The Real Estate Law Review

Fourth Edition

Editor
David Waterfield

Law Business Research

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EDITOR'S PREFACE

The fourth edition of *The Real Estate Law Review* is testament to the book's success and the significance of real estate as a global asset class. A great deal has happened since the first edition appeared in 2012, and this fourth edition coincides with renewed confidence in the real estate market. The real estate market is often described as cyclical, and there is no doubt that we are now seeing positive investor sentiment in a market enjoying upward momentum.

The fourth edition of *The Real Estate Law Review* features 35 jurisdictions, and we are delighted to welcome a number of new notable practitioners who have helped bolster the strength and depth of this invaluable publication. Each chapter of *The Real Estate Law Review* has been updated to focus on key developments in that jurisdiction and their impact on the relevant domestic and wider global real estate market. *The Real Estate Law Review* offers real estate practitioners and their clients an immediate and accessible summary of the position in the many countries covered, as well as the global real estate market as a whole. The globalisation of the real estate market continues apace, and it is fundamentally important to develop an understanding of the legal and commercial opportunities and challenges pertinent to each country, and how each local market forms an integral part of the global picture.

This fourth edition seeks to provide an overview of the state of the global real estate investment market. Although there is without question significantly more good news around, the financial and economic turmoil of recent years serves as a reminder of how fragile markets can be, and a number of obstacles remain on what may prove to be a bumpy road to global recovery. Sustainable growth across the eurozone remains illusory, Japan continues to flirt with recession, the fear of a hard landing in China and other developing economies remains, there is continuing instability in Ukraine and the Middle East, and the Ebola outbreak in West Africa is a global concern.

Once again, I wish to express my deep and sincere thanks to all my distinguished colleagues who have contributed to this edition and the success of *The Real Estate Law Review*. I would also like to thank Gideon Roberton and his publishing team for their tireless work in coordinating the contributions and compiling this fourth edition.

David Waterfield
Slaughter and May
London
February 2015

Chapter 19

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 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, 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 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.

	December 2009	*December 2010*	*December 2011*	*December 2012*	*December 2013*	*December 2014*
Public offer (100 million won)	8,560	8,915	8,512	10,484	10,982	11,723
Private offer (100 million won)	107,028	132,398	155,783	188,529	221,008	270,969
Total (100 million won)	115,588	141,313	164,294	199,012	232,070	282,692
No. of REFs (Private REFs)	298 (290)	317 (308)	342 (334)	408 (394)	470 (455)	583 (562)

(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 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. These REITs were backed by government investments as part of the government's initiative to promote REITs and investments in the real estate market.

	January 2009	*September 2010*	*February 2011*	*May 2012*	*December 2013*	*July 2014*
Total capital (100 million won)	24,905	35,912	39,832	41,799	– *	– *
Total assets (100 million won)	48,837	72,565	74,106	82,339	123,000	123,000
No. of REITs	20	42	65	75	80	84

(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 Foreign 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, we have seen foreign investors returning to the Korean real estate market and in particular with respect to office buildings, hotels, retail malls and logistics. One of the more noticeable foreign investment trends in Korea has been Chinese investments in Jeju Island. 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.

	2009	*2010*	*2011*	*2012*	*2013*	*2014**
Land (m^2)	13.456 million	11.130 million	9.904 million	10.605 million	11.508 million	11.5435 million
Buildings (m^2)	941,000	679,000	697,000	805,000	730,000	–

(Source: MOLIT; * until October 2014)

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 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 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 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

Beginning in 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);

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; and

f 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: 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 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 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.

That said, 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 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, employees) but are not entitled to receive corporate tax exemptions like the other REITs (as of July 2012, out of a total of 75 REITs, there were only 10 SM-REITs, and as of March 2014, out of a total of 84 REITs, there were 12 SM-REITs).

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.

On 29 September 2014, the government submitted a draft amendment to the Real Estate Investment Company Act to deregulate stringent laws that curbed investments into REITs. Such amendments include:

a making the REIT approval process less stringent, as well as shortening the approval review period;
b increasing flexibility on financing through loans and bonds and capital increase;
c expanding investment methods and decreasing disposition restrictions; and
d lowering the distribution requirement to maintain tax benefits for SM-REITs.

The draft amendment is now under review by the National Assembly of Korea and, if approved, the Real Estate Investment Act will be more amenable to flexible investment, and the regulations will be less strict than applied previously.

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 the relative ease of forming a trust-type REF over a corporation-type REF is preferred by investors.

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 (SPC), 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 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. 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 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 such 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.

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 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 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

On 28 May 2013, amendments were made to the Financial Investment Services and Capital Markets Act that became effective on 29 August 2013. One of the main priorities of the amendments 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, the term collective investment is now defined as monies collected from two or more investors, which means that there has to have been an actual investment by two or more investors to qualify as a collective investment. As a result of the above change in definition, dissolution of a collective investment scheme will now be required where the number of investors is reduced to one. However, reduction to 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.

While the relevant amendments came into force on 1 January 2015, the amendment to the definition of collective investment will not affect collective investment schemes 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 are issued for capital injections (including issuance to the existing investor) after 1 January 2015, they will need to be issued to at least two investors.

ii Real Estate Investment Company Act

The Enforcement Decree of the Real Estate Investment Company Act was amended on 17 January 2014, and came into effect on 18 January 2014. The main purpose behind such amendment was to establish a secure real estate investment market by implementing specific procedures and certain standards applicable to real estate transactions. In particular, the amendments sought to implement a specific procedure for appraising target real estate properties, implement specific criteria to determine the qualification of major investors of SM-REITs, and increase the number of institutions (institutions that manage deposit funds of the Korea Post Office or insurance reserves of the Korea Post Office) that are exempt from restrictions relating to the share ownership and public offering of a REIT.

On 28 October 2104, further amendments to the Enforcement Decree of the Real Estate Investment Company Act were made effective. The following are key highlights of such amendments:

a REITs may dispose of any acquired residences after a period of one year (previously, this was three years);

b the list of real estate transactions that are exempt from mandatory appraisal requirements has been expanded to include real estate purchases that were made pursuant to the process and calculation method set forth in the Industrial Sites and Development Act and the Special Act on the Construction of Public Residences;

c if REITs invest in (1) 50 per cent or more of the equity interests in a judicial person or partnership (provided that 80 per cent or more of the assets of such judicial person or partnership comprise certain types of interest such as ownership, right to use or beneficiary interest in real estate), or (2) securities issued by a collective investment vehicle on real estate (including foreign vehicles), such investment amounts will be deemed to be an 'asset' of the relevant REIT; and

d REITs may issue any type of bond (previously, REITs were only allowed to issue securitised bonds or bonds that satisfied certain investment and credit ratings).

iii Soil Environment Conservation Act

The Soil Environment Conservation Act imposes strict liability on a person causing soil contamination. In particular, a person who falls under any of the following categories is regarded as a 'polluter' for the purposes of such Act: persons who own, occupy or operate certain facilities subject to the control of specific soil contamination that have been a cause of soil contamination at the time of the occurrence of soil contamination; or persons who have taken over the controlled facilities. However, the Constitutional Court has found that deeming all persons who have taken over facilities causing soil contamination to have caused that soil contamination is against the 'principle of trust protection', and that imposing strict liability for soil pollution and the possible imposition of large clean-up costs on a person with little or no connection to the soil contamination violates such person's property rights and right to equality. As a result, the Soil Environment Conservation Act was amended on 24 March 2014 to reflect the Constitutional Court's concerns by clarifying the definition of polluter, expanding the list of exempt parties and circumstances, enforcing damage limits and providing polluters with due process and hearing opportunities. According to the amendments:

a a transferee that conducted a soil environment evaluation at the time of the transfer and confirmed that the contamination level was under such level as would cause concerns that human health or property or the growth of animals or plants would be adversely affected shall be assumed to be acting in good faith and without fault (previously, such assumption was not granted in spite of a transferee's soil environment evaluation and confirmation);

b a person's civil liability for damages due to soil pollution and such person's statutory responsibility for clean-up are clearly defined;

c the person responsible for pollution will not be labelled as a 'polluter' but rather as the 'person responsible for clean-up', and certain exceptions are introduced for persons who own, occupy, operate or assume certain contaminated facilities and are subject to strict liability;

d if multiple parties are responsible for the clean-up, the local government shall set up a soil clean-up committee and the committee shall determine the most reasonable and effective measures for cleaning up the contaminated area; and

e the relevant provincial, city and district officials shall notify the local environment office of any contamination incidents without delay when they assign relevant staff to take appropriate measures in securing and inspecting the contaminated premises, and notify the head of the local environment office of the report submitted to them after completing the inspection.

iv Building Act

The Building Act was amended and became effective on 28 May 2014. The key amendments are as follows:

a constructions that are subject to preliminary approval will be determined by the relevant local ordinances considering the local government's circumstances, such as environment or regional traffic (previously, mandatory preliminary approval for construction of a building that is at least 21 storeys high or has a total floor space of at least 100,000 square metres was required);

b developers must place a safety management security deposit into escrow when constructing a building with a total floor space of at least 1,000 square metres (previously 5,000 square metres) to promote safety management on the construction site, and funds placed into such escrow account may be used to address urgent safety measures;

c the walls and floors of certain buildings that are designated by presidential decree shall be constructed in accordance with the specification rules issued by the MOLIT in order to reduce noise in common living facilities; and

d the interior structure and design of certain buildings that are designated by presidential decree shall be constructed in accordance with the specification rules issued by the MOLIT in order to prevent fire hazards.

Additional amendments to the Building Act were passed on 14 January 2014 and have been effective since 15 October 2014. Such additional amendments include the following:

a certain land within a scenic zone designated by the Minister of Land, Infrastructure and Transport pursuant to the National Land Planning and Utilisation Act may be subject to special ordinances that regulate the decoration, height, etc., of the building;

b the city mayor or the provincial governor may designate a 'special construction area' for the purpose of building a creative building or structure that reflects the unique characteristics of the city or province (previously only the Minister of Land, Infrastructure and Transport had such authority); and

c certain areas designated by presidential decree that are susceptible to natural disaster must obtain prior approval for construction.

v Act on the Maintenance and Improvement of Urban Areas and Dwelling Conditions for Residents

The Act on the Maintenance and Improvement of Urban Areas and Dwelling Conditions for Residents was amended on 21 May 2014 and became effective on 22 November 2014. Some of the key changes are that one or more appraisal experts appointed by the city mayor or district alderman must be included for the appraisal process in a housing redevelopment project or an urban restoration project to increase the credibility of the process, and the consent of at least 80 per cent of the owners of land that are subject to the project (previously this was 90 per cent) must be obtained for an urban restoration project.

vi Tax Acts

Amendments to the Corporate Tax Act were made on 31 December 2011 and have been effective since 1 July 2012. Under the amendments, 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 in order to be taxed at the reduced tax rate applicable under the relevant tax treaty. In cases where the Korean-sourced income is paid through an overseas investment vehicle, such overseas investment vehicle must submit to the withholding obligor an overseas investment vehicle report, together with a detailed statement on the beneficial owner of the income, prepared on the basis of a request for the application of treaty-reduced tax rates submitted by the beneficial owners of such overseas investment vehicle. 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., reduced tax on interest and dividends) are required to submit the list of the investors (beneficial owners) to the withholding obligor.[6] Those 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, the exemptions are no longer available, pursuant to amendments to the Special Tax Treatment Control Law (STTCL), effective as of 31 December 2011. The amendments apply to bonds issued after 1 January 2012. However, interest on foreign currency denominated bonds issued outside of Korea is still exempt from income tax or corporate tax.

There is uncertainty whether a transfer of real property made by certain investment vehicles or SPCs constitutes an individual asset transfer, which is subject to VAT, or a comprehensive business transfer, which is not. This issue is important, because if the Korean tax authorities view a transaction as a comprehensive business transfer as opposed to an individual asset transfer for the tax treatment of the seller and the purchaser, the purchaser may not be entitled to the deduction or refund of paid VAT for the 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, and penalties thereon as well. Because of this uncertainty, there had been many disputes between sellers and purchasers about whether a transfer of real property constitutes a comprehensive business transfer. In this regard, effective from 1 January 2014, and pursuant to amendments to the VAT Law of Korea, the purchaser may withhold VAT from the seller when it pays the sales price for the comprehensive business transfer and pay such VAT to the relevant tax office on behalf of the seller by the end of the month in which the payment is made. If such withholding and payment of VAT is made, the purchaser can deduct the paid VAT even if the transfer constitutes a comprehensive business transfer. However, the above amendments apply only to the comprehensive business transfer; accordingly, there remain uncertainties and risks for the seller and purchaser if the Korean tax authorities take a view different from that of the seller and purchaser.

In addition to the above-mentioned amendments, there have been other amendments to the Korean tax laws in 2015. According to the amendment of the International Tax Coordination Law of Korea in relation to the thin capitalisation rules, which was passed in the National Assembly on 3 December 2014, the ratio for the thin capitalisation rules will be changed from 1:3 to 1:2, and the new ratio will apply from 2015. Accordingly, the interest on borrowings from a foreign controlling shareholder

6 To be entitled to the exemption under the relevant tax treaties, foreign funds are required to obtain the applications for exemption from the investors (beneficial owners), together with their residency certificates, and submit such applications and residency certificates to the withholding obligor in addition to an overseas investment vehicle report with the list of the investors.

(FCS) or unrelated third party with the FCS's guarantee exceeding 200 per cent[7] of its equity will not be tax-deductible and will be treated as dividend income for Korean tax purposes. Furthermore, according to the revised STTCL passed in the National Assembly of Korea on 3 December 2014, a 30 per cent reduction (50 per cent for PFVs) of the acquisition tax for REFs, REITs and PFVs has been abolished as of 1 January 2015, except for PFVs that have been established and registered with the court registry prior to 31 December 2014, which can be entitled to the 50 per cent reduction of the acquisition tax for real property acquired by 31 December 2015.

VIII OUTLOOK AND CONCLUSIONS

Korea has continued with amendments to real estate-related laws intended to promote investments in real estate, and we expect that this will further positively impact real estate investments in 2015. The tax authorities, however, have decided to not extend the reduction on acquisition taxes (see Section VII.vi, *supra*). In addition, from 1 January 2015, an REF is required to have a minimum of two investors (the regulators have not published any guidelines on the minimum amount of shareholding or whether the shareholders can be related parties). These changes may have an impact on the use of REFs and PFVs for certain types of real estate investments in 2015.

Following a considerable number of divestments in 2013 by foreign financial investors and real estate funds in Korea, due in part to the impact of the financial crisis in their home countries, we have seen foreign investors returning to Korea, and in particular acquiring trophy assets in the Seoul Central Business District and investing in hotel, retail and logistic development projects. Korean and domestic financial institutions and real estate players, including funds and asset management companies, were not affected as severely by the crisis, and continue to be active in both local and outbound investments.

The acquisition of overseas properties (including pension funds, financial institutions and real estate funds) in other countries (including Australia, Canada, France, Germany, the United Kingdom and the United States) by Korean investors increased in 2014, and we expect this trend to continue into 2015.

7 It should be noted that the 600 per cent rate for financial institutions is unchanged.

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 real estate funds 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 Law, and clerked at the Hawaii Supreme Court.

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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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