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Research Report

Rental Housing Policy in Response to the Increase in the Share of Wolse (Monthly Lease)

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Rental Housing Policy in Response to the Increase in the Share of Wolse (Monthly Lease)*

Inho Song, Fellow at KDI

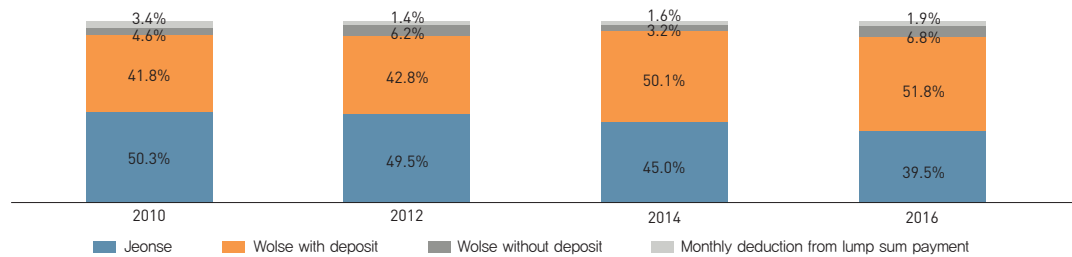
“In Korea, jeonse is continuing to decrease while monthly leases (‘wolse’ in Korean) increase, particularly among the young and senior populations. Indeed, compared to other age groups, they face larger financial and credit constraints. Thus, a market for wolse with deposit must be created with quality homes and varying deposits to establish a broader range of housing choices for these groups. To that end, policy efforts are needed to eliminate any loopholes in support programs in order to secure housing stability for senior wolse tenants who are in the bottom income decile.”

I . Increased Proportion of Wolse and Changes in Rent Prices

There are three types of monthly leases or wolse in the Korean rental market: security deposit with monthly rent (or ‘wolse with deposit’), monthly rent with no deposit, and deduction of monthly rent from a lump sum payment. However, all methods of wolse are swelling in number as jeonse (or key money deposit, referring to a large lump sum payment without monthly rent) continues to decline. Indeed, the proportion of wolse reached 55.0% in 2014, outgrowing that of jeonse (45%), and gained another 5.5%p in 2016 to mark 60.5%. The increase was mainly driven by the growing proportion of wolse with deposit, which accounts for 85.6% of the wolse market and 51.8% of the total rental housing market, as of 2015.

* Based on Song, Inho, *Policy Responses for the Rental Housing Market*, Policy Study 2016-04, Korea Development Institute, 2016 (in Korean).

[Figure 1] Changes in the Proportion of Jeonse and Wolse



Note: Wolse includes wolse with deposit, wolse without deposit and monthly deduction from lump sum payment.

Source: Ministry of Land, Infrastructure and Transport, Korea Housing Survey, 2006-2016.

<Table 1> Changes in the Rent Prices of Apartments Converted from Jeonse to Wolse with Deposit

(10,000 won)

	Jeonse → Wolse with deposit (27,223 households)			
	Before conversion		After conversion	
	Deposit	Wolse	Deposit	Wolse
Average	19,284	0	18,252	27

Source: Ministry of Land, Infrastructure and Transport, Korea Housing Survey, 2016.

Low interest rates cause jeonse lessors to increase the deposit or convert to wolse with deposit.

One of the main factors spurring the surge in wolse is low interest rates (2-3%). From the lessor's perspective, low rates mean low returns. As a result, many lessors choose to raise jeonse or convert it into wolse with deposit altogether, at a conversion rate of 6-7% (the annualized rate in converting jeonse to wolse). Needless to say, lessors will continue to choose wolse over jeonse if the interest rate persists at the current low level and conditions remain unchanged.

The rise in the supply of wolse and decline in that of jeonse occurs mainly when the jeonse contract expires; it is at this time that most lessors make the changeover to the wolse-with-deposit system. According to the 2016 Korea Housing Survey by the Ministry of Land, Infrastructure and Transport, the average deposit for apartments that switched from jeonse to wolse with deposit decreased by 10 million won, from 190 billion won to 180 million won. Meanwhile, the average wolse rose by 270,000 won (yearly 3.24 million won), which is equivalent to an increase of 100 million won in jeonse at the current interest rate—provided that 100 million won equates 3% in interest yields.

For apartment rentals that remained jeonse, the key deposit sum rose 30 million won, from 170 million won to 200 million won. Simply put, it has become more profitable for lessors to convert to the wolse system. The profit gap between jeonse and wolse with deposit can be understood by the gap between the interest rate (3%) and conversion rate (6-7%).¹⁾

The reason why tenants accept this transition from jeonse to wolse is as follows. While lessors are in an advantageous position with relatively strong bargaining power and have the option to raise jeonse or convert to wolse, it is highly likely that tenants have little choice due to difficulties that include a shortage of money (lump sum) to pay for the increased jeonse, credit constraints

1) The conversion rate is higher than banks' interest rate because the wolse risks of lessors (e.g. lack of monthly payments) are added onto the interest rate (risk-free). Meanwhile, jeonse tenants face credit (loan) constraints and have difficulty in moving to other jeonse homes that demand more money.

Lessors make use of their strong bargaining power to induce tenants to choose wolse instead of jeonse amid the growing trend of high jeonse deposits.

<Table 2> Rent Prices: Before (Jeonse) and After Conversion (Wolse with Deposit)

(10,000 won)

Rent prices: before and after conversion	Before conversion (jeonse)		After conversion (wolse with deposit)			
	All housing types	Apartment	All housing types		Apartment	
	Deposit	Deposit	Deposit	Wolse	Deposit	Wolse
Renewal Contract (Average)	16,904	20,505	3,855	25	4,168	18
Previous Contract (Average)	14,354	17,448	3,770	16	4,085	14

Source: Ibid.

and limited jeonse homes on the market. According to the Housing Perception Survey by Gyeonggi Research Institute, 39.2% of lessees answered that wolse entailed less financial burden while 23.3% pointed to a lack of jeonse housing and 10.8% to a small household.²⁾

Meanwhile, the deposit itself varies considerably between jeonse and wolse with deposit—the average deposit for jeonse³⁾ is 170 million won while that for wolse with deposit is 39 million won. This implies that tenants under wolse-with-deposit contracts would be more financially burdened if they shift to jeonse.

II . Rent-to-Income Ratio (RIR) in the Rental Housing Market

In this study, the proportion of housing expenditure in current income (including earned and business income, property income, social insurance benefits, government grants and private transfer income) is expressed through the rent-to-income ratio (RIR). For instance, an RIR of 30% means that 300,000 won of an income of 1 million won is spent on housing.

Wolse tenants exhibit a higher RIR than jeonse tenants. As of 2016, the RIR of the former is 32.1%, which is 10.1%p higher than that of the latter (22.0%). Additionally, the average monthly income of wolse tenants is about 1 million won lower.

There are several reasons why the income of wolse tenants is lower than that of jeonse tenants. Firstly, wolse tenants are mostly comprised of the young (under 30 yrs) and senior (over 60 yrs) populations. Moreover, their numbers are quickly increasing. In fact, there has been a marked decline in jeonse and increase in wolse among these two groups. Specifically, the proportion of young wolse tenants increased by 5%p from 74% in 2014 to 79% in 2016 while that of senior tenants ascended by 7%p from 56% to 63% over the same period.

Additionally, as aforementioned, young and senior wolse tenants have low monthly incomes, with 43% of the former and 59% of the latter falling into the 2nd income decile (D2); meaning they earn less than 1 million won per month. In particular, most seniors are concentrated in D2 and as such, are in a comparatively weaker position than the young in terms of income distribution.

The RIR of wolse tenants is higher than that of jeonse tenants.

The rental housing market is exhibiting a continued trend of decreasing jeonse and increasing wolse particularly among the young and seniors.

The level of monthly income of the young and seniors is mostly lower than other age groups.

2) Gyeonggi Research Institute surveyed tenants in Gyeonggi province regarding their reason for choosing wolse (Nam *et al.*, 2014).

3) Based on the median price of rent. No meaningful changes were observed when taking into account other median prices, e.g. the median deposit of wolse with deposit is 15 million won while that of jeonse is 130 million won.

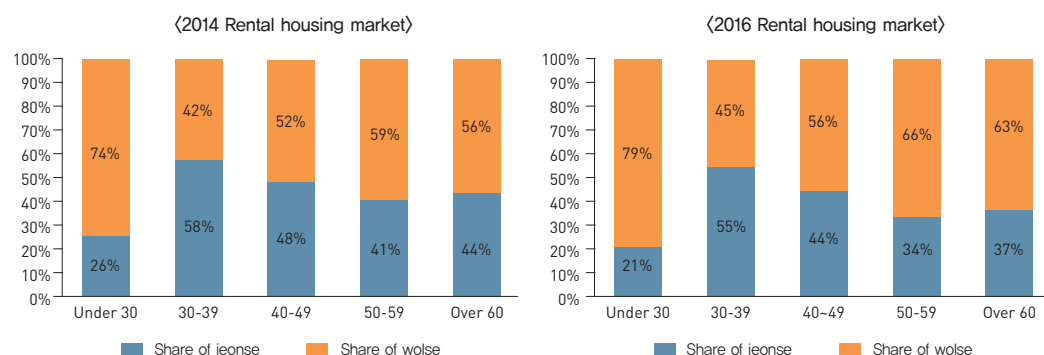
<Table 3> RIR Comparison between Jeonse and Wolse Tenants

	2016	
	Wolse	Jeonse
Average RIR	32.1%	22.0%
Median RIR	25.5%	17.1%
Average monthly income	2,130,000 won	3,060,000 won
Median monthly income	2,000,000 won	3,000,000 won

Note: Housing expenditure includes monthly rent and utility bill (water, lighting and heating). Housing expenses (RIR x monthly income) for wolse and jeonse tenants are at a similar level on average as a conversion rate of 3% was applied.

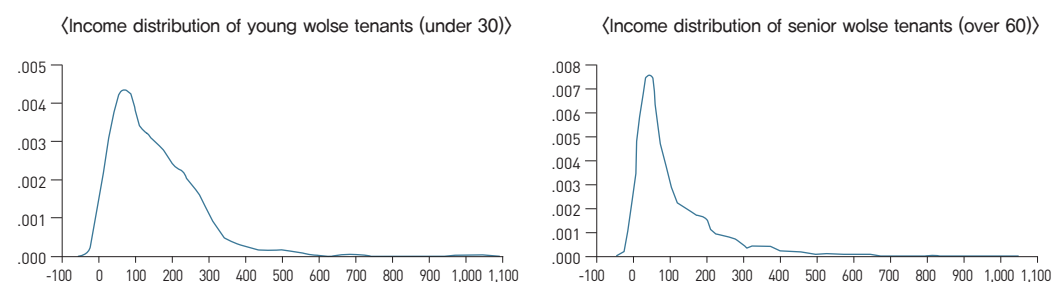
Source: Ibid.

[Figure 2] Proportion of Rental Housing by Age Group



Source: Ibid.

[Figure 3] Income Distribution of Young (under 30 yrs) and Senior (over 60 yrs) Wolse Tenants



Note: Income distribution is Kernel density estimates and also can be expressed in income density. Vertical axis is as of 10,000 won.

Source: Ibid.

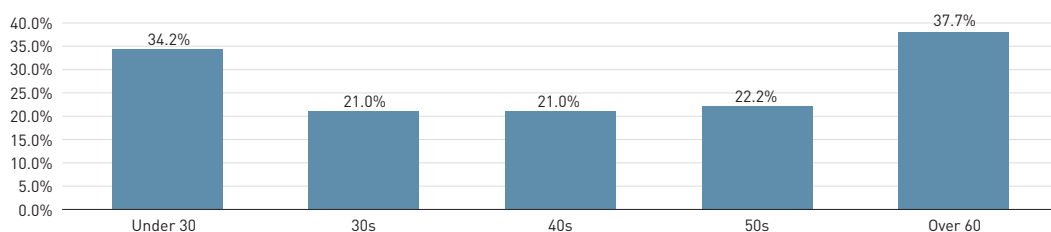
The RIR of young and senior wolse tenants is higher than that of other age groups.

Almost a half of senior wolse tenants in the bottom income decile were found to spend over 50% of their income on housing.

Accordingly, low-income young and senior wolse tenants have to shoulder a higher RIR than other age groups. The RIR of these groups were recorded at 34.2% and 37.7% in 2016, respectively, much higher than the 20% of other age groups.

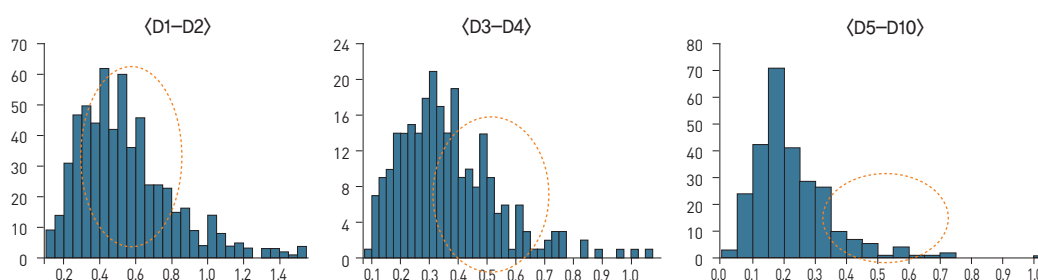
With regards to the senior population, which is in an even weaker position than the young population in terms of income, the RIR of wolse tenants rises significantly in line with a fall in income. Senior wolse tenants with a RIR of over 30% account for 20.1% of D5-D10 and 60.6% of D3-D4. For those in the bottom (D1-D2), the proportion soars to 82.5%, with the majority on government housing support (targeted at those in D1-D4 whose RIR is over 30%). Furthermore, 48.7% of senior citizens were found to be spending over 50% of their current income on housing.

[Figure 4] RIR of Wolse Tenants by Age Group



Source: Ibid.

[Figure 5] Distribution of the RIR of Senior Wolse Tenants by Income Decile



Note: The horizontal axis is on a decimal point basis: for example 0.4 is an RIR of 40%. The horizontal axis denotes observation frequency.

Source: Ibid.

<Table 4> RIR of Senior Wolse Tenants by Income Decile

Income RIR	D1-D2		D3-D4		D5-D10	
	%	Cumulative	%	Cumulative	%	Cumulative
0-30%	17.5	17.5	39.4	39.4	79.9	79.9
30-50%	33.8	51.3	43.5	82.9	16.2	96.1
Over 50%	48.7	100	17.1	100	3.9	100

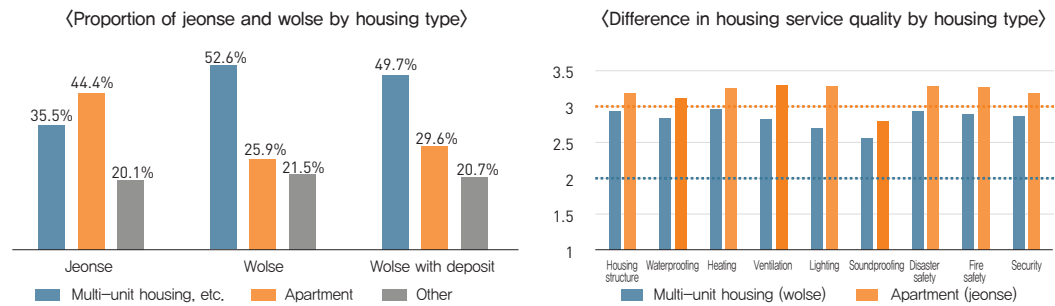
Source: Ibid.

III. Housing Service Quality: Jeonse vs. Wolse

Of all rental housing, apartments account for 44.4% of jeonse while multi-unit housing (including commercial and general detached houses) account for 52.6% of wolse. Indeed, the difference in the quality of housing service is most notable for the two.

According to the housing service quality survey conducted for nine categories—housing structure, waterproofing, heating, ventilation, lighting, soundproofing, safety and security—on a scale of 1 to 4 (1=poor, 2=slightly poor, 3=slightly adequate and 4=adequate), apartments scored a holistic average of 3.3 while multi-unit housing scored an average of 2.7. In fact, apartments scored above 3 in almost all categories while multi-unit housing scored below 3 in all nine, pointing to a quality gap between jeonse and wolse.

[Figure 6] Proportion of Jeonse and Wolse and Difference in Housing Service Quality by Major Housing Type

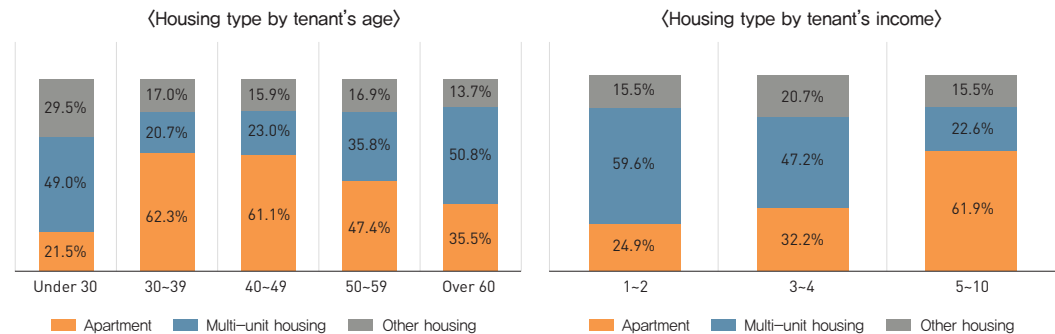


Note: 1) Vertical axis: 1 = poor, 2 = slightly poor, 3 = slightly adequate and 4 = adequate.

2) Other types of housing include row houses, multi-household housing and officetels.

Source: Ibid.

[Figure 7] Housing Type by Age and Income of Tenant



Source: Ibid.

When the survey was confined to housing types for wolse with deposit, apartments scored 3.3 on average, while again, multi-unit housing scored lower at 2.8. On the other hand, the quality of other housing, including row houses, multi-household housing and officetels, scored 2.7-2.8 on average, similar to that of multi-unit housing. In fact, these two types of housing [other housing and multi-unit housing] accounted for 70.4% of the wolse with deposit market. This implies that the market for quality housing has yet to fully develop.

If the housing type is examined by age group and income level, most young (78.5%) and senior (64.5%) tenants lived in 'other housing' or multi-unit housing. Moreover, 75.1% of low income households in D1-D2 were found to live in either of the two types.

Most young and senior tenants live in multi-unit housing or 'other housing' with poor service quality.

IV. Rental Housing Policy in Response to the Increase in Wolse

1. Housing Support for Low-income Seniors

The results of this study reveal that low-income seniors living in wolse housing shoulder a

significantly higher burden in terms of housing expenses. For instance, almost a half of low-income senior walse tenants (D1-D2) are spending more than 50% of their income on housing. This, in turn, could pose a risk to their housing stability. Thus, a mechanism that can secure a certain level of housing stability must be offered to the poorest senior walse tenants.

Of all senior walse tenants, 274,000 households belong to the lowest income decile (D1), and within this group, 96,000 live in public rental housing while 105,000 are subsidized with a government housing allowance. This means an estimated 73,000 senior walse tenants are neglected. The figure is higher still if the beneficiaries of both are also accounted for.⁴⁾

Hence, the rent standard for low-income groups should be updated and other criteria for priority recipient selection must be formulated so that no vulnerable groups are neglected from housing support. To that end, efforts should include close collaboration between the government and relevant organizations (by integrating the housing support databases of local governments, Korea Land & Housing Corporation (LH) and Korea Inclusive Finance Agency) and setting up a single control authority to establish a mechanism that can efficiently provide housing support.⁵⁾

In addition, the rental housing policy—including a guaranteed limit for jeonse loans—must prioritize the distribution of resources to vulnerable groups such as low-income and senior households above all others. This is because, despite the existence of blind spots in the housing support for low-income seniors, a certain portion of the financial resources for the rental housing policy is being given to ordinary households regardless of their income level. For instance, regardless of the fact that the loan conditions of the housing finance system applies to only low-income households, ordinary households can easily borrow a maximum of 0.3 billion won in the form of a jeonse loan at an annualized rate of 2.3-2.9%.

Of senior walse tenants in the bottom income decile (D1), an estimated 73,000 are excluded from the government housing support program.

The financial resources for the rental housing policy need to be distributed to vulnerable groups such as low income and senior households.

2. System Improvements to Create a Quality Market for Walse with Deposit

In the midst of a rapid increase in the number of single-person households and senior citizens, there has been a continued decrease in jeonse and an increase in walse in Korea's rental housing market.⁶⁾ This is particularly true for the young and senior populations, who have a tendency to select low quality housing due to financial and credit constraints. Considering the significant differences in the quality of housing services and rent deposits between jeonse and walse, a rental housing market must be created that enables tenants to choose from a variety of quality walse housing with varying deposit amounts.

For this, a revision must first be implemented of systems connected to rental income to encourage

A rental housing market must be created where financially burdened tenants can choose from a variety of quality walse homes with varying deposits.

4) Chun (2017) estimated approximately 130,000 households in D1 received no housing support.

5) An inefficient delivery system creates loopholes in housing support. Examples are ① households are not aware of their entitlement to housing support benefits, ② administrative authorities fail to notify the concerned households and ③ the concerned households fail to report their income condition to the registration authority.

6) Song (2016) observed that when a tenant is older and has fewer household members, he/she is more likely to choose walse than jeonse. Considering that the increasing walse housing in the rental housing market is connected to social structural factors, the existing rental housing policy, which mostly focuses on jeonse agreements, needs to be revised in a direction that could bring a balance between jeonse and walse.

a better supply of jeonse housing and smoother transition from jeonse to wolse with deposit. As an example, income tax for wolse is currently only applicable to wolse lessors with two or more homes, while it is applicable to jeonse lessors with three or more homes (or when jeonse deposits exceed 300 million won). This could act as an incentive for owners of two homes to convert to jeonse in order to evade taxes. Indeed, if the income tax were to be the same for both wolse and jeonse, this could contribute to bringing a regulatory balance to the market.

The New Stay project needs to shift its focus towards using existing rental apartments (unoccupied) instead of building new ones.

Meanwhile, to enhance the housing stability of the middle class, the government has pushed for the 'New Stay' project which aims to upgrade wolse homes (mostly multi-unit housing) and supply quality wolse apartments with varying deposits. Such a policy goal is certainly in line with a policy direction that well reflects the recent changes in the rental housing market.

However, the project has been criticized as private construction companies benefit through tax credits, split taxation and eased regulations on building permits, without regard for vulnerable groups, which has in turn, triggered controversy over fairness. To tackle this problem, the project needs to shift its focus towards utilizing existing rental apartments (unoccupied) instead of building new ones. For instance, if an individual provides an existing apartment for wolse with deposit with similar terms as the project (eight-year period with maximum 5% rent increase), the person should be given government incentives such as tax credit.

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