing business of multi-unit dwellings, such company will be exempted

from the obligation of publicly offering its shares and the ownership restriction of a single shareholder (e.g., 30 per cent in a self-managed REIT).

In addition, under amendments made on 16 July 2013 and effective on 17 January 2014, a REIT should employ an appraiser to appraise the real estate in question and report the results to the Minister of MOLIT to gain approval of its business, and the Minister of MOLIT should examine the eligibility of the major shareholder who holds more than 5 per cent of the outstanding shares of a self-managed REIT as part of the process of confirming that the self-managed REIT has met the minimum capital requirements under the Real Estate Investment Company Act.

iii Commercial Building Lease Protection Act

Amendments to the Commercial Building Lease Protection Act (the CBLP Act and, as amended, the Amended CBLP Act) were promulgated on 13 August 2013. The purpose of the amendments is to further protect commercial tenants. The Amended CBLP Act is applicable to lease agreements newly entered into or renewed after 13 August 2013 (with certain exceptions).

The Amended CBLP Act recognises a tenant's right to renewal of its lease agreement, even if such tenant's lease deposit exceeds the amount prescribed by the Presidential Decree of the CBLP Act (which was the threshold used to protect smaller tenants). In addition, the Amended CBLP Act includes a new provision that allows a tenant to request an increase or decrease of rent or lease deposit at the time of renewal, taking into account various factors such as the tax and public utilities for that building, rents and lease deposits of the surrounding commercial buildings, and other economic circumstances. Under the former provisions of the CBLP Act, such right of renewal was not available to tenants whose lease deposits exceed the amount prescribed by the Presidential Decree (e.g., 300 million won in Seoul). However, the Amended CBLP Act recognises a tenant's right to renewal, regardless of the amount of lease deposit, to the extent that the entire term (as extended) does not exceed five years. For renewal of a lease under which the lease deposit is lower than the amount prescribed by the Presidential Decree, it is not possible to increase the rent or lease deposit by more than 9 per cent. However, under the Amended CBLP Act, there is no specific limit on an increase of rents or deposits for large tenants, although the tenant has the right to request an increase or decrease of the rents or lease deposits at the time of renewal, considering taxes or other changes in economic circumstance. Given the foregoing, it is anticipated that rent increase issues will arise when a large tenant exercises its right to renew based on this new provision.

Under the CBLP Act, when a tenant requests renewal of a lease agreement, the landlord may only refuse to renew for justifiable reasons (e.g., if the tenant defaults on rent payments for three payment periods). However, landlords had been broadly relying on the general provisions as a basis to refuse tenants' renewal requests on grounds that buildings were scheduled for demolishment or reconstruction. To better protect tenants, the Amended CBLP Act now provides that the landlord can only refuse the tenant's request for renewal in cases where the relevant construction plan was specifically notified to the tenant at the time of execution of the lease agreement, where there is a risk of accidents, or where the building is required by law to be demolished or reconstructed.

Under the CBLP Act, if a commercial building was to be foreclosed, a small tenant with a secured leasehold interest and lease deposit was entitled to receive, in

priority over any other persons with mortgage rights or other interests in such building, an amount determined by the Presidential Decree based on the economic conditions of the relevant region, to the extent that such amount did not exceed one-third of the price of the building. To better protect small tenants, the Amended CBLP Act has increased the upper limit from one-third to one-half of the price of a building. This amended provision came into effect as of 1 January 2014.

iv Housing Act

Amendments made to the Housing Act on 6 August 2013 will become effective on 7 February 2014. The main purpose of the amendments are:

a to adopt rental house management business for the purpose of facilitating the supply of rental houses and provide opportunities for private investors to participate in markets related to rental houses;

b to reduce the landlord's burden of management of a rental house;

c to provide the landlord with stable earnings;

d to provide the lessee with comprehensive rental house management services by introducing provisions such as registration of the rental house management business, purchase of insurance and supervision of rental house managers; and

e to revitalise housing developments by regional housing associations.

v Rental Housing Act

The Rental Housing Act was amended on 4 June 2013; the amendments have been in effect since 5 December 2013 and aim to:

a revitalise the supply of rental houses by introducing:
- land–leasehold rental houses, where rental house providers construct and supply rental houses on land leased by the constructor;
- *jeonse* (leasehold by *jeonse*) rental houses, where rental house providers such as the government sublease existing houses in urban areas upon leasing them through *jeonse* agreements; and
- quasi-public rental houses, with certain restrictions such as compulsory lease periods and limitations on rent increases; and

b reduce the lessee's economic burden by permitting payment in instalments in the case of rental houses provided by providers such as the government.

vi Act on the Promotion of Constructing Green Buildings

The Act on the Promotion of Constructing Green Buildings has been effective since 23 February 2013. Under this Act, the Minister of MOLIT must promulgate, on an annual basis, the energy consumption standards relevant to each type of building:

a if a developer wishes to construct a building, it must design the building so that it is compliant with the relevant energy consumption standards promulgated by the Minister, and the developer must submit documents evidencing thereof when applying for a construction permit;

b if a developer wishes to convert an existing building into a green building to promote efficient energy consumption, the existing building must be compliant with the above standards;

c if a developer wishes to construct a building[6] that has a total area of $500m^2$ or more, the developer must apply for a construction permit, apply for an approval of the change of use or submit an energy saving plan as set out by the Presidential Decree if it wishes to amend the contents of the building registry; and

d if an owner or manager of a business facility (with total area of 3,000 m^2) or communal residence (located within a residential area that has 500 or more residences and has installed a database system for building energy and gas use) wishes to sell or lease such property, the relevant transaction document must be accompanied by an energy efficient grade report[7] that includes various measures such as the property's annual energy use and gas emission rate.

vii Corporate Tax Act

Amendments made to the Corporate Tax Act on 31 December 2011 have been effective since 1 July 2012. Under these, in order to be taxed at the reduced tax rate under the relevant tax treaty, foreign entities that earn income sourced in Korea are required to submit a request for the application of treaty-reduced tax rates to the relevant withholding obligor. Where the Korean-sourced income is paid through an overseas investment vehicle, such vehicle must submit to the withholding obligor:

a an overseas investment vehicle report; and

b a detailed statement on the beneficial owners of the income based on their request for the application of treaty-reduced tax rates.

However, foreign investors who invest in overseas depository receipts issued by Korean companies will be exempted from the obligation to submit a request for the application of treaty-reduced tax rates. Accordingly, foreign funds wishing to enjoy the benefits afforded by tax treaties in respect of their income from Korean investments (e.g., an exemption from tax on capital gains realised from the transfer of shares, and reduced tax on interest and dividends) are required to submit a list of the investors (beneficial owners) to the withholding obligor. Foreign funds that fail to submit such list may not be entitled to the tax treaty benefits.

Previously, interest on foreign currency denominated bonds issued in Korea was exempt from income tax or corporate tax. However, these exemptions are no longer available, pursuant to an amendment to the Special Tax Treatment Control Law, effective as of 31 December 2011.[8] The amendment applies to bonds issued after 1 January 2012.

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6 Certain properties, such as a single residence home, zoo or botanical garden, are exempt.

7 However, certain buildings that are located within maintenance areas as designated by the Act on the Maintenance and Improvement of Urban Areas and Dwelling Conditions for Residents, deemed outdated or defective pursuant to the Act on the Promotion of Constructing Green Buildings, or subject to an auction or similar type of sale procedure, are exempt from attaching an energy efficient grade report to their respective transaction documents.

8 It should be noted that foreign currency bonds issued overseas are still exempt from income tax or corporate tax. However, what constitutes 'issued overseas' is not absolutely clear.

It is uncertain whether a transfer of real property made by certain investment vehicles or special purpose companies (SPCs) constitutes an individual asset transfer, which is subject to VAT, or a comprehensive business transfer, which is not. This issue was important in the past because, if the Korean tax authorities view a transaction as a comprehensive business transfer as opposed to tax treatments by the seller and the purchaser, the purchaser may not be entitled to a deduction or refund of the VAT paid for VAT invoices received for such transfer, and the seller and the purchaser may be subject to certain penalties. On the contrary, if the Korean tax authorities view a transaction as an individual asset transfer when the seller and the purchaser file tax returns separately, the seller may be required to pay VAT, as well as penalties thereon. Due to this uncertainty, many disputes had arisen between sellers and purchasers regarding whether a transfer of real property constitutes a comprehensive business transfer.

However, effective from 15 February 2013, and pursuant to amendments to the VAT Law of Korea and the Presidential Decree thereof, the VAT paid by the purchaser for VAT invoices can be deductible or refundable even if the VAT invoices are received for VAT-exempt transactions, including comprehensive business transfers, if it is proved that the seller has fully paid the VAT collected from the purchaser to the tax authorities and an amended VAT invoice has not been issued. Therefore, after 15 February 2013, if the seller issues VAT invoices and fully pays the VAT collected from the purchaser to the tax authorities, the purchaser can deduct such paid VAT even if the transfer constitutes a comprehensive business transfer. As such, we believe that the VAT risks involved in the transfer of real property by certain investment vehicles or SPCs has been reduced significantly.

viii Ruling of the Korean Constitutional Court on lease term limits

Under the Korean Civil Code, a lease term shall not exceed 20 years unless it is a lease of land for the purpose of owning an extremely durable building or structure (e.g., a stone building), or a lease of land for the purpose of planting trees or producing salt. In all other cases, even if the parties contractually agree to a lease term exceeding 20 years, the lease term will only be valid for the maximum 20-year period.

On 26 December 2013, the Korean Constitutional Court ruled that the above Civil Code provision is unconstitutional on the grounds that the purpose of such law is unclear and that, although there may be some socio-economic benefits that justify, to a certain extent, the enactment of such law, it violates the principle against over-restrictions and is detrimental to the freedom of contract. As a result, the above provision is no longer effective. However, the scope of an acceptable lease term (e.g., in perpetuity or 100 years) remains to be seen until the above provision is amended or the Court renders a judgment that provides further guidance.

VIII OUTLOOK AND CONCLUSIONS

As outlined above, there have been many recent amendments to Korea's real estate-related laws that are intended to promote investments in real estate, and we expect that this will have a positive impact on real estate investments in 2014. We also witnessed a large number of divestments in 2013 from foreign financial investors and REFs in Korea,

due in part to the impact of the global financial crisis in their own countries. The impact on Korean and domestic financial institutions and real estate players, including funds and asset management companies, has not been as severe, and as such domestic investors were much more active in the Korean real estate market. This trend has continued, but we are also seeing foreign investors and investments return to Korea, in particular in the areas of sale and leasebacks, shopping malls and hotels (which continue to be popular due in part to the rise in tourism from other parts of Asia, including China and Japan).

The acquisition of overseas properties in major countries (including Australia, Germany, the UK and the US) by Korean investors, including pension funds, financial institutions and REFs, has continued to increase. We expect that this trend will continue in 2014.

Appendix 1

ABOUT THE AUTHORS

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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 University School of Law. 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.

ROBERT C YOUNG

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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 Law, and clerked at the Hawaii Supreme Court.

EUN NYUNG LEE

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Mr Eun Nyung Lee is a partner at Shin & Kim. His practice primarily focuses on corporate and financial transactions, particularly mergers and acquisitions (M&A),

real estate and international arbitration. He has significant experience in cross-border M&A, domestic M&A, real estate, private equity, acquisition financing and real estate financing. He worked as an international lawyer in the Hong Kong office of Cleary Gottlieb Steen & Hamilton, and was involved in capital market transactions such as IPO and debt offering.

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