The Effect of COVID-19 on Korean Outbound Investment in Real Estate

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On March 11, 2020, the World Health Organization (WHO) declared COVID-19 a pandemic with the global infection count at 1,518,875 cases in over 214 countries as of April 9, 2020. The WHO further stated that COVID-19 is not just a public health crisis, but it is a crisis that has negatively impacted and continues to impact every sector of the global economy.

In Korea alone, there have been 10,423 confirmed cases and 204 deaths as of April 9, 2020.

As South Korea struggles with the ongoing spread of COVID-19, extremely volatile exchange rates and dampened investment sentiment are posing challenges to the country's asset management companies as they try to adopt new strategies for survival.

Outbound investment by Korean investors grew 66 percent year-on-year to $12.5 billion in 2019. Of that investment, 68 percent of the capital was deployed in Europe, 15 percent in North America and 17 percent elsewhere in Asian.

In Europe, Paris saw $3.9 billion of investments from Korean investors in 2019. This preference for France can be explained by the country's low financing costs and the hedging premium between the won and the euro.

Although Europe represents a large proportion of the Korean capital, Korean investors are also increasing their activities in the US where investment turnover increased by 33 percent year-on-year.

In early 2020, Korean investors continued to show strong interest in investing abroad. In a survey conducted before the spread of COVID-19, some 79% of Korean investors said they intended to invest outside of the Asia-Pacific region in 2020.

But for now, off-shore investment by Korean asset management firms has come to a grinding halt. Deals that have been inked, like one large AMC's $5.8 billion acquisition of luxury hotels from a Chinese insurance group, may run into headwinds when trying to find investors and lenders to close the deal.

One of the primary problems is the difficulty in conducting on-site evaluations of properties due to travel bans. That, and a strengthening of the US dollar, is putting increasing pressure on local asset management companies which have to repay debts to global lenders in dollars. Moreover, especially in hotels and retail REIT's, earnings from leasing has rapidly shrunk due to the collapse of the tourist industry around the world. Increasing vacancies and US rent strikes are posing greater uncertainty in terms of leasing revenues.

Amid the growing uncertainty, Korean asset management companies are trying to protect their investment projects as best they can while at the same time bracing for continued impact of COVID-19 on their businesses. In terms of ongoing transactions, some AMC's report that investment projects have not entirely halted, and they are doing what they can to secure investors and lenders and negotiate purchase and sale agreements, but all the while knowing that it may be some time before a physical inspection of the subject property can be completed. It is simply too soon to say when the overseas investment climate for Korean investors will stabilize enough for them to continue their activities on some sort of normal footing.

Some observers are starting to predict a three-step process over the next two years.

Phase 1: Lack of Liquidity (month 0-6, starting from January 2020)

In this Phase, transaction markets will decline, given debt unavailability and price/value uncertainty. Debt capital markets will decline, and equity capital markets will see continued volatility.

Phase 2: Balance Sheet Correction (months 7-12)

In this Phase, the cost of capital will increase, and credit ratings for certain tenants will decrease, which will have an impact on lenders, leading to higher margins. There will be increasing loan loss provisions which will eat up equity. Moreover, the transaction market will remain in decline.

Phase 3: Recovery (months 13-24)

In this Phase, markets will head toward stabilization but will not peak.

The silver lining in all of this turmoil may be a quicker and more widespread adoption of technological solutions, enabling companies to be more resilient and stable. The adoption of digital tools has been gradual and, in some parts of Asia, slow as companies lacked any compelling reasons to alter their approach. But Korean companies have always shown a particular adeptness in adopting new technologies to service emerging marketplace issues.

Now, COVID-19 has forced companies to adopt digital solutions at a much faster pace. In the retail sector, e-commerce has been critical for ensuring business survival, while in the office sector, cloud-based working tools and video conference systems have facilitated remote and home working. Some commercial real estate sectors have utilized virtual reality technology to conduct site visits and interior viewings, while artificial intelligence-enabled people flow controls have been deployed by facilities management teams to monitor the body temperature of building visitors and mitigate the spread of the virus.

Dentons Global stands ready to assist the real estate industry as it grapples with key legal and commercial issues in these unprecedented and rapidly evolving times.

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