INTRODUCTION OF REITS AND CHANGE OF CONSTRUCTION INDUSTRY STRUCTURE

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Introduction of Reits and the effect on real estate development market

In July 2001, real estate investment trusts (Reits) and corporate-restructuring Reits will be established due to new laws regarding real estate investment trusts. Reits will increase real estate liquidity by promoting trade of real estate and its related securities including corporate-restructuring real estate. In particular, lar ge scale funds financed through the stock market will flow into the real estate market. and be used to invest in areas such as real estate trade and rent business. Accordingly, Reits will invigorate the real estate market.

In July 2001, real estate investment trusts (Reits) and corporate-restructuring Reits will be established due to new laws regarding real estate investment trusts.

In three to five years, Reits are expected to invest in real estate development in order to get higher profit rates. Accordingly, the real estate development market is expected to expand through the introduction of Reits. In the early stages however, Corporate Restructuring Reits and Reits oriented to the rent business are expected to be activated. Corporate Restructuring Reits have more tax benefits for corporate, acquisition, and listing tax than general Reits. Reits oriented to the rent business can minimize investment risk.

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Table 1. Reits and Corporate Restructuring Reits

	Reits	Corporate Restructuring Reits
Law	law of real estate investment trusts	law of real estate investment trusts
Setup capital	50 billion won	50 billion won
Capital composition	70% above of real estate and its related securities	70% above of corporate-restructuring real estate
Dividends	more than 90% of profit	no restrictions
Developing business	30% of equity	30% of equity
In kind investment	possible after listing in developing business	30% of equity in setup
Tax benefits	50% deduction of acquisition · listing tax	exemption from corporation · acquisition · listing tax

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After the disposition of corporate-restructuring real estate and the disposal of established profitable rent buildings, Reits based on risk management ability will increasingly participate in the real estate development market. It is expected that the market for Reits will increase to about 30 trillion won. Therefore, considering that related laws limit the development investment to 30% of a Reit's equity, the real estate development market is expected to grow to about 9 trillion won.

Reits and structure of construction industry

Excessive debt ratios and financial costs are raising the possibility of bankruptcy and threatening the existence of the entire construction industry.

The construction industry has a shaky financial structure due to debt-oriented financing. In addition, the construction industry is faced with a crisis situation due to an industry downturn. Except for government-ordered construction works, most private construction projects depend on bank loans to finance the initial stages of construction such as land purchase. As a result, excessive debt ratios and financial costs are raising the possibility of bankruptcy and threatening the existence of the entire construction industry.

The change of the construction industry will be accelerated by the strengthened new roles of agents.

In 2000, the real estate development market is estimated at 9 trillion won amounting to 14% of gross domestic construction orders and 24% of private construction orders. Therefore, the growth of the real estate development market following the introduction of Reits will reform the structure of the construction industry by promoting professional real estate development investment and evolving the financing methods of construction companies. The change of the construction industry will be accelerated by the strengthened new roles of agents. Major new agents will include asset management companies that manage the assets consigned by Reits and developers that plan and execute real estate development, and operate the real estate.

In particular, real estate developers who connect Reits with real estate development will change the construction industry structure into one in which developers place orders to construction firms. Accordingly, several big construction companies are expected to become developers supplying real estate services

Figure 1. REITs and Construction Industry

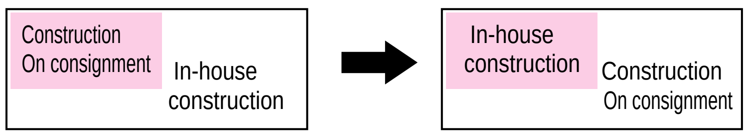
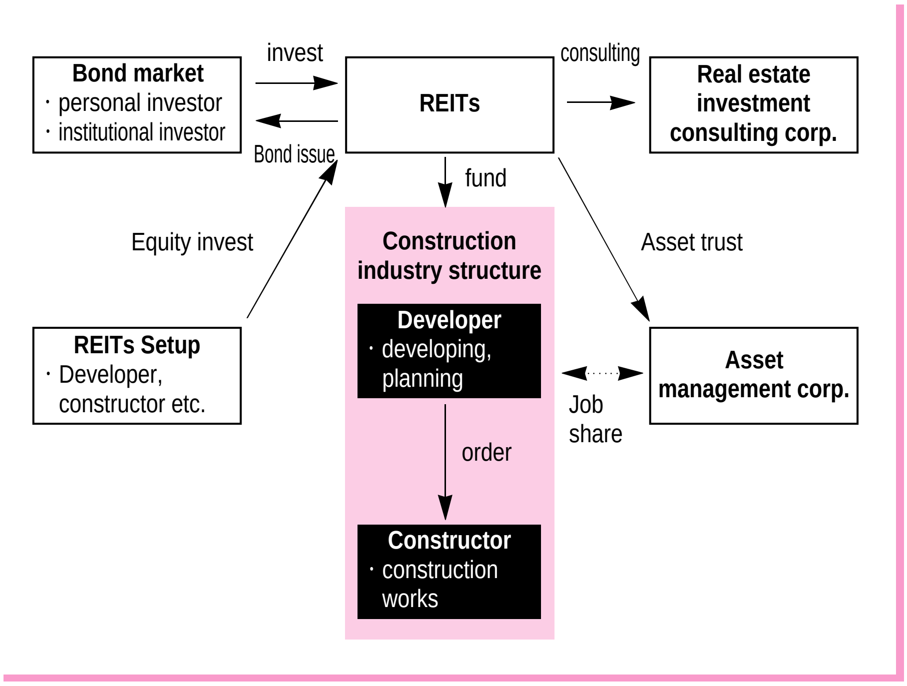


Figure 2. Business Risk of Construction Companies



including development, financing, and management. In addition, developers are expected to reduce the risk of construction companies by taking on functions such as development planning and financing.

Implications

The expansion of the real estate development market due to the introduction of Reits will require construction companies to rethink their business portfolio strategy. In the past, construction companies managed their risk through diversification such as building construction, civil engineering, and plant construction. Recently however, with the maturation of the construction industry, growth and profit rates in all fields have declined, leading to higher risk.

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Therefore, construction companies are expected to separate in-house construction from consignment construction and externalize the risk of in-house construction. They may also try to strengthen their development functions or focus on consignment construction. As the functions of Reits and developers mature, business opportunities for construction companies may arise in the after-market sector. The stimulation of Reits and developers will also create new demand in areas such as real estate maintenance and management services. VIP

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