



ARTHUR I. SEGEL

## New Songdo City

In April 2005, somewhere over the Pacific Ocean on his flight back from Incheon, South Korea to Boston, John Hynes kicked off his muddy shoes and tried to relax. He had just spent many hours surveying a 1,500-acre reclaimed land site<sup>a</sup> and future home to New Songdo City, a massive development project that proposed to build an entirely new city literally from the ground up. Once finished, 30 million square feet of residential and 50 million square feet of office and retail space would have been built to serve 65,000 residents and 250,000 workers. Hynes was the CEO of Gale International, which had been selected as the lead developer by the Korean government in 2001.

New Songdo City was the centerpiece of South Korea's vision to become the principal business hub in northeast Asia. The government had already invested \$6 billion in the state-of-the-art Incheon International Airport and the land reclamation project in support of the vision. With its strategic location, advanced infrastructure, and business-friendly environment, New Songdo City offered multinational corporations an attractive base for operations in the region. (See **Exhibit 1** for a map of the region and New Songdo City.)

On Hynes's mind was the unique design of the city. In 2001 he had hired Kohn Pedersen Fox (KPF) to design a high-quality urban living experience that would be critical to successfully marketing the project. Hynes believed that KPF was one of the few architectural firms that possessed the international experience and scale to tackle a project of this magnitude, and in the fall of 2003 he was very pleased with the master plan. However, he was also well aware that new-city designs had been tried and widely criticized in many areas of the world. Hynes believed that it was possible to design a city with charm and personality from its inception, but critics thought that those traits would need decades to evolve as they had in the great cities of the world.

Even if a modern utopia could be built overnight, skeptics questioned whether the quality of life would be enough to persuade companies to move to the future city over alternatives such as Shanghai, Hong Kong, Tokyo, and Seoul. Hynes was making a big bet that superior design coupled with tax breaks from the Korean government would stimulate demand for a city that did not yet exist. Pre-construction commitments from corporations and residents would be critical to the success of the project.

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<sup>a</sup> A reclaimed land site refers to an area that has been converted from water to land.

Aside from the design and marketing challenges, the construction and financing timeline weighed heavily on his mind. Necessary permits were taking longer than anticipated, and cash from a \$180 million loan that Hynes secured in 2004 would run out in a matter of months. He had been successful to date in continuously refinancing debt on a short-term basis, but he was negotiating a critical \$1.5 billion loan that would sustain the project for at least the next few years. The project was estimated to require at least 10 years and more than \$20 billion of investment to complete.

Hynes reclined in his seat and tried to get some sleep. New Songdo City offered him the opportunity of a lifetime, but he wondered how he found himself responsible now for building a city 6,000 miles away after starting as a Boston commercial leasing agent 20 years ago.

## A New Engine for Growth

South Korea's rise from the ruins of the Korean War (1950–1953) was nothing less than an economic miracle. Starting in 1960, South Korea's economy grew at an 8% average annual rate over the next 30 years, and the country developed into a major industrial and manufacturing power.<sup>1</sup> The government's export promotion policies gave rise to the chaebols,<sup>b</sup> which established Korea's strength in electronics, chemicals, auto production, shipbuilding, textiles, and steel.

During the 1990s, other Asian countries such as China, Thailand, and Malaysia emerged as competitors. With nearly 70% of Korea's manufacturing having already moved to China in the past decade, the Korean government reexamined the country's position in the global economy, a task that took on greater urgency after the 1997 Asian financial crisis had exposed the flaws in Korea's development strategy.<sup>2</sup>

To build a new engine for growth, the government declared in August 2003 the formation of free economic zones (FEZs) in the port areas of Incheon, Busan/Jinhae, and Gwangyang. These FEZs were to help Korea transform itself into a service-based economy and become the central hub for commerce in the region.

Northeast Asia represented tremendous economic strength and potential with a combined population of 1.5 billion people across Japan, China, and South Korea (see **Exhibit 2** for country macroeconomic data). The region was expected to lead growth for the global economy in the twenty-first century and contribute 30% of the world's gross domestic product (GDP) by 2020.<sup>3</sup>

North Korea, however, posed a threat to regional security. Its authoritarian regime and its nuclear weapon ambitions threatened to destabilize the tense peace that had existed along the world's most heavily armed border, where thousands of U.S. troops were also stationed.

### *Incheon Free Economic Zone and New Songdo City*

Located on Korea's western coast 40 miles southwest of Seoul, the Incheon FEZ offered many enticements to foreign businesses and investment in the form of no tariffs, corporate and personal income tax exemption, inexpensive land, flexible labor policies, English-based administration, relaxed foreign currency regulations, and foreign-owned and -operated schools and hospitals.<sup>4</sup>

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<sup>b</sup> Chaebols were large conglomerates that dominated Korea's economy by diversifying across multiple industries. For example, Samsung, one of the largest chaebols, had leading businesses in semiconductors, electronics, financial services, and shipbuilding.

New Songdo City was a key feature of the Incheon FEZ's plan to create an attractive environment where its target foreign residents could both work and live (see **Exhibit 3** for location of New Songdo City site). Originally intended to be a cyberport prior to the Asian financial crisis, New Songdo City was envisioned in the revised plan as an international hub city that featured Korea's high-tech prowess.

With its goal of becoming the key logistics and business center in the region, the Incheon FEZ also offered the Incheon International Airport, an ultramodern facility that opened in 2001 at a cost of \$5 billion and was still undergoing expansion. Construction of a bridge linking the airport directly with New Songdo City was expected to be completed in 2008. Once finished, travel time by car between New Songdo City and the airport was expected to be 15 minutes, allowing New Songdo City's residents and travelers easy access to the 700 million people, or 50 cities with populations greater than 1 million, within three and a half hours' flight time from Incheon.<sup>5</sup>

## John Hynes's Background

John B. Hynes, III, grew up in Boston, Massachusetts, where his family enjoyed a well-known legacy. The city's convention center was named in honor of his grandfather, John B. Hynes, I, who served as a popular mayor of Boston from 1947 to 1960. The senior Hynes's term in office began rather unexpectedly when both the incumbent mayor and the city council president were sent to prison for mail fraud. State legislative member and future speaker of the House of Representatives, Tip O'Neill, appointed the senior Hynes, a city clerk at the time, to become mayor overnight.

John B. Hynes, III, was a gifted athlete and was recruited to play baseball at Harvard University. It was on the ice rink, however, where Hynes stood out as a star goalie and captain of the hockey team. Chet Stone, Harvard's longtime equipment manager, noticed Hynes for other reasons. He described him as a hard worker who "was a smart kid, with good looks, intelligent as anything, and he had a way with people. He had leadership. I thought maybe someday he'd be mayor of Boston."<sup>6</sup> Upon graduation in 1980, he was drafted by a professional hockey team, but a knee injury led Hynes to pursue other interests. He chose to remain in Boston and took a job as a commercial leasing agent.

Hynes enjoyed great success, leasing 6 million square feet of space over the next 17 years. In 1997, Stan Gale, founder of the development firm The Gale Company, approached Hynes with the opportunity to open a Boston office. Gale brought strong relationships with Morgan Stanley and wanted to invest in value-add deals in the Boston area. Hynes initially rebuffed the idea, but in 1998, when approached again, he was ready to try something new and accepted the offer. In 1999, Hynes set up his office with himself, two desks, an assistant, and a mandate to "find deals." He recalled the difficult start to the venture:

In the next six months, I underwrote 20 deals, of which we did zero. The market had gotten so strong. Vacancy rates had gone from 20% to 2%-3%. We had missed the market by two years. There just were not any value-add plays that made sense. I did notice that there were very few development deals coming online, but I knew that a half-dozen or so had been approved by the city but had never been built. I told Stan we should get them.<sup>7</sup>

Hynes did just that. One Lincoln Street, a site originally approved for a 37-floor tower in 1992, went bankrupt and had never been developed. Another developer then held a two-year option on the property that was set to expire in 90 days unless the developer raised the requisite financing to secure the adjacent sites. With his detailed knowledge of the Boston market and a back-of-the-

envelope analysis, Hynes secured financing for the project, approached the property owners the day the other developer's option expired, and convinced them to grant him the development rights.

Gale and Hynes initially put up the equity to repermit the development for a 1 million-square-foot, 36-story office tower with an estimated total project cost of \$350 million. At the time of this initial investment market rates were \$53–\$55 per square foot, but tenants were unwilling to sign preconstruction leases at higher than \$45 per square foot. Convinced that rates would move upward, Hynes began construction of One Lincoln Center with no prelease commitments from any tenants. In May 2001, State Street signed a record 20-year lease, the longest in the history of Boston, for the entire 1.1 million square feet, at \$80 per square foot. Upon completion, American Financial Realty Trust, a public real estate investment trust (REIT), purchased the building for \$705 million—at that time a national record of \$671 per square foot. This was nearly twice the amount per square foot paid for the landmark Hancock Tower just one year earlier.

## Getting the New Songdo City Deal

The Korean government granted POSCO Engineering & Construction (E&C), a subsidiary of the world's second-largest steel company, the development rights to New Songdo City with instructions to partner with an American developer. POSCO E&C hired Jay Kim, a semiretired real estate consultant, to help them find such a partner.<sup>8</sup> In early 2001, Hynes received a call from Kim:

Jay Kim called me out of the blue. He had gone online looking for a U.S. developer. Because of the One Lincoln Street deal, one of the largest office buildings built and sold for a record-breaking price, we were listed as number one. Everyone in the market was so busy at the time, he couldn't find anyone to take on the project. I also initially rebuffed him as well, telling him that I was in the middle of a big deal [closing of One Lincoln Center]. His response was "you don't know what big is."<sup>9</sup>

After closing One Lincoln Center, Hynes and Stan Gale flew to Korea for initial due diligence. Hynes recalled:

We spent three days poking around trying to understand the dynamics and potential of the deal. We saw that the central government, the city government, and POSCO were serious about the project. So it was really a government-sponsored initiative more than anything else, and it was only going to work as an international business center if it had U.S. sponsorship in order to attract corporate interests and provide international companies with some comfort that they were truly dealing with a non-Korean authority. Yet you can't do it—no one can possibly do this project—without some very strong local representation, and we had that in POSCO. And then finally, the government had already invested upwards of \$10 billion. If this project didn't happen, those billions of dollars would not be fully utilized.

The due diligence that we did was the fact that the government really wanted this thing and they were putting their money behind the dream as opposed to having us come in and saying, "You guys figure out how to pay for it, and we'll help you." Some countries do that. Gerald Hines is working on a big project in India where he has to figure out a way to pay for and build the infrastructure. In exchange, Hines gets the land for free. That wouldn't have interested us. This does.<sup>10</sup>

In July 2001, on his second trip to Korea, Hynes signed a memorandum of understanding with POSCO E&C to develop New Songdo City. The partnership, named New Songdo City Development LLC (NSCD), was set up as a 70/30 joint venture with Gale as the controlling interest. Gale would be

the project's developer, and POSCO E&C would be the construction manager. POSCO E&C would earn an additional 3% contractor's fee and would be solely responsible for all completion guarantees (see **Exhibit 4** for joint venture [JV] structure).

## Realizing the Vision

*New Songdo City will have "the skyline vistas of New York, the strolling walks of Boston, the reflections of Venice, the kinetic energies of Wall Street, the pocket parks of London . . . the stunning impact of Sydney's Opera House, the street scenes of Paris and Soho, the polish of Park Avenue."*

—New Songdo City marketing literature<sup>11</sup>

Behind these lofty images were thousands of granular details planned with meticulous care. Gale, POSCO, and the Korean government worked together to determine the following uses: office mixed use, retail mixed use, residential mixed use, residential blocks, private school, public school, cultural center, convention center, hotel, government center, hospital, park, and golf course.

While uses such as open spaces were not revenue generating, Hynes believed they would be critical to the overall success of the project. He described the importance of the park and other recreational areas: "One of our hardest tasks was convincing the Korean government that some of the most valuable real estate should be used for quality-of-life projects like the park and not for residential or office buildings. That was a clear example where we as 'foreign' developers really brought an international perspective to this development."<sup>12</sup>

With the list of required land uses in hand, urban designers and architects at KPF spent two years collaborating on land-use locations, public transportation routes, width of city streets and sidewalks, shape of the city skyline, and form of the buildings themselves, among other details. KPF had very little information to guide it aside from the shape of the city and the geographic proximity to important areas such as the Incheon Airport and Seoul. Other than that they had to design a grand, new city from scratch. (See **Exhibit 5** for an outline of the site.)

In order to find inspiration for this unique opportunity, KPF looked toward community planning models and actual cities throughout the world. During the 1950s and 1960s, the ideal community in the United States was based on single-family, detached homes with wide open spaces in suburbs away from the congestion of central business districts (CBDs). Recently, that version had given way to the idea of sustainable cities or "hub cities" with relatively small districts that provide residents and visitors with a mix of shopping, dining, and cultural attractions and easy access to mass transit without relying on personal automobiles.<sup>13</sup> KPF adopted this hub-city approach as the basis for the design of New Songdo City.

In order to create the ideal city based on this model, KPF decided to blend aspects of other international cities (see **Exhibit 6** for examples of city layouts). There were two reasons using other cities as models was important. The first was to have "measuring sticks to help gauge the crucial aspects of scale, proportion, configuration, and density."<sup>14</sup> The second reason was to provide the city with a heterogeneous structure and make it feel as if it had evolved over many decades. Planned heterogeneity was a key criterion for the final design from the start, according to Jamie Von Klemperer, the project's principal architect at KPF:

This variety in geometry and open space has been deliberately planned, since the mix of styles seen in different cities is the result of a long historical process, whereas we are building the city in a period of 10 years. However, we are also trying to avoid overplanning the

development, which we believe has plagued other satellite cities such as Bundang [south of Seoul] where the spatial formula is monotonous.<sup>15</sup>

If KPF could emulate the signature aspects of other cities that worked so well in other parts of the world and then blend these aspects together, it could use proven models for guidance and at the same time build something unique.

However, Professor Dennis Frenchman, director of city design and development at MIT, was unconvinced:

As far as Gale's promise of the strolling walks of Boston, the reflections of Venice, the street scenes of Paris and Soho, these icons of urbanity are extraordinarily difficult to achieve and sustain even in the cities where they are located, and they cannot simply be mass produced in a few years. They also require a culture and level of mature community that takes generations to create.<sup>16</sup>

## Regional Competition

Hynes knew that New Songdo City would have to compete with established economic centers such as Shanghai, Hong Kong, Beijing, Singapore, Tokyo, Mumbai, and Seoul (see **Exhibit 7** for real estate market data).

### *Shanghai*

Because of China's market potential and growth, many companies were opening operations there due to a belief that "you have to be in China to do business in China." Shanghai was a top choice and was aggressively competing for status as an economic hub in Asia. By the end of 2004 the vacancy rate for prime office space was 7%, having trended down steadily from a peak of almost 60% at the end of 1998. Even more impressive was that during this time the amount of prime office space doubled from roughly 30 million to 60 million square feet.<sup>17</sup>

As had Incheon, Shanghai had set aside a 54-square-kilometer (km<sup>2</sup>) piece of land only 50 km from downtown Shanghai called New Lin Gang City. It was adjacent to the new Yangshan International Deep Sea Harbor and Pudong International Airport. Eventually, the Pudong Airport would have twice the passenger capacity as the Incheon Airport.<sup>18</sup>

At the heart of New Lin Gang City lay a 5.6 km<sup>2</sup> lake called Water Drop Lake, surrounded by lush gardens and beaches. A peninsula extended into the lake and housed a theater, museum, aquarium, and cultural resorts. The planned population for this area was 500,000 to 600,000 people. Surrounding New Harbor City was the Lin Gang Industrial Area, which would be home to a variety of manufacturing, high-tech, and logistics companies. The development would also feature an 18-hole golf course in the northern part of the city as well as a modern metro system featuring a Maglev.<sup>19</sup>

China had also established free economic zones 15 years earlier in the nearby cities of Tianjin and Dalian that offered developed ports, cultural amenities, and a large number of universities.<sup>20</sup>

### *Hong Kong*

Hong Kong was seen as a preferred location for companies in trading, logistics, banking, and media. It often served as a hub for multinationals operating in Asia or as a financial base for business

with mainland China. Companies were drawn by its low 17.5% tax rate, political stability, security, and wide use of English. Hong Kong's legal system and respect for intellectual property were also key attractions.<sup>21</sup>

In 2004, Hong Kong was home to 966 regional head offices, up from 948 the year before despite the SARS scare. At the end of the year, the vacancy rate for prime office space was 6.9%, having come down from a peak of roughly 13% just the year before. The total amount of prime office space, roughly 40 million square feet at the end of 2004, had been relatively flat compared with that of the prior year.<sup>22</sup>

### *Beijing, Singapore, Tokyo, Mumbai, and Seoul*

Beijing, though without the prestige of Shanghai, was quickly becoming a business and technological hub in Asia. The total amount of prime office space was roughly equal to Shanghai's, but it had a vacancy rate of 15.5% at the end of 2004. This was down from a peak of almost 35.0% at the end of 1999. Singapore, a country with a world-renowned business culture, had a vacancy rate for prime office space that had come down to 6.8% at the end of 2004 from a peak of roughly 12.5% in the middle of 2003. Tokyo was a major financial and business hub but was plagued by Japan's long recession and high cost of living. However, the market had been improving recently with a vacancy rate for prime office space of 3.5%, down from 9% at the end of 2002. In Mumbai, a technology and finance center in India, prime office vacancy rates were slowly trending down but were still 22.3% at the end of 2004. In South Korea itself, Seoul had been the engine that drove the economic growth of Korea since the 1960s, but its quarters had become cramped due to massive urban migration over time. The prime office vacancy rate of 4.0% was roughly at its historical average over the last 10 years.<sup>23</sup>

### *A Better Alternative?*

Hynes firmly believed that cheaper rents, taxes, and other incentives available in New Songdo City would give it a distinct advantage over the regional competition. He also felt that a company could locate in New Songdo and still benefit from cheap labor markets elsewhere: "Companies can take advantage of China's low labor cost and still enjoy the high quality of life that New Songdo will provide. Korea has a great legal and judicial system compared to China. You can own land in Korea, but not in China. If you want to locate in New Songdo, you would deal with Gale International, while in China you would probably work with some government agency."<sup>24</sup>

In the end Hynes believed that New Songdo City would be a success because "there's a quality of life that has been designed into this place that doesn't exist anywhere in Korea and maybe anywhere in the world."<sup>25</sup> Gale found the right partners with global reputations so that New Songdo City would have international schools, a top-quality hospital, and cultural and arts centers in order to claim a real advantage over other cities. The Harvard Advisory Group partnered with Gale to design the foreign schools, Philadelphia International Medicine helped design and run the hospital, and Jack Nicklaus signed on to design the golf course. The cultural center would include a fine arts museum, a world-class aquarium, and a performing arts center modeled on Sydney's famous opera house. Hynes commented that "there's a climate here, a community climate, that's very different than anything else you'll find in Seoul. Your kids can walk to school, there's plenty to do, lots of amenities. Everything's brand new."<sup>26</sup>

## Executing the Plan

While designing a world-class city and competing with established economic centers represented significant challenges, executing the plan entailed even greater ones. KPF's master plan had been approved on schedule, but the more detailed district unit plan (DUP) was taking longer than expected to receive approval from the Korean government. The DUP described the specific sequence and manner in which the buildings and various parts of the city were to be built. Without a DUP, Gale could not start construction and, according to Hynes:

If we had six corporations, each with a quarter of a million square feet of space that needed to be here, we wouldn't even know where to begin because we don't have our approvals. So, you know, you've got a government over here that's like, "Where are the corporations?" and we're saying, "Give us our permits!" Corporations don't want to talk to us. I mean, why would a CEO waste his time on us if we don't even have our permits in place?<sup>27</sup>

Instead of delaying construction further, Gale opted to proceed with a DUP that had been authorized when the failed Daewoo Group had owned the site's development rights. Fortunately, the first phase of the old DUP closely matched the initial area for development, known as Parcel I, under Gale's new DUP. Ground was broken in November 2004.

The selection of Parcel I was a key decision as it would have to prove the viability of the project and its vision. The phasing of New Songdo City into a total of five discrete and sequenced parcels was vital to Gale's risk mitigation and financing strategy, and it was also important to the Korean government. It was concerned that developers would try to cash in on the residential boom and shun office development. To prevent this, approval of the DUP (for Parcels II–V) was contingent on adequate office space being built with each parcel. Hynes hoped that their current plan would address the government's concern and that he would receive full DUP approval in June 2005.

One concern that lay dormant for the moment was potential damage to the environment. In 2003 Birds Korea, a group that described itself as "the national and international network dedicated to the conservation of birds and their habitats in South Korea and the broader Yellow Sea Eco-region," began objecting to the land reclamation of the tidal flatlands at Songdo.<sup>28</sup> In December 2003, Tim Edelsten wrote, "Despite being an urban location ringed by roads and construction, the area still supports several globally threatened waterbird species in internationally important concentrations, and should of course . . . be conserved."<sup>29</sup> With the land reclamation complete, the issue was closed. The group lamented that this "mega-project, mega-expensive to both the environment and in terms of tax dollars, will of course be completed without the benefits of an Environmental Impact Assessment process befitting one of the world's leading economies."<sup>30</sup>

By spring 2005, with construction under way, Hynes had already reached out to 2,200 companies in search of tenants.<sup>31</sup> While many were aware of New Songdo City, few were willing to commit. However, a major U.S. retail REIT saw significant promise in the area. In November 2004, Taubman Centers signed a letter of interest to form a JV with Morgan Stanley and Gale that would give Taubman exclusive rights to New Songdo City's retail development.<sup>32</sup> During the groundbreaking ceremony for Parcel I in 2001, John Chambers, CEO of Cisco Systems, expressed via video his interest in establishing a presence in New Songdo City.<sup>33</sup>



## Arranging the Financing

*We need to match the financing to the design.*

—Jonathan Thorpe, senior vice president, Finance, NSC

By September 2003, Gale had already incurred \$10 million in initial predevelopment costs. Estimates of the total investment needed to complete New Songdo City over 10 to 15 years ranged anywhere from \$20 million to \$26 billion, an amount greater than the \$14.6 billion cost of the Big Dig project in Boston.<sup>34</sup> Neither POSCO E&C nor its parent carried a sufficient balance sheet to finance the project, and despite significant infrastructure investments from the Korean government, external financing would be required.

In order to make the investment palatable to investors, Hynes utilized a staged financing strategy that raised the minimum amount of funds necessary to reach a specific milestone, which then enabled him to secure the next round of financing.

Fresh off the State Street deal, Gale experienced little difficulty convincing Morgan Stanley to help arrange the first \$90 million of financing in October 2003. Woori Bank, a local Korean bank, and the state-run Industrial Bank of Korea contributed \$50 million, with the remaining \$40 million provided by Morgan Stanley, ABN Amro, the Bank of Nova Scotia, and other investors. This first round of financing allowed Gale to purchase the 94 acres of land in Parcel I, which the Korean government agreed to sell for approximately \$640,000 per acre in exchange for Gale's donating the completed convention center.<sup>c</sup> This first parcel purchase signified the first-ever foreign ownership of Korean soil. The financing also gave the JV company New Songdo City Development (NSCD) \$21 million in working capital and reimbursed Gale \$9 million of its fronted costs. The debt was a nonrecourse loan with an effective interest rate of 10.5% and was expected to be refinanced within a year.

In July 2004, Gale International raised another round of financing through a new \$180 million loan facility from Morgan Stanley, ABN Amro, and Woori Bank. The nonrecourse bridge loan carried a 9% interest rate, and its funds were used to repay the original \$90 million loan, fund an additional \$40 million in working capital, and pay \$50 million in predevelopment assessment and engineering expenses for a residential block in Parcel I (see **Table A** below).

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<sup>c</sup> This cost reflects the net effect of the Korean government's donation of the land for the building of the convention center.

**Table A** Staged Debt Financing for New Songdo City

<b>Debt Schedule</b>	<b>Amount</b>
Stage 1—Predevelopment cost (2001–2003) <ul style="list-style-type: none"> <li>- Funded by Gale</li> <li>- Fund working capital</li> </ul>	\$10M
Stage 2—Land Loan (2003–2004) <ul style="list-style-type: none"> <li>- Funded by Woori Bank, ABN Amro, Morgan Stanley, and Consortium</li> <li>- Financing of Parcel 1 land purchase</li> <li>- Fund working capital</li> <li>- Repayment to Gale for predevelopment costs</li> </ul>	\$90M
Stage 3—Bridge Loan (2004–2005) <ul style="list-style-type: none"> <li>- Funded by Woori Bank, ABN Amro, Morgan Stanley, and Consortium</li> <li>- Repay land loan</li> <li>- Fund working capital</li> </ul>	\$180M
Stage 4—Land Loan (anticipated July 2005) <ul style="list-style-type: none"> <li>- Repay bridge loan</li> <li>- Financing of Parcel 2 and 3 land purchase</li> <li>- Fund working capital</li> </ul>	\$1.5B

Source: Gale International.

At this time, Hynes decided to bring on an additional foreign equity investor, which the Korean government had strongly encouraged. Morgan Stanley again was the logical choice, and in late 2004, NSCD contributed equity of \$21 million, of which \$15 million came directly from Morgan Stanley in exchange for a 12.5% stake of Gale's share in the NSCD joint venture and the remaining \$6 million came from POSCO E&C.

By spring 2005, the \$180 million loan had been fully drawn down, but NSCD was close to securing its next financing for \$1.5 billion. Specifically, the new loan would be used to repay existing debt of \$180 million, purchase land in Parcels II and III, and construct quality-of-life projects (e.g., convention center, central park, schools) and other working capital needs.

Hynes was confident that negotiations for the new nonrecourse loan would be successful and carry an interest rate of 7.4%. While the Korean government emphasized the importance of office development, Woori Bank, Kookmin Bank (another major Korean bank), and ABN Ambro were underwriting this loan based solely on revenues from the residential and retail buildings.<sup>d</sup> With their local knowledge of the development risks, only the Korean banks were capable of underwriting the residential construction. Implicit in the agreement was the continued involvement of the financiers in subsequent rounds that inevitably would arise in the next few years.

NSCD had already negotiated purchase prices for land in Parcels I through IV and an option on Parcel V. From the first four parcels, NSCD forecasted \$10 billion in residential sales in the first eight years. Although no residential units would be completed before early 2006, NSCD would still generate approximately \$500 million from the presale of units during the last six months of 2005. The revenue from retail, the golf villas, and the hotels would total \$185 million in 2006 and then grow at

<sup>d</sup> Office buildings were individually underwritten by separate partnership agreements. Returns to both equity investors and debt financiers were entirely underwritten without consideration of revenue from office development.

25%–30% a year through 2015. The development costs for the infrastructure and underwritten assets would be \$13.1 billion. (See Exhibits 8 and 9 for parcel and financial data.)

Despite the risks, Hynes was optimistic about New Songdo City's future: "We don't need a lion's share of the companies looking to locate in Asia to make New Songdo a success. If we manage to lease 2 million square feet of office space per year, we will be ahead of *pro forma*. We do not need to be the solution to everybody."<sup>35</sup>

## Similar Projects with Mixed Results

Although not as grand in scale, other large urban development projects had been attempted around the world with mixed success. Often, these projects had failed to fulfill their purpose or had been criticized for a lack of charm and personality.

Since 1981, the London Docklands redevelopment project was intended to bring new life to this derelict area of London. The cornerstone of the Docklands redevelopment, Canary Wharf, was plagued with lack of commitment from the government, bad planning, and financial distress. It had taken more than a decade to become a reality and receive international recognition as a success.

In 1999, Hong Kong attempted to capitalize on the Internet boom when it launched its Cyberport project. The government spent \$2 billion on 24 acres of seaside residential and office development. The project had been shrouded in secrecy and controversy, as it was awarded to a local tycoon who stood to make more than \$1 billion on this venture. Lease up had been slow, and as of 2004, occupancy was at only 42%.

Similar projects in Malaysia (Cyberjaya) and Singapore (One North) had fared no better. Persuading companies to set up operations in these planned wonder cities had proved difficult. Many high-tech companies endorsed these projects at the outset, but when development was complete, they moved only low-skill operations there or avoided their commitments altogether.

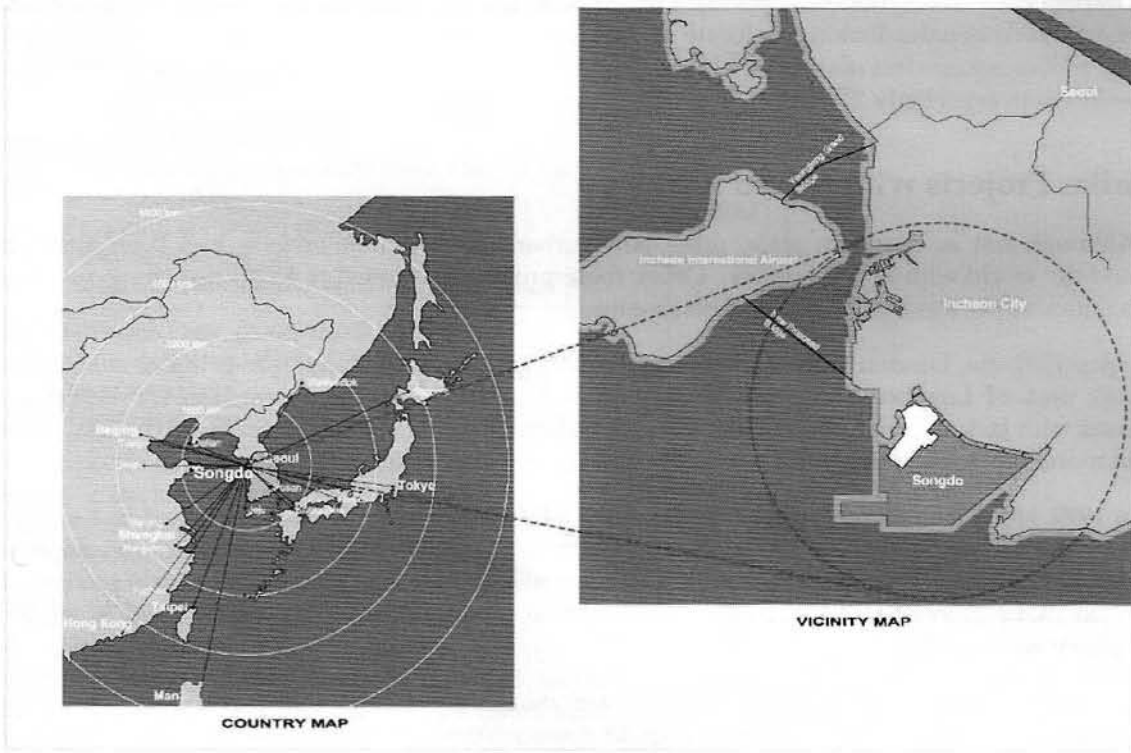
## Looking Ahead

Hynes was well aware of the difficulties encountered in other projects, and the first test of New Songdo City was fast approaching. Back in New York, Hynes was looking over the final details of the sale of the first residential block of the city, scheduled for June 2005. He was relying on income generated from the sale, in addition to the \$1.5 billion financing package he hoped to close in the next few weeks, to finance the construction of the quality-of-life areas. If residential unit sales were strong, Hynes would have a much easier time marketing the city and facilitating future financing. Weak residential sales would only fuel skepticism and cast a cloud over the city's future.

The uncertainty and challenges of New Songdo City made Hynes wonder whether he had made the right decision in taking on this behemoth project. It would take more than 10 years of his full commitment before the city would be fully built. Most of the expected returns for Gale, if any, were years from materializing. If the returns did materialize, would the Korean public allow an American firm, and the first foreign land owner, to take significant profits after all the government investment? Had he properly identified and mitigated all the major risks, or were there others still looming?

He reflected on the challenges he had experienced to date with New Songdo City: "Seventy percent of what we try to do doesn't work, so we bat .300 around here. But you can get in the Hall of Fame like that."<sup>36</sup>

Exhibit 1 Map of Region and New Songdo City



Source: Gale International.

**Exhibit 2** Comparable Country Data

	South Korea	Japan	China	Hong Kong	Singapore	USA	Taiwan	Thailand	Malaysia	India
Population (millions)	47	127	1,294	7	4	288	23	64	23	1,041
GDP (US\$m)	\$477	\$3,993	\$1,266	\$161	\$87	\$10,383	\$281	\$127	\$95	\$510
Per capita GDP (US\$) <sup>a</sup>	\$10,060	\$31,320	\$980	\$23,080	\$20,710	\$35,990	\$12,520	\$1,970	\$4,130	\$490
Corruption Index TI	47	24	71	16	5	17	35	64	39	90
Business environment ranking <sup>b</sup>	22	27	38	7	5	4	16	31	30	40
Global competitiveness ranking <sup>c</sup>	31	21	22	6	2	1	12	26	16	30
Cost of living (USA =100) <sup>d</sup>	97	138	90	113	98	100	89	61	62	45
Life expectancy (men)	71.8	77.9	68.9	77.3	75.9	74.3	74.1	65.3	70.8	63.2
Adult literacy rate	98%	99%	91%	94%	93%	99%	96%	93%	89%	61%
Mobile Phone per 100 pop.	68.0	63.7	16.1	94.3	79.6	48.8	106.2	26.0	37.7	1.2
Computers per 100 pop.	55.6	38.2	2.8	42.2	62.2	66.0	39.5	4.0	14.7	0.7

Source: "Pocket World in Figures," *The Economist*, 2005 edition.

<sup>a</sup>Unadjusted purchasing power parity.

<sup>b</sup>Reflects the opportunities and hindrances to conduct business; based on rankings of 145 countries.

<sup>c</sup>Ranking reflects assessments for the ability of the country to sustain high rates of GDP per capita growth; based on rankings of 44 countries.

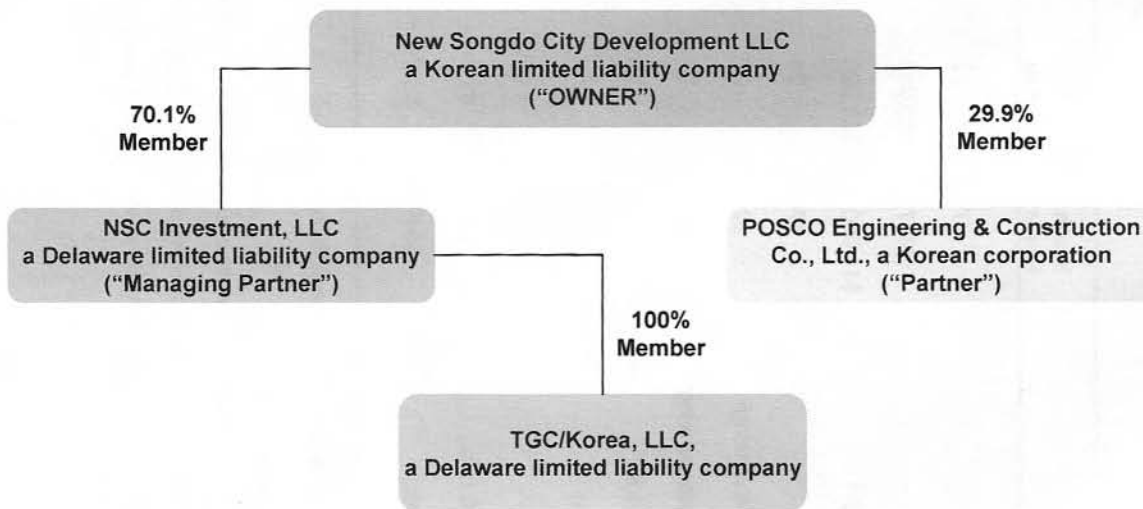
<sup>d</sup>Index is based on typical urban prices an international executive and family will face abroad.

Exhibit 3 New Songdo City Current Site



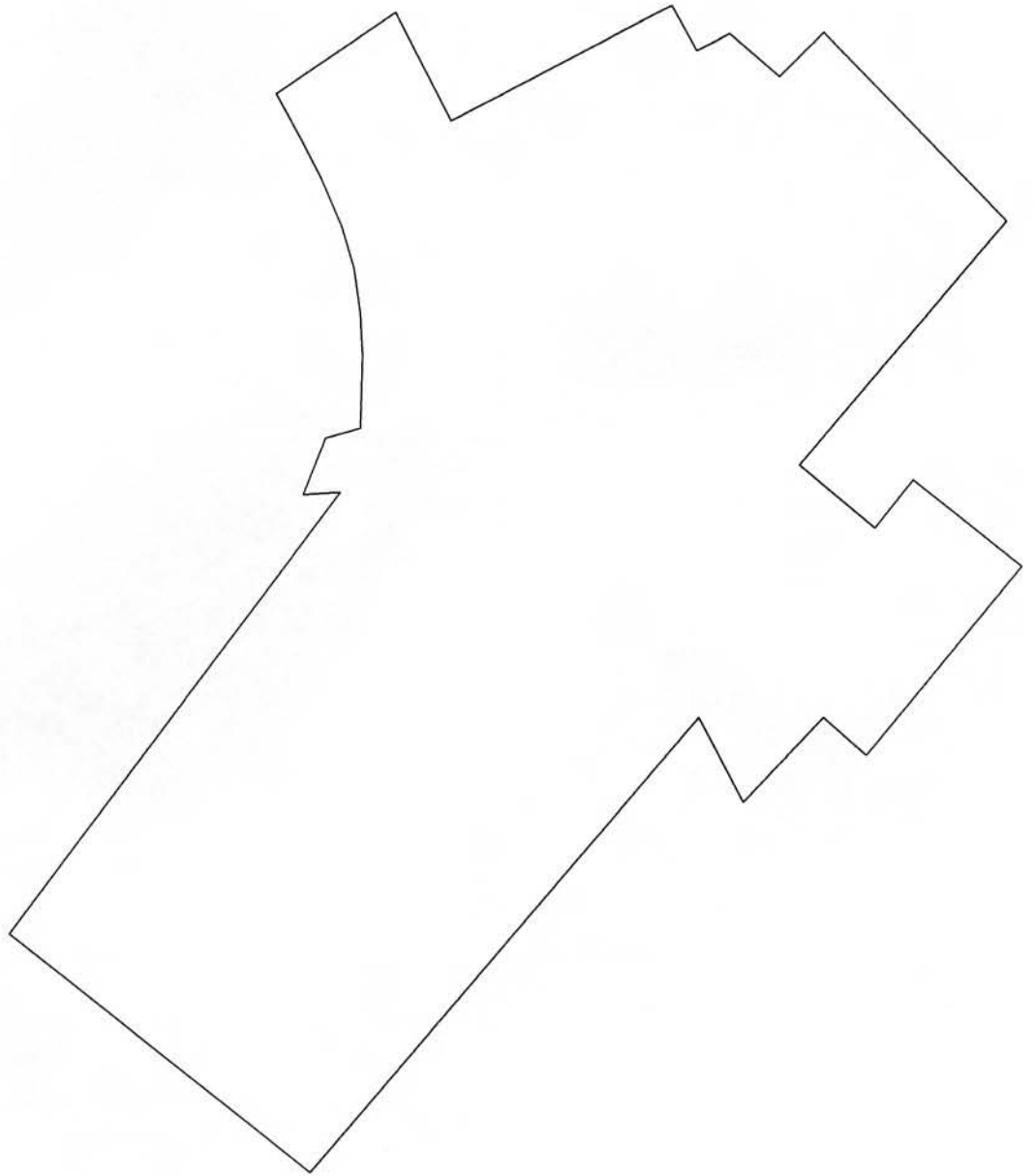
Source: Gale International.

Exhibit 4 JV Structure of New Songdo City Development LLC



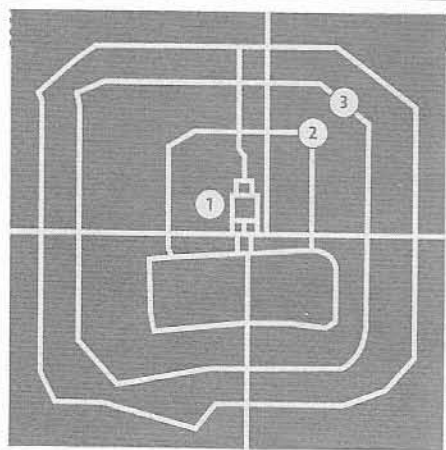
Source: Gale International.

Exhibit 5 Outline of Site

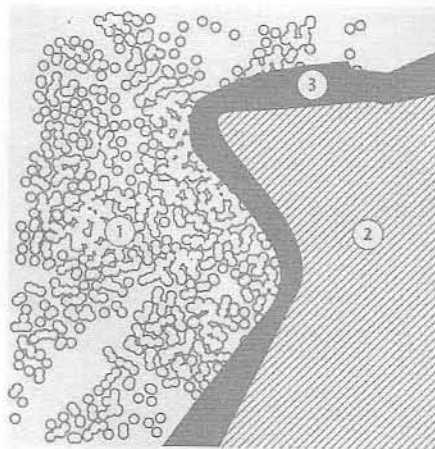


Source: Gale International.

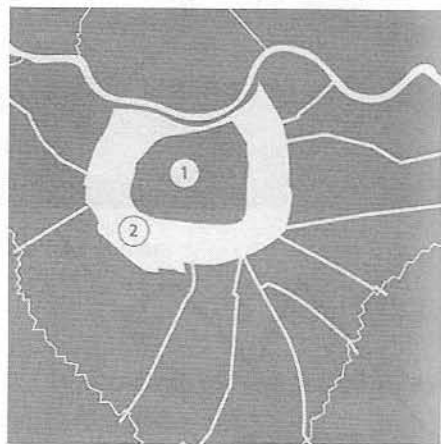
Exhibit 6 Examples of City Layouts



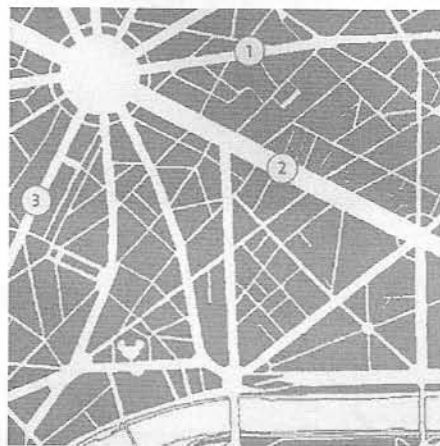
BEIJING NUCLEUS



SHANGHAI DUAL LOBE



VIENNA RADIAL SECTOR



PARIS RADIAL SECTOR



LONDON HETEROGENEOUS



**Exhibit 7** Summary of Fourth-Quarter 2004 Prime Office Stock, New Supply, Occupancy, and Vacancy Factor

	Office Stock sq. ft.	New Supply sq. ft.	New Absorption sq. ft.	Vacancy %	Change in Vacancy from Prior Quarter %
Shanghai	60,000,000	823,800	1,760,700	7.0	(1.8)
Hong Kong	40,000,000	--	1,214,200	6.9	(4.4)
Beijing	60,000,000	387,500	1,271,200	15.5	(1.5)
Singapore	6,000,000	--	15,200	6.8	(0.3)
Tokyo	40,000,000	147,800	3,408,600	3.5	(0.3)
Mumbai	2,250,000	--	30,000	22.3	(1.9)
Seoul	65,000,000	--	287,200	4.0	(0.9)

Source: "Asia Pacific Office Market Review," Q4 2004, CB Richard Ellis, p. 14.

**Exhibit 8** Detailed Parcel Description

Parcel Description	Parcel I	Parcel II	Parcel III	Parcel IV	Parcel V ( <i>Optioned</i> )
<i>Land Size</i>	94 Acres	632 Acres	205 Acres	380 Acres	189 Acres
<i>Land Acquisition Cost (per acre)</i>	\$1 million <sup>a</sup>	\$650,000	\$650,000	\$1.5 million	TBD
<i>Land Acquisition Date</i>	2003	2005	2006	2007	TBD
<i>Build-out Sq. Ft.</i>	10.5 M SF	15.7 M SF	17.5 M SF	25.6 M SF	20.8 M SF
<i>Estimated Cost to Develop</i>	\$2.0 billion	\$3.1 billion	\$3.4 billion	\$4.6 billion	\$5.2 billion
<i>Construction Time Frame</i>	2005–2008	2005–2010	2006–2011	2008–2015	2006–2014

Source: Gale International.

<sup>a</sup>Estimates on cost to develop do not reflect office building development and construction costs.

## Exhibit 9

Proposed Set-up	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
In \$MM	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Total
<b>Sources</b>												
<i>Residential Sales</i>	500	1,188	1,188	1,188	1,188	1,188	1,188	1,188	1,188	-	-	10,000
<i>Retail / Hotel / Other</i>	-	185	236	301	383	489	623	795	1,013	1,292	1,647	6,965
<i>Total Sources</i>	500	1,373	1,423	1,488	1,571	1,676	1,811	1,982	2,201	1,292	1,647	16,965
<b>Uses</b>												
<i>Land</i>												
<i>Parcel 1</i>	60											
<i>Parcel 2</i>	411											
<i>Parcel 3</i>		133										
<i>Parcel 4</i>			570									
<i>Development</i>	1,310	1,310	1,310	1,146	1,146	1,146	1,146	1,146	1,146	1,146	1,146	13,100
<i>Interest</i>	56	111	111	154	140	119	89	46				827
<i>Total Uses</i>	1,836	1,554	1,991	1,301	1,287	1,266	1,235	1,193	1,146	1,146	1,146	15,101
<i>Net After Uses</i>	(1,336)	(182)	(568)	188	284	411	576	790	1,055	146	501	1,863
<i>Cumulative</i>	(1,336)	(1,518)	(2,086)	(1,898)	(1,614)	(1,203)	(628)	162	1,217	1,362	1,863	
<b>Sources:</b>												
<i>Debt</i>	1,500		2,086									
<i>Debt Repayment</i>	180		1,500	188	284	411	576	628				
<i>Equity</i>	22											
<i>Profit</i>								162	1,055	146	501	
<b>IRR Calculation on Equity</b>	71%											
<b>Maximum Shortfall</b>	2,086											

Source: Casewriters.

## Endnotes

<sup>1</sup> Yasheng Huang, "Korea: On the Back of a Tiger," HBS Case No. 700-097 (Boston: Harvard Business School Publishing, 2000).

<sup>2</sup> *New Songdo City*, Kohn Pedersen Fox Associates, New York City, p. 9.

<sup>3</sup> Planning Office of Free Economic Zone, "Hub of Northeast Asia," Planning Office of Free Economic Zone Web site, <http://www.fez.go.kr/english/index.php?m=fez.hub>, accessed April 2005.

<sup>4</sup> Planning Office of Free Economic Zone, "Advantage of FEZ," Planning Office of Free Economic Zone Web site, <http://www.fez.go.kr/english/index.php?m=fez.advantages>, accessed April 2005.

<sup>5</sup> *Ibid.*

<sup>6</sup> Bella English, "He'll Build This City," *The Boston Globe*, December 13, 2004, via Factiva, accessed February 2005.

<sup>7</sup> John B. Hynes, III, interview by authors, New York City, April 13, 2005.

<sup>8</sup> "CEO Luncheon Gateway to Asia: New Songdo Intelligent City," *The Korea Society Quarterly*, Vol. 4, No. 1, p. 45, [http://www.koreasociety.org/TKSQ/TKSQ%20PDF/TKSQ\\_4-1/38\\_47\\_EVENTS%20IN%20REVIEW\\_CA.pdf](http://www.koreasociety.org/TKSQ/TKSQ%20PDF/TKSQ_4-1/38_47_EVENTS%20IN%20REVIEW_CA.pdf), accessed April 2005.

<sup>9</sup> "Charm City?" *Newsweek International*, March 29, 2004.

<sup>10</sup> John B. Hynes, III, interview by authors, New York City, April 13, 2005.

<sup>11</sup> Bella English, "He'll Build This City," *The Boston Globe*, December 13, 2004, via Factiva, accessed February 2005.

<sup>12</sup> John B. Hynes, III, interview by authors, New York City, April 13, 2005.

<sup>13</sup> *New Songdo City*, Kohn Pedersen Fox Associates, New York, p. 33.

<sup>14</sup> *Ibid.*, p. 44.

<sup>15</sup> Wohn Dong-hee, "A City from Scratch," *Joins.com*, January 20, 2005, via Factiva, accessed February 2005.

<sup>16</sup> Bella English, "He'll Build This City," *The Boston Globe*, December 13, 2004, via Factiva, accessed February 2005.

<sup>17</sup> "Asia Pacific Office Market Review," Q4 2004, CB Richard Ellis, pp. 14–29.

<sup>18</sup> *Shanghai Lingang Industrial Area*, Shanghai Economic Development Group, brochure, 2004.

<sup>19</sup> *Ibid.*

<sup>20</sup> Bella English, "He'll Build This City," *The Boston Globe*, December 13, 2004, via Factiva, accessed February 2005.

<sup>21</sup> Rebecca Fannin, "The Three Capitals of China," *Chief Executive*, Iss. 204, December 2004, p. 50.

<sup>22</sup> "Asia Pacific Office Market Review," Q4 2004, CB Richard Ellis, pp. 14–29.

<sup>23</sup> *Ibid.*

<sup>24</sup> John B. Hynes, III, interview by authors, New York City, April 13, 2005.

<sup>25</sup> *Ibid.*

<sup>26</sup> *Ibid.*

<sup>27</sup> *Ibid.*

<sup>28</sup> <http://www.birdskorea.org/birdskorea.asp>, accessed July 2005.

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> John B. Hynes, III, interview by authors, New York City, April 13, 2005.

<sup>32</sup> "Media Release: Taubman Centers, Inc.," AAP MediaNet Press Releases, November 9, 2004, via Factiva, accessed February 2005.

<sup>33</sup> "Work Starts on Billion-Dollar Asia Business Hub," *Agence France Presse*, November 11, 2004, via Factiva, accessed February 2005.

<sup>34</sup> Sean P. Murphy, "Expenses Reviewed in Big Dig Leaks Probe," *The Boston Globe*, April 7, 2005, [http://www.boston.com/news/traffic/bigdig/articles/2005/04/07/expenses\\_reviewed\\_in\\_big\\_dig\\_leaks\\_probe/](http://www.boston.com/news/traffic/bigdig/articles/2005/04/07/expenses_reviewed_in_big_dig_leaks_probe/), accessed May 2005.

<sup>35</sup> John B. Hynes, III, interview by authors, New York City, April 13, 2005.

<sup>36</sup> John B. Hynes, III, interview by authors, Boston, Massachusetts, December 6, 2005.