

The Influence That Jeonse Rental System Brought to the Housing Bubble in Korea

Lancheng Fei^{1, a, *}

¹*Panyaden International School, Chiangmai, 50230, Thailand*

a. 2012004@panyaden.ac.th

**corresponding author*

Abstract: The bubble burst, and the South Korean property market plummeted. Thousands of Koreans should not be able to afford their debts and choose to commit suicide. Prior to this, South Korea's real estate market soared rapidly, and no one noticed the abnormality and the future direction of the real estate market. That was a miracle, but it only lasted for a while, and one of the most important factors that accelerated its destruction was a rental system called Jeonse. The purpose of this paper is to explore the impact of Jeonse, a unique rental system, on the Korean real estate market. Housing prices in South Korea have soared amidst the global pandemic. By studying macroeconomics, the global capital chain, and policy-related factors that affect the market, it seems necessary for the government to understand the importance of controlling leverage and properly using quantitative easing. Those methods can theoretically prevent the economic crisis, slow down the creation of bubbles, or decrease the influence made by the contagions it creates.

Keywords: South Korea, housing market, Jeonse, leverage, capital chain

1. Introduction

From the economic crisis in 2008 to the ups and downs of Japanese real estate, to the current collapse of South Korea's real estate market. For decades, the real estate market has seemed to be a place of opportunity and pitfalls. Many ordinary people made money either because of luck or because they really seized the opportunity, but at the same time, many ordinary people also lost everything in the chaos of real estate. Therefore, understanding the real estate market and real estate bubbles is beneficial for both individuals and institutions. Understanding market trends and bubbles can help investors seize opportunities and obtain good returns; buyers can buy at low prices and avoid excessive consumption; governments can optimize policies and maintain market stability. However, ignoring the housing bubble could trigger a serious crisis. The bursting of the bubble could lead to the collapse of the financial system and affect the economic stability of the entire region. Purchasing overvalued properties when a bubble is about to burst is also likely to leave individuals in financial distress. So now that the real estate market has become an irreplaceable concept, an unignorable opportunity, it seems all the more important that people care about it.

The discovery of housing in Korea started in 1968. Burns and Tjioe see the concept of housing as a tool but not a final target and introduce the International Housing Productivity Study to assess the social and economic returns of housing investment in monetary terms. Finally, they stated that investment in housing should be viewed as a productive tool for development, producing outputs

similar to investments in health and education. Their preliminary results at that time suggest that housing improves human resources and can compete as a productive investment. This perspective should guide future resource allocation and policy decisions [1].

Now, there are already a lot of researchers who have decided to put their eyes on the housing market in Korea. One of the most popular areas that people chose to research on is the macroeconomic and microeconomic related to the housing market. Back in 2003, Yoon examined issues such as rising deposit costs worldwide, economic changes, low-interest rates, and redevelopment projects, as well as addressing challenges such as volatile rent-to-let prices, security of tenure, and disputes between landlords and tenants. Investigate the factors leading to the rise of the full-rent system and shift to monthly rent in the Korean housing market. It was determined that the increase in the price of full rent and the conversion of monthly rent affected the affordability of tenants. Instability in the pass-on rental market, evictions of tenants during rising house prices, and disputes between landlords and tenants are prominent issues. Differences in payment method preferences further complicate the rental housing market [2]. Also in 2004, Kim analyzed data on residential investment, housing wealth, housing finance evolution, price trends, and their macroeconomic linkages. Thereby investigating the relationship between housing and the Korean economy, focusing on investment, housing financing, price trends, and policy implications. Finally, it was stated that housing is crucial to the Korean economy, accounting for a large part of GDP and investment, and also affecting housing price trends. Government intervention has also been suggested to affect housing supply and price volatility. Real estate market dynamics affect consumption, inflation, and macroeconomic conditions[3]. Lately, in 2023, The author Suh. employed a general equilibrium model that incorporates two region- and housing-market-specific shocks. Simulations analyze consumption, housing services, debt, and welfare impacts. Study the macroeconomic consequences of different housing cycles in different regions and assess the impact of stabilization policies. Finally, it finds that housing cycles in specific regions create economic inequality, asymmetrically affecting consumption, housing services, debt, and welfare. Housing supply policies are beneficial to affected areas, countercyclical loan-to-value ratio policies are unfavorable to borrowers, and headwind monetary policies have a limited effect on stabilizing housing prices in areas [4].

Another relatively popular area is to focus on “speculation”. Back in 2004, researcher Chung. And Kim worked on using policy to combat speculation using regression analysis and three estimation techniques. Emphasizes the influence of speculation in Gangnam District, compares it with the Japanese real estate bubble, and proposes anti-speculative measures. The presence of foam was verified using different methods. Finally, they find that speculative demand significantly drives up housing prices; bubbles exist to varying degrees. Speculative demand outpaced normal demand, driven by falling interest rates, rising money supply, and loose housing policies [5]. Same in 2009, the author Xiao. and Park. analyzed the relationship between the apartment house price index and GDP, wages, population, and rational bubble proxies from 1998 to 2006. Aiming to investigate the role of rational speculative bubbles in the sharp rise in apartment house prices in Seoul, South Korea. Assess the impact of fundamental and speculative demand factors on house prices. In the end, it was found that rational speculative bubbles drove the surge in apartment prices in Seoul. Condominium prices are more responsive to fundamental and speculative demand than townhouses or single-family homes [6].

Noticeably, politics-related areas are also a field that people chose to dig into. In 2020, the author Jang. And Song. wishes to evaluate the South Korean government’s policies to stabilize the housing market and prices by analyzing apartment prices from 2012 to 2019, concerning policy and institutional changes. Finally, three results are emphasized: the policy restrains the price rise, improves the market efficiency, and makes the price tend to be balanced, which proves the effectiveness of the policy in stabilizing prices and improving the environment [7]. And lately, in

2023, the author, Kim examines the impact of South Korea's housing policy on the housing market in the Gangnam region. By using the AITS-DID approach, it is found that policies do not stabilize prices, leading to unintended consequences. Finally, self-sufficient communities require long-term urban planning to address housing market imbalances [8].

Other than these differing research orientations, there is also research on land use and city designs. In 2017, Kang evaluated the effect of spatial accessibility and centrality on housing prices in Seoul, South Korea by using a multilevel hedonic price model combined with street configuration and building density indicators to assess the impact of land use on housing prices (2010). Finally, the mixed-use of land is emphasized in the conclusion, highlighting the need for an efficient transport network, buffer zones are crucial to mitigate the negative impact of industrial land use, etc [9]. Another study by Yun also presents a youth universal rental housing program in South Korea that utilizes a unique universal tenure system. It demonstrates how the program can have a positive impact on beneficiaries without negatively impacting the community. Adopting the hedonic price model and the hierarchical linear model, it highlights that the plan combines the policy characteristics of the demand side and the supply side. This innovative attempt provides new insights into housing challenges [10].

There were not many people focused on the term Jeonse and the influence it brings to the housing market. Therefore, this paper will focus on the concept "Jeonse", and analyze from different perspectives linking to the bubble it creates and what the government can do to deal with it.

2. Jeonse Description

Jeonse is a method of leasing real estate that has become particularly popular in Korea in recent years. On the surface, this form of leasing seems to be no different from free. Under this structure, when the deal is closed, tenants will pay the landlord a deposit of 50% to 80% of the purchase price. It is worth noting that when the landlord receives the deposit, they have the right to do anything with the money. After this process, tenants can move in at any time. The important thing is that when the rental period expires, the landlord will be required to return the deposit received from the tenant when renting the house to the tenant intact. At this point, it looks like the tenant is living in someone else's house for free for a while.

3. The Evolution of Jeonse

Since the 1900s, the structure of Jeonse has already existed. However, after the establishment of the Republic of Korea in 1958, governments acknowledged its legality and clarified some rules within the structure of Jeonse in their civil code. Therefore, seeing 1958 as a threshold, this new and special method of house renting started gradually getting more popular. With the rapid economic growth of South Korea in the 1970s, a large number of people flooded into the city. The model of Jeonse quickly became popular. Due to the serious shortage of urban housing, and the situation a lack of housing forms like public rental housing that can replace Jeonse while the housing price was significantly increasing. Like this, until the 21st century, a majority of the population in Korea already decided to put their money on Jeonse to stably gain more benefits from it. Plus the increase in the demand specifically for Jeonse was caused by the lower interest rates every year. Until 2020 when the covid - 19 reached a climax globally, the interest rate in Korea already was lowered to 0.5% by the government, and this is also a significant reason for the creation of the housing bubble. Simultaneously, this movement caused more people to take their assets out of banks and put them into the market of Jeonse.

4. A Utopian Benefit Triangle? Three Winners at the Same Time?

For a normal resident in Korea, it is worth it if they only need to pay some rental deposit that is going to be given back when renting time runs out, then basically you can live in the house for free. In this situation, tenants are usually happy about the deal. On the other hand, as a landlord or the owner of the house. In a situation where the interest rate is extremely low and using the deposit from tenants to start more cycles, Jeonse can gain comparatively more benefits than leaving those deposits in banks. Therefore, with extremely high leverage, a lot of people decided to focus on Jeonse and bought a big number of houses. As a result, the majority of them made a lot of money with the cycle of buying a house and using Jeonse to attract tenants. In this situation, most landlords are satisfied with their results. At the same time, banks also gained a lot of benefits according to the extremely broad range of their housing-related business scale. Most banks get a huge amount of money based on the spread of income. That can mostly replace the loss of money deposited by people. And in this situation, these banks are staying very positive about their financial results. Certainly, if the housing prices are not falling, the three sides: tenants, landlords, and banks would always be in a situation of triple-win, where everyone is gaining profit. However, the reaction of the Korean government to prevent losses when the FED was raising their interest rates was to increase their interest rate. When the interest rate got higher, it might be more valuable to put money into the bank than doing any Jeonse that has 0 income from interest.

5. Fall

The triple-win situation of the housing market in Korea created by the system of Jeonse dramatically raised the housing price. The housing index in Korea rose from around 80 in 2020 to more than 100 after 2022. But these rises are only because of the low interest rate in Korea. Therefore, when the interest rate was raised by the government in 2022, the triple-win would surely be destroyed. The Jeonse creates a capital chain that seems ideal and sustainable, but behind the appearance, when the housing market starts falling, the landlord would likely be in danger. With the increases in the interest rate, a lot of tenants chose to take their money back and put them back into the bank. But at the same time, landlords who use high leverage to buy more houses are now under a higher debt. This caused a lot of them to lose the ability to give tenants their deposits back as they should. With that, a lot of landlords flee with tenants' money, whereabouts unknown. This again leads to a disaster on the side of tenants. Those who get loans to pay for the Jeonse housing then get no payback from the landlord, so they are in trouble paying the loans to banks. Therefore, the capital chain ruptures, bubbles burst, and the entire housing market collapses. Those disasters became the haze over Korea, a huge number of people deficit and lost everything, and many of them chose to end their lives themselves. And looking back to the bubble at the beginning of everything, the Jeonse system is truly a factor that accelerated the rise of the housing market, and the creation of the bubble that destroyed everything in the end.

During the creation of the bubble, the Korean government did not notice that there would be a dangerous bubble soon caused by the Jeonse rental system. The Covid-19 pandemic forced Korea to lower its interest rate. However, even though they knew that lower interest rates meant higher market liquidity, they were ruling the entire housing market with a relatively loose policy. In this kind of economic environment, a lot of people chose to do something about leverage and believed that they were soon going to be rich. Without many kinds of protective behavior in the housing market, the housing price increases dramatically with the fake "ideal benefits triangle". Not long after that, the bubble was finally ready to be popped.

To effectively avoid the creation of a bubble when the "ideal benefits triangle" is increasing the housing price rapidly, the supervision of the risk of capital chains is relatively important. The collapse

of the capital chain is one of the major issues that pop the bubble. When landlords lose the ability to pay back the deposits back, tenants would accordingly have no money to pay for their loans from the bank as they should get that money from their landlords. At the same time, plenty of tenants fall into the same trap, so this somehow pushes the problem into a regional issue. And to avoid this, a harsh law is surely necessary to solve the problem with power. The government plays an irreplaceable role in the economic system, it is usually the powerful player that has authority to change the foundation of the system. Therefore, with some rules set by the government, it might be possible to actually avoid the disaster.

To find some ways that effectively avoid the collapse of a capital chain, looking at the risk of trades and business could be a solution. Therefore, “leverage”, the degree that measures risks could be a spot to focus on. When the leverage is high, it means that the loan on this person is a lot more than the money he had originally. Simultaneously, when the leverage is lower, the risk of the business is comparatively lower. Therefore, the aim of the regulation is simply to supervise and control the degree of leverage people take to try to gain profits. With a limited leverage degree, landlords will not be able to expand their range of business by getting loans from banks. On the other hand, it will also prevent a large number of tenants from getting into the Jeonse market and renting houses with the money of the bank. With the regulation, the creation of a housing bubble will be a lot slower according to the low leverage. Therefore, the risk of an economic collapse would be proportionally lower when limiting the degree of leverage.

On the other hand, imagine that the bubble has already popped. There should be other ways for the government to control the disaster and minimize the loss. Before digging into the field of networks to find something useful, it is necessary to understand that since the time when the bubble was first created, it will surely explode someday in the future. There is no way to make a housing bubble completely disappear, what can be done is just to minimize the influence it causes by setting something up in a limited amount of time. Between the influence of the popped bubble spread along the entire country, there is a short period for the ruler to react and make serious decisions. Mentioned that no one is able to completely stop the influence after it is already there, so the target here is just to somehow reduce the impact of the contagion, and find several methods to achieve a soft landing in the crisis. Eventually, the economic disaster won't damage the economy entirely.

If governments want to deal with the aftermath of the contagion, they have to lose some other things to fix the issue. The main problem of this contagion is the lack of market liquidity caused by the collapse of the capital chain within the “ideal benefits triangle”. Aiming to increase the market liquidity, an easy way is to simply decrease the interest rate again. However, if the gap between the Korean interest rate and the rate of the FED is too big, a lot of funds in Korea will flow to the US. This is surely going to somewhat make the situation better, but compared to preventing the consequences of a bubble in the housing market, it is more important to follow the US raising their own interest rate to prevent capital outflows, maintain exchange rate stability, and curb inflation. Other than decreasing the interest rate directly, there is another emergency method to use to increase the market liquidity. It could work if the government directly injected money into the market, which is “Quantitative easing”. Noticeably, this method is also going to decrease the interest rate, but the degree of interest rate it lowers is a lot less than directly decreasing the interest rate. At the same time, during quantitative easing, the central bank also buys government bonds or financial assets to increase the money supply in the market. This stimulates the market that is in danger just like doing CPR to a shocked person. With the risk of inflation and the consequences that money is flowing to the US, Quantitative easing would theoretically decrease the impact of the contagion made by the bubble and achieve a soft landing. Overall, quantitative easing is a possible solution facing the contagions made by the popped bubble, but at the same time, it would also damage the economic system to various degrees. Governments need to weigh the pros and cons of doing that and make their choice.

6. Conclusion

Until now, the paper discussed what happened during the bubble in the housing market in Korea, how Jeonse accelerated and strengthened the power of the contagions after the bubble, what the possible preventive measures for the creation of the bubble, and the solutions that can save the market after the bubble is popped. During the creation of the bubble, the Joence system caused the “ideal benefits triangle” where the tenants, landlords, and banks were all happy about their gains. However, as soon as Korea decreases its interest rate, the high degree of leverage directly breaks the capital chain. The dangerous contagions created by the high degree of connection within the benefits triangle quickly spread throughout the entire Korea. On the other hand, to effectively prevent it, controlling the leverage would effectively lower the risk of collapsing capital chains. If the bubble has already popped, quantitative easing is the last solution that would simulate the market and carry out a successful soft landing. In the end, economic crises seem like something that’s unavoidable or it is simply associated with the development of the financial system. However, I believe that since more researchers are starting to dig into this field, there will be ways found to eventually predict a crisis or a bubble.

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