

Part One. FRAMEWORK FOR THE HOUSING SECTOR DEVELOPMENT

This part aims at giving the reader a basic overview of the current framework conditions of the Russian Federation's housing sector.

Chapter I gives an overview of selected socio-economic aspects that influence housing. *Chapter II* assesses the most important housing reforms that the Government has initiated during the past decade. In addition, the chapter examines how variations within the housing sector of the different regions of the Russian Federation affect housing policy design. *Chapter III* gives an overview of the existing housing stock and reviews the supply and quality of housing, housing needs and tenure structure. *Chapter IV* analyses the institutional framework of the housing sector. It gives an overview of the federal, regional and local institutions involved in housing policy implementation. It also assesses the involvement of civil sector institutions as well as international organizations in housing. *Chapter V* gives an overview of the major legal developments within the housing sector during the past decade and, finally, *chapter VI* analyses the financial framework conditions of the Russian Federation's housing sector. It discusses recent trends in housing finance and assesses current government and private investment in housing. It also analyses existing housing finance instruments and institutions

Chapter I

THE SOCIO-ECONOMIC FRAMEWORK

A. General information

Geographic situation

The Russian Federation is situated in Eastern Europe and Northern Asia, and borders the Arctic Ocean between Europe and the Northern Pacific Ocean. With a total land area of 17,075,400 km², it is the largest country in the world. Its land boundaries total 19,990 km and it shares land borders with Azerbaijan, Belarus, China, the Democratic People's Republic of Korea, Estonia, Finland, Georgia, Kazakhstan, Latvia, Lithuania, Mongolia, Norway, Poland and Ukraine, and maritime boundaries with Japan and the United States.

Political system

The Russian Federation is a federal republic. Its new Constitution was adopted on 12 December 1993. The Constitution created a two-chamber legislature: the lower house or State Duma, with 450 deputies elected by constituencies, and the upper house or Federation Council, with 178 deputies, two from each of the Russian Federation's 89 republics and regions. The head of State is the President, elected for a four-year term.

The country is administratively divided into 49 oblasts, 21 republics, 10 autonomous okrugs, 6 krais, 2 federal cities (Moscow and St Petersburg), and 1 autonomous oblast². The recent creation of seven federal districts headed by presidential representatives is aimed at ensuring that regional legislation complies with federal law and at strengthening the federal authorities' control over the regions.

² In the following these entities will be referred to as *regions*.

B. Economy

Overall economic development

In the aftermath of the Soviet Union's disintegration, the Russian Federation's economy was marked by collapsing output and surging inflation. Twelve years later, the Russian Federation is still actively establishing an effective market economy and beginning to achieve strong economic growth. By the end of 1997, it had made economic progress. Inflation had been brought under control, the rouble had stabilized, and an ambitious privatization programme had transferred thousands of enterprises into private ownership. The financial collapse in August 1998 brought this positive development to an abrupt halt. Annual inflation, which had fallen to a post-Soviet low of 6.4% at the end of June 1998, reached 84.5% by end of that year. However, the feared return to hyperinflation did not materialize, and inflation fell to 36.5% at the end of 1999; in the first quarter of 2003 inflation was at 14.6%.

The sharp devaluation of the rouble in August 1998 delivered a stronger than expected boost to the Russian economy. Gross industrial output, which had fallen continuously since 1990, jumped by 9.4% in 1999, as Russian enterprises took advantage of the gains in competitiveness brought about by devaluation. The rise in international oil prices helped to sustain the recovery in 2000, when industrial output rose by another 12.4% and this underpinned real GDP growth of 10% - the best economic performance in 30 years. Growth slowed in 2001 and 2002, to 5% and 4.3% respectively, and the engine of growth shifted from net exports to domestic demand. The growth rate for 2003 is estimated at 6.2%.³

³ EIU, Country Profile Russian Federation: 2003.

Wages and income

The collapse in the economy following the Soviet Union's disintegration had its effect on wages and, consequently, living standards. According to the official Goskomstat estimates, the ratio of the average monthly wages and other payments to the subsistence level of the working population has decreased from 335% in 1991 to 207% in 2001. Although it is argued that living standards have not been as badly affected as official statistics might suggest – partly due to the notorious underreporting of wages to avoid taxation – there is, however, little doubt that living standards were hit hard by the market reforms.

Wages are by far not the only source of household income. Other sources such as transfers from the State (pensions, unemployment benefits, allowances, etc.) as well as cash and non-cash income from home production and the informal sector, sales/rentals of personal property and dividends made up slightly more than 50% of average household income in 2001.⁴

The structure of household income sources has changed markedly during the past decade with increasingly less income coming from the public sector. In addition to a lesser share of the population working for the public sector, those who do work there find it necessary to complement public sector wages by other sources of income, as public sector wages as a rule are too low to secure a living. Multiple jobs held by one individual is therefore a strong feature of the Russian Federation's labour market.

Compared to other countries in transition, however, the shift to private sector employment has been relatively slow. While in 1992, nearly 95% of wage income reported by households was earned from work for State-owned organizations, this proportion had fallen only to 71% by 2000. The main reason is likely to be the slow growth of small and medium-sized enterprises in

the Russian Federation, which often account for a large share of total employment growth in other industrialized countries.⁵

As household incomes fell in the 1990s, income inequality increased dramatically. The transition has been associated with a large increase in wage differentials – across regions, across industries and sectors, and across types of workers. According to official estimates, the Gini coefficient rose from 0.289 to 0.396 between 1992 and 2001, demonstrating the growing inequality in society. According to Goskomstat the lowest income quintile of the population today earns 5.9%, while the highest income quintile earns 47% (2002). The UNDP common country assessment found that wage inequality as well as its increase during the period of transition is much greater in the Russian Federation than in other countries in transition including Hungary, Poland, the Czech Republic and Slovakia.⁶

Unemployment

Parallel to declining incomes, unemployment increased. Between 1992 and 1998 it rose from 5.2% to 13.3%. It began decreasing only in 1998 and reached 8.8% in 2002, which however is still well above the 1992 level. Although the unemployment rate in the Russian Federation seems large, it is comparable to that of West European countries, such as France and Germany. There are, however, large regional variations in the unemployment rate ranging from 1% in Moscow to 23% in the Ingush Republic. Furthermore, according to a study conducted by UNDP in 2002, there is some evidence that regional variations in unemployment have increased over time.⁷ Unemployment also varies across age groups, with young people facing the highest rates. In November 2000, unemployment was as high as 35.1% among those under the age of 20 and 16.6% for youth aged 20-24 years. The absolute number of unemployed in these two age groups more than doubled between 1992 and 2000.⁸

⁴ According to information from the Russia Longitudinal Monitoring Survey, 2002.

⁵ UNDP, Common Country Assessment: 2002.

⁶ UNDP, Common Country Assessment: 2002.

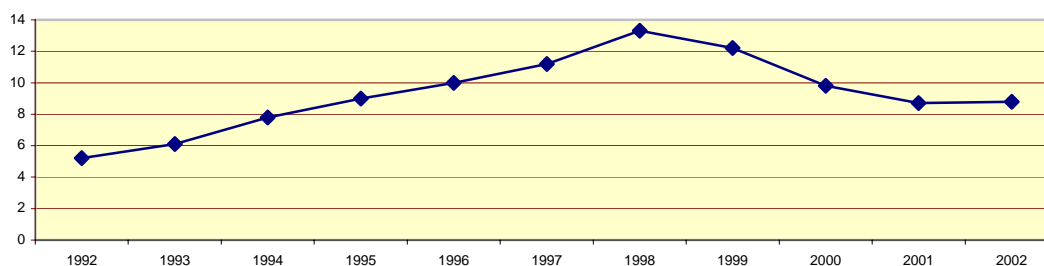
⁷ UNDP, Common Country Assessment: 2002.

⁸ UNDP, Common Country Assessment: 2002.

Table 1. Unemployment

Year	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Unemployment rate (%)	5.2	6.1	7.8	9.0	10.0	11.2	13.3	12.2	9.8	8.7	8.8

Source: UNECE, Economic Survey of Europe 2003, based on the Russian Federation Goskomstat's monthly estimates according to the ILO definition, i.e. including all persons not having employment but actively seeking work.

Figure II. Unemployment

One characteristic of the situation in the Russian Federation is that the persistently unemployed constitute a very large share of the unemployed. According to UNDP, the proportion of unemployed individuals who were unemployed for over a year increased rapidly – from 18.2% in 1993 to 40.3% in 1998 and to 42.3% in 2000.⁹ Persistent unemployment tends to be concentrated in certain geographical regions, especially those that have experienced little economic growth. The lack of regional labour mobility is a problem.¹⁰

Poverty

The economic contraction during much of the transition coupled with declining wages as a result of the sharp drop in the number of public sector jobs and the decline in real public sector wages as well as rising income inequality led to a sharp increase in poverty, with children aged 7-15 and women being affected most.¹¹ However, with economic growth resuming the incidence of poverty is declining. The number of people with incomes below the subsistence level is at its lowest since the early 1990s, according to official Goskomstat data.

⁹ UNDP, Common Country Assessment: 2002.

¹⁰ UNDP, Common Country Assessment: 2002.

¹¹ UNDP, Common Country Assessment: 2002.

Table 2. Population below the subsistence level

	1992	1995	1996	1998	1999	2000	2001	2002	2003
Subsistence minimum level, per capita (roubles)	1,900	264,100	369,400	493.3	907.8	1,210	1,500	1,725	2,121
Population with income less than the minimum subsistence level (million people)	49.7	36.6	32.5	34.2	41.6	42.3	39.9	33.3	25.9
Population with income less than the minimum subsistence level (%)	33.5	24.7	22	23.3	28.4	29.1	27.6	23	18

Source: Russian Statistical Yearbook 2002, Goskomstat.

The socio-economic position of the Russian Federation 2003, Goskomstat

Housing affordability

Research conducted in Russian cities shows that the affordability of housing and services during the past decade has fallen mainly due to the deep economic crises and falling incomes as well as the decreasing volume of State financing of running costs and capital investments in the housing sector.

The programme of phased rent increases and housing allowances, introduced at the beginning of 1994, caused a further decline in housing affordability for most tenant households.

Estimates given by the Russia Longitudinal Monitoring Survey indicate that housing payments rose about 230% in real terms from September 1992 to October 1995 across the country with the average real household income decreasing. However, as of October 1995, the share of rent and utilities still appeared negligible at nearly 6% of total household income and this proportion has hardly changed since. This is much lower than in the countries in transition in Eastern Europe. For example, households in Poland and Hungary typically spend over 20% of their income on housing and utility services.¹²

Table 3. Household expenditure for rent and utilities (percent of total income)

Date	9/92	10/95	10/96	11/98	10/00	10/01
Expenditure	2.8	4.8	5.9	6.0	5.5	6.5

Source: Russian Longitudinal Monitoring Survey, 2002.

¹² The World Bank. Infrastructure and Energy Department: Europe and Central Asia Region. Housing and Communal Services in Russia: Completing the Transition to a Market Economy. Final Report. October 7, 2002.

Although the figures above concern mainly tenant households, affordability for homeowners and tenants is almost the same. The reason is that rent payments are roughly equal to the property tax owners have to pay. Moreover, maintenance and service provision are normally carried out by municipal maintenance enterprises, which tend to charge the same fees to all units of an apartment block, regardless of whether the individual units are rental or owner-occupied.

One particular aspect of affordability is the access to affordable and adequate housing of the socially weak. The retreat of the State from housing provision has resulted in a decrease in the availability of public housing services for the population at large. At the same time privatization has resulted in many new homeowners who are too poor to maintain their property. At present the shift from public service provision to the general public to targeted provision to the socially weak has not been fully accomplished yet and there are still few mechanisms in place to support socially weak households. Housing affordability and accessibility are becoming a growing problem for the socially weak. This will be addressed in detail in chapter IX.

Those households who are relatively well-off still face problems improving their housing conditions due to the near impossibility of obtaining long-term bank credits at reasonable interest rates. Despite the decrease in housing prices after 1998 and the reduction in the ratio of the purchase price for housing to household income, the majority is therefore still not able to actively participate in the housing market.¹³

C. Population/ migration

Total population

According to the census of 2002, the total population of the Russian Federation is 145.2 million. Density fluctuates widely, from 56.1 people per km² in the Central Federal District to 1.1 people per km² in the Far East Federal District. The Russian Federation is a country of cities: 106 million people live in one of its 2940 cities while a little less than 39 million people live in 155,288 human settlements in rural areas.

Demographic trends

Since 1992 the Russian Federation has experienced negative population growth, because the death rate exceeds the birth rate. During the past 10 years the Russian Federation has experienced a population loss of 0.7% to 0.9% per year. The loss has been partly compensated by immigration. Nevertheless, the population declined by approximately 3.1 million people between 1992 and 2003.

The decline in birth rates is a long-term demographic trend which is not confined to the Russian Federation alone but which has affected most industrialized countries. This trend has been strengthened by the economic transition with its sharp decline in incomes and growing uncertainty. However, the most striking factor – which sets the Russian Federation apart from other industrialized countries – is the unusually high and increasing death rate. Particularly worrying is the sharp increase by more than 50% in the death rate among young people aged 15-24 years over the past ten years. Both deaths from natural causes and deaths from preventable causes (accidents, murder, suicide) contribute to this rise.¹⁴ The average life expectancy is 66 years,¹⁵ while it is substantially higher for women (72.9 years) and much lower for men (60.8 years). The average life expectancy in Western countries is around 77 years.

The demographic developments pose a number of challenges. One of these is the considerable predominance of women in the middle and especially in the elderly population groups and the resulting large share of female-headed households. The declining birth rate also contributes to an ageing population. However, this is not as serious a problem yet in the Russian Federation as in many other Western industrialized societies, because it is still in the first stage of the population ageing process with the middle-age group remaining stable while the percentage of the older groups grows and the percentage of children diminishes.¹⁶

¹³ UN-Habitat, *The State of the Russian Cities*: 2002.

¹⁴ UNDP, *Common Country Assessment*: 2002.

¹⁵ World Bank, *Country Brief*: 2001.

¹⁶ UNDP, *Common Country Assessment*: 2002.

Migration

The migratory patterns in the Russian Federation during the past decade saw a reversal in some of the traditional trends. While the rural population has steadily declined in both absolute and relative terms since the beginning of the 20th century, this trend decreased sharply in 1989 and reversed into an urban-to-rural flow in 1992 and 1993. The economic collapse during those early years of transition affected the urban areas the most, while the impact was slightly softer in rural areas due to possibilities for self-sufficiency. While the flow of people from rural to urban areas continued from 1994 onwards, it took place at a reduced pace than in the late 1980s. However, owing to the net immigration of ethnic Russians from other former Soviet republics, the rural population has continued to increase in absolute terms since 1992.¹⁷

Another reversal of earlier trends is the migratory movement from the north-east to the south-west

of the country, which has characterized the past decade. The northern region contains the majority of the nation's natural resources. During the Soviet era the Government regarded the industrial development of the north as strategic priority and, therefore, channelled large subsidies to the region and encouraged large-scale labour inflow. These policies resulted in the north having a relative large population, which would not have developed under normal circumstances, i.e. without the large subsidies. The transition resulted in a sharp reduction in these subsidies, which in turn resulted in some people leaving the north because there are no economic opportunities.

Citizens who relocate from the far north and other areas of equal status are eligible for housing subsidies from the federal budget if they meet certain conditions. The criteria for eligibility and the amount of subsidies are regulated by the federal Law on Housing Subsidies for Citizens Moving from Regions of the Far North and Areas of Equal Status.¹⁸

¹⁷ UNDP, Common Country Assessment: 2002.

¹⁸ Law No. 125-FZ of October 25, 2002.

Chapter II

HOUSING REFORM

This chapter provides an overview of the most important housing reforms that the Government has initiated during the past decade in view of the changing framework conditions of the housing sector (sect. A). In addition, the chapter addresses the question of how variations within the housing sector of the different regions of the Russian Federation affect housing policy design (sect. B).

A. Major steps in the housing sector reform

Housing plays an important role in a country's economy. The housing sector typically accounts for 10-20% of total economic activity and housing investment constitutes 2-8% of GDP. Beyond its economic role housing is also often an individual's biggest asset. With the majority of the population of the Russian Federation having become homeowners with the right to exercise any sort of transaction such as to sell, grant and bequeath, housing has turned into the biggest asset of most households.

The structure of the Russian Federation's housing sector has undergone major changes during the past decade. Probably the biggest development was the privatization policy, which led to a change in ownership structure by allowing individual tenants to claim ownership of their units and by transferring the State housing stock, including the housing stock of former State enterprises, to municipalities. Today private housing makes up 59% of the total housing stock compared to 33% in 1990.¹⁹

Following the first steps in the privatization process the Government endeavoured to establish the legal basis for regulating the new housing situation. The passage of the Law on the Fundamentals of Housing Policy in December 1992 was important in this context, for the rental sector as well as for the owner-occupied sector. It laid the foundations for a programme to increase rents, introduced housing allowances, provided

for improved maintenance of State housing by introducing competitive procurement procedures, reduced tenant rights by permitting eviction from municipal flats to low-quality housing for the non-payment of rent, established condominiums, clarified property rights, and improved possibilities for mortgage lending.²⁰

More legislations and reforms later strengthened and redefined some of the principles laid down in the Law on the Fundamentals of Housing Policy. In particular, they aimed at further advancing the privatization of the housing stock of the State, municipalities and State enterprises, setting the legal basis for the establishment of homeowners' associations, increasing the activity of the housing market, reforming the housing and utility sector, and initiating reforms in social allowances.

This legislative activity is impressive. Yet, the primary goal of housing reform has undoubtedly been to establish market relations throughout the sector, privatization becoming the key instrument in this process. All households in publicly owned multi-apartment blocks became part of the reform, as residents were granted the right to privatize free of charge the flat that they were occupying. Most crucially, it was assumed that together with this transfer of ownership the new owners would take over the management and maintenance of the housing stock.

The implicit aim of housing privatization was, therefore, to shift responsibility for the maintenance of the housing sector to consumers, who, through the provision of legal title, would be given the incentive to invest in their own housing. The presumption was that tenants would form building-level management structures. In accordance with the federal Law on the Fundamentals of Housing Policy, occupants were given the right to participate in the management of the housing stock, a right which was later further developed in the Law on Homeowners' Associations. Due to the limited financial means of the new owners, however, municipal

¹⁹ Institute for Urban Economics, Urban Management Reform in Russia: 2001.

²⁰ Institute for Urban Economics, Urban Management Reform in Russia: 2001.

authorities continued to manage and maintain the housing stock.

In reality, therefore, privatization has not yet led to a widespread change in the management structure of, in particular, the multi-unit apartment buildings. It has not given the owners of units in these buildings real management authority over the building and adjacent grounds.

Today there are only some 4000 homeowners' associations in the Russian Federation covering just about 1% of the total housing stock. In addition, most existing homeowners' associations have been created for newly constructed buildings. Only few associations have been formed for existing buildings. The main reasons for the slow development are, next to deficiencies in the regulatory framework, little public promotion of homeowners' associations for the management of the common property and inadequate support from local administrations.

The multi-unit housing stock therefore effectively remains public housing from the perspective of repairs, maintenance, upgrading and utilities, regardless of the percentage of apartments that are privatized. The municipality is still viewed as the owner of the building and property, and municipal enterprises continue to provide maintenance, repair and rehabilitation – generally at inadequate levels mostly due to the lack of funding.

Competition for housing maintenance services is consequently still low and a functioning market for housing and utility services hardly exists. However, some improvements are visible, such as the slow but steady increase in the number of private companies within the sector. In addition, households' payments towards the costs of housing and utility services increased substantially along with decreases in budget subsidies for these services and the implementation of targeted social support to low-income households.

Having realized the importance of finding solutions to the current problems in the management and maintenance of the existing housing stock, the Government announced in September 2001 the federal programme 'Dwelling' for the years 2002-2010 with two subprogrammes 'Reform and upgrading of the

housing and utilities sector in the Russian Federation for 2002-2010' (government decision of November 2001) and 'Relocating the citizens of the Russian Federation from slums and dwellings in emergency repair' (government decision of January 2002). The federal programme (including its subprogrammes) calls for significant reforms in the housing and utility sector. Its principal goal is to find a complex solution for introducing the principles of sustainability in the housing sector and allowing residents to enjoy affordable, safe and comfortable housing conditions. Four key actions are identified in the federal programme to achieve this goal:

(a) Ensuring the stable and effective provision of housing and utility services which includes the provision of targeted social support to needy residents;

(b) Making housing more affordable through the development of an effectively functioning housing market and appropriate financial instruments as well as providing support to residents with lower incomes to improve their housing conditions;

(c) Increasing the volume of housing construction by taking into account the demand and requirements of residents;

(d) Ensuring that the federal budget is used more effectively to address the needs of disadvantaged population groups.

The two subprogrammes spell out further strategies for the provision of housing and utilities as well as for the rehousing of residents from condemned dwellings. The reforms included in the federal programme and its subprogrammes are to be implemented in phases until 2010. This is likely to constitute a considerable challenge as implementation is already behind.

On a positive note, the measures stipulated in the federal programme include a review of the Russian Federation's current system of support to socially weak households. It is of great importance to have a targeted, means-tested housing allowance programme as an integral part of reforming the housing and utility sector. A rise in tariffs for maintenance and utility services towards cost-covering levels is possible only when provisions are made for that part of the population that is not able to pay. The first steps for a targeted housing support programme have

already been taken through the introduction of the housing allowance programme. However, more will have to be done, as much of the social system operating today still relies heavily on granting social benefits on the basis of privileges for certain population groups, which are often not the most needy.

The current discussions on the carrying-out of the federal programme on housing reforms show how complex and how interlinked with other policy areas the housing sector is. Reforms in the housing sector cannot be designed without considering their social implications nor can they be implemented without corresponding land reform or municipal reforms, for instance in the role of municipalities vis-à-vis federal or regional institutions. Indeed, the need to balance economic and social efficiency emphasizes the place that housing reform occupies in the Russian Federation's overall social and economic development programme.

A crucial factor for the success of housing reforms is the position of the municipal authorities as legislation grants them the authority to determine the administrative structure used to manage municipal housing and utility services, to set the tariffs of municipal enterprises, and to decide on the time and form of carrying out reforms in this sector of the economy. In addition, the administration of land is effectively in the hands of the municipal authorities as they establish land use, rearrange land plots from one use category to another, set rates for land, undertake inventories of land, supervise municipal land use, protect the property rights of landowners and settle disputes.

To encourage municipalities to actively engage in the process of reform, an all-encompassing municipal reform needs to be carried out. The main component of the reform needs to be a provision that balances the obligations of municipal authorities with their financial capacities. State services were transferred to the municipal sector between 1993 and 1998. By 1998 coverage of these services was supposed to be fully effected from the municipal budget, but the municipal budget is not large enough to cover all expenses. Municipal authorities do not receive sufficient subsidies to comply with the tasks entrusted to them by federal legislation and do not

have sufficient capacities to generate their own funds. As a consequence, the new Law on Local Self-Government is crucial to introduce a balance between the sources of financing and budgetary responsibilities between the different levels of public authority. Its implementation must be accompanied by an amendment of budgetary legislation at the municipal level. Such legislation will need to recognize that different municipal authorities will have different abilities to implement the reform and the legal framework will need to be developed accordingly.

It is to a large extent these structural problems related to the mismatch between responsibilities and capabilities at different institutional levels that account for the partial and limited impact of reform today. It is necessary to resolve these structural problems for reforms to be effective in the Russian housing sector. In addressing these problems, the situation of the country as a whole but also the particularities in the different regions will have to be taken into account.

B. A need for a regional, differentiated housing policy?

The Russian Federation has a large population. It includes areas with very different geographic conditions and cultural traditions. The question therefore is how effective national housing policies can be and if an overall strategy for the housing sector for the entire country is feasible at all. The same question could be posed for conducting this very study. Is it possible to conduct a study with significance for the Russian housing sector as a whole? Will research show that the housing situations in different regions/ geographical areas are so different that a differentiated analysis for these regions/groups of regions is necessary and that different conclusions and recommendations will have to be made for different parts of the country?

The methodological concept of this study was specifically designed to help answer these questions and to identify regional variations in housing policy requirements. For this reason different regions of the country were visited and the research was based on information from across the country.

There are certainly for some regions extreme challenges which do not exist for other areas of the country. The best examples are the large-scale depopulation of the far northern settlements and the inward migration across the south-west. In particular, the massive depopulation of the northern settlements is unique and would merit extensive study in its own right.

Beyond these extreme challenges, divergences in economic development are the main explanatory factor for differences in the housing situation across regions. In particular, the ability of the regional or municipal authorities to provide their own resources or attract private resources for the financing of major repairs and/or new construction depends heavily on their overall economic situation.

In general, however, it can be concluded that, although there are regional variations with regard to the housing situation, the basic concerns and challenges in the housing sector are similar across the country. The differences are most often a

reflection of the extent to which a certain problem or challenge within the housing exists, rather than a difference in the nature of the problem or challenge. Basic housing policy therefore will not require differentiation between different regions. However, its implementation will have to take into account regional particularities.

Of prime importance for the implementation of the housing reform is, however, that the coordination between the different levels of government, the federal, regional and municipal levels works well, that the roles and responsibilities of each level are clearly defined and that a regular system of communication is established. The need to bring the federal and regional levels closer to improve the quality of housing policy and implementation will be discussed throughout the report and in particular chapters IV and VII will analyse the current relationships between the federal, regional and municipal level, and will provide suggestions for improving them.

Chapter III

THE HOUSING STOCK

A. Supply of housing

Total housing stock

According to official statistics, the housing stock of the Russian Federation stood, at the beginning of 2003, at more than 2 850 million sq. metres of dwelling space. Some 72.5% of the total housing stock was situated in urban areas. Official

statistics also show a clear increase in dwelling space between 1990 and 2002.

In general, statistics on the supply of housing have to be treated with caution as they sometimes provide contradictory information. In addition, units of measurement differ from most other countries, further complicating comparisons.

Table 4. The housing stock

Year	1990	1995	2000	2001	2002
Housing stock (million m ² of dwelling space)	2,425	2,645	2,787	2822	2853
- Urban	1720	1911	2020	2045	2069
- Rural	705	734	767	777	784
Average dwelling space per inhabitant (m ²)	16.4	18	19.3	19.7	20
- Urban	15.7	17.8	19.2	19.5	19.8
- Rural	18.2	18.6	19.8	20.2	20.6

Source: The Russian Statistical Annual Edition 2003, Goskomstat, pp. 199, 200, 202.

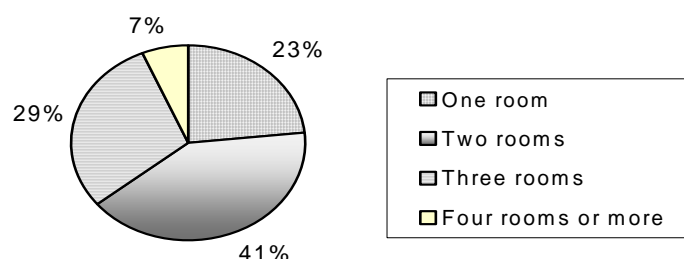
It should be noted that figures for the total housing stock include special-purpose houses such as hostels, shelters, homes for the elderly, children's homes, boarding houses for the disabled and boarding schools. They do not include cottages (dachas) or hotels or other premises intended for temporary residence. In Western countries special-purpose houses are not included in figures for the total housing stock, which makes comparisons with the Russian Federation difficult.

At the beginning of 2002 the housing stock of the Russian Federation was made up of more than 18.9 million residential buildings, composed of 55 million apartments. With 49.8 million households living in the Russian Federation in 2001, the total

number of dwellings exceeds the total number of households.

Dwelling space

In urban areas residential buildings mainly consist of multi-storey apartment blocks and in rural areas of single-family houses. Of the 55 million residential apartments, 23.2% are one-room flats, 41% two-room flats, 29.3% three room flats and 6.5% flats of four rooms or more. The area of a flat typically includes living rooms and bedrooms as well as auxiliary premises, such as kitchens, corridors, bathrooms, store-rooms, and staircases within a flat. Common corridors and staircases or balconies are not included.

Figure III. Number of rooms

Source: The housing economy in Russia, 2002. Collection of Statistics/ The State Statistics Committee of Russia (Goskomstat). - Moscow, 2002, p.110.

The average size of a flat amounts to approximately 51 m² and the average dwelling space per person is about 19.7 m², which is low in comparison to West European countries but about average for Eastern Europe. Newer flats are normally bigger. In 2001 the average size of

newly constructed flats was 83 m², and flats with three rooms or more represented 50% of the total number of new flats.²¹ The number of flats per 1000 inhabitants is 360 – 380. The average occupancy rate per flat is 2.7 persons and per room 1.2 persons.

Table 5. Comparison of housing stock indicators, late 1990s

	m ² /inhabitant	Dwellings/thousand inhabitants	Number of rooms per dwelling	Average completed dwellings per thousand inhabitants, late 1990s
France	43	490	3.9	5.4
Sweden	43	482	4.3	1.3
Portugal	28	482	4.3	11
EU	---	450	---	5.4
Estonia	22	430	---	0.6
United Kingdom	35	417	5.2	3.4
Hungary	29	400	---	2
Russian Federation	19.7	360	2.3	1.1 - 2.6
Ireland	33	341	5.3	12.4
Poland	18	300	---	2.1

Source: Housing Statistics in the European Union 2001. State Research Centre, VTT Finland. Goskomstat.

²¹ According to Goskomstat.

Table 6. Number of occupants per room

<u>Country</u>	Number of occupants	<u>Country</u>	Number of occupants
United States	0.5	Uruguay	1.1
Germany	0.5	Republic of Korea	1.1
Norway	0.6	Russian Federation	1.2
France	0.8	Israel	1.2
Japan	0.8	Turkey	1.3
Poland	1.0	Peru	2.0

Source: United Nations indicators on housing.
 Unstat.un.org/unsd/demographic/social.htm,copyright 2003.

The number of flats per 1000 inhabitants in the Russian Federation is not extremely low compared to Western countries but the flats are small with, on average, only 2.3 rooms per flat. Therefore, the number of persons per room is clearly higher than in Western countries.

As the population has decreased, the housing situation, in terms of available number of flats according to the official statistics, is improving. However, official statistics, do not take adequately into account the condition of the housing stock, which is worsening continuously due to the nearly complete absence of renovation and reconstruction. Statistics on renovation and reconstruction are very limited.

According to expert estimates,²² approximately 150,000 flats become uninhabitable every year due to lack of repairs. It is estimated that over the past few years around 40 million m², i.e. approximately 800,000 flats, have been taken out of the stock due to poor quality. Together with the low rate of new construction this might mean that, contrary to official statistics, there has been no increase in the total housing stock in recent years.

The scale of new construction to replace the run-down housing stock is limited. New housing construction in the Russian Federation has slowed

down significantly since 1990. New construction in 2001 was about 40% of the volume of new construction in 1990. Housing statistics indicate that the Russian Federation is producing about 32 million m² dwelling space and 380,000 dwellings annually, that is, 2.6 dwellings per 1,000 people. But more detailed surveys of different regions suggest that the real number is much lower, even under 200,000, which would mean about 1.4 dwellings per 1,000 persons.²³ In Western Europe the average number is 5 to 5.5 dwellings per 1,000 persons (see chap. X).

B. Quality of the existing housing stock

Age and design of the housing stock

The housing stock in the Russian Federation is young compared to that in Western Europe. The industrialization of construction started in the Soviet Union in the 1950s. Thereafter, precast concrete large-panel construction developed quickly. Most of the apartment buildings were constructed between 1960 and 1985, and as a result the urban housing stock today consists mainly of a few standard building types.

Residential panel buildings can generally be divided in three basic categories:

- *First generation*: five-storey buildings often called *khrushchevki*. *Khrushchevki* were

²² E. Hekali, Hansa Renovation Project, Finnish Association of Construction Industry.

²³ State research centre, VTT, Finland, Academic J. Rekitar, Russian Federation.

built between 1959 and 1969 and about 10% of residential buildings belong to this category. The buildings do not have lifts. Flats and rooms are small. Total dwelling space varies between 30 and 61m². There are four subcategories but the differences are not great. Most *khrushchevkys* are in a poor state of repair. Many five-storey buildings are situated in fairly attractive areas, not far from city centres.

- *Second generation:* these buildings were built between 1961 and 1975. The number of storeys varies but nine-storey buildings are the most common. The buildings are long and there are usually five to nine staircases in each. The external walls are different lightweight concrete structures without separate thermal insulation material. The housing norms of 1963 regulated their design and construction. The dwellings in this category are more comfortable than those in the first-generation buildings.

- *Third generation:* these buildings were built mainly after 1975 in the suburbs. Large elements and prefabricated modules were used. These buildings are nine-storey or higher, tower-type blocks of flats or long, narrow buildings with four to seven staircases. The external walls are 35 cm thick expanded-clay lightweight concrete.

Although the above-described urban housing stock is fairly new, technically it is not in a good condition owing to its low-quality construction and poor maintenance. Energy efficiency is generally poor. The thermal insulation of the precast panel walls does not meet modern standards. Moisture and mould problems appear in some apartments due to poor thermal insulation. The surroundings including streets, courtyards and parks are usually poorly maintained too. The limited variation in the urban housing stock results in suburbs of great uniformity, which are not geared towards individual wishes or needs.

There are also older buildings and other types of buildings in urban areas but these are much less common. One category is the famous “Stalin-era” buildings, which can be recognized by their typical architecture. These prestigious buildings are situated in good places in city centres; their technical condition, however, is partly problematic. In St Petersburg, for instance, there are also historically valuable residential buildings with communal flats, which are in urgent need of repair. In many towns there are also old wooden individual houses which are in very bad condition owing to a complete lack of repair.

Table 7. Age of the housing stock

Construction date	% of dwelling space		
	Moscow	St.Petersburg	EU
Before 1917	2	19	32
1918 - 1945	3	3	
1946 - 1975	52	43	40
1976 and later	43	35	28

Source: Moscow City Bureau of Housing Stock Technical Inventory 2002. Hansa Renovation.
Project, Finnish Association of Construction Industry: St.Petersburg State.
Housing Statistics in the European Union 2001.
Sciotech 1998.

Run-down and dilapidated (“emergency”) housing stock

The technical condition of the country’s housing stock is worsening continuously. More than 290 million m² or 11% of the housing stock needs urgent renovation and re-equipment, 250 million m² or 9% should be demolished and reconstructed. Gosstroy estimates that the annual need for renovation is equal to 4 – 5% of the total housing stock. However, in 2001 only 0.3% of the housing stock was actually renovated.

The State guarantees that citizens who live in dwellings or houses which do not fulfil the minimum safety or health requirements will be rehoused. There are no federal standards or guidelines defining run-down or dilapidated housing. Local authorities and special boards inspect the houses and estimate the “rate of wear”.

Housing with a rate of wear exceeding 60% is classified as run-down or dilapidated and is

subject to demolition. The numbers have increased continuously over the past years. In 2003 the housing stock classified as run-down or dilapidated represented more than 87 million m² which is 2.7 times more than in 1990. The share of run-down or dilapidated housing within the total amount of the housing stock has increased from 1.3% in 1990 to 3.1% in 2001 (see table 8).

The rate of demolition of condemned housing has been extremely slow in recent years. On average, around 2 – 3 million m² (about 60,000 dwellings) have been removed from the housing stock, i.e. only 3.5% of the run-down or dilapidated stock. However, according to estimates of Russian and foreign experts over the past years over 40 million m² (approximately 800,000 flats) have not been inhabited due to their poor condition. At present, 2 million people live in officially condemned stock. In the absence of adequate maintenance and repair the share of the run-down or dilapidated housing is likely to increase sharply in the near future.

Table 8. Run-down and dilapidated housing stock (2001)

Year	1990	2001
Total run-down and dilapidated housing stock (thousand m ²)	32,200	87,800
- Rund-down stock	28,900	80,000
- Dilapidated stock	3,200	7,800
Share of run-down and dilapidated housing (%)	1.3	3.1

Source: The Housing Economy in Russia 2002, *Goskomstat*, p. 87.

Unfinished construction

Insufficient investments and rising construction costs have often resulted in delays in construction or in an inability to complete the already started work. As a result, at the end of 2002, unfinished residential buildings (excluding individual houses) represented 40.1 million m², i.e. twice the volume of dwellings completed in 2002. In many areas it is expected that construction on this unfinished buildings will not resume in the near future due to a lack of financing or a lack of active demand. Nevertheless, the amount of unfinished housing is gradually decreasing: in 2002 it was 4.2 million m² (9.5%) less than in 2001 and 50 million m² less than in 1995, i.e. the unfinished housing stock has been halved (see table 9).

Table 9. Estimated unfinished housing

Year	1995	1996	2000	2001	2002
Number of residential houses	80,800	68,700	41,100	38,700	34,100
Total floor area (million m ²)	90.1	76.6	45.3	44.3	40.1

Source: The Russian Statistical Annual Edition, 2003, Goskomstat, p. 444.

There are strong regional differences in the volumes of unfinished construction. It is extremely high in the regions of Tula, Murmansk, Kamchatka, Magadan and the Jewish autonomous region, where in 2001 the ratio of the total unfinished dwellings to completed new dwellings was 10:1. Only in Moscow did the volume of unfinished housing not exceed annual dwelling completions at the end of 2001.

Housing amenities

There have been improvements in housing utility services during the past six years. However, in 2002, 13% of the housing stock in towns and

urban settlements remained without running water, 15% without sewerage, 12% without central heating, 20% without fixed baths or showers and 23% without running hot water. In rural areas between 59 and 81% of the housing stock had no such utilities. There is no piped water in 10 towns (i.e. in 1% of their total number), in 110 urban settlements (6% of all urban settlements) and in 110,100 rural settlements (71% of rural settlements). About 71 million people, i.e. 49.6% of the total population live in housing equipped with all amenities; 61% of the urban population and only 16.2% of the rural population.

Table 10. Housing amenities (%)

	Running water	Sewerage	Central heating	Gas	Fixed baths (showers)	Running hot water	On-floor electric stoves
Total housing stock							
1995	71	66	68	61	69	55	15
2001	74	70	75	64	70	61	16
2002	74	70	75	64	70	61	17
Urban housing stock							
1995	84	82	85	77	67	72	20
2001	87	85	88	80	69	77	22
2002	87	85	88	80	69	77	22
Rural housing stock							
1995	35	24	23	20	73	12	2
2001	40	31	40	24	74	19	3
2002	41	31	41	24	75	19	3

Source: The Russian Statistical Annual Edition, 2003, Goskomstat, pp. 199-201

Energy efficiency

The Russian housing stock has poor energy efficiency, but not so poor as sometimes estimated in energy-saving calculations. Measurements in Baltic and Russian panel-block buildings show that their energy consumption is about 1.1 to 1.7 times higher than that of Finnish energy-efficient multi-storey residential buildings. In Estonia it is estimated that different renovation measures to save energy in the Soviet-era large-panel buildings can reduce heat consumption by 7% to 27%. Energy-saving measures in old buildings are often technically problematic and expensive. Their payback time is long. They are often economical only in combination with other renovation measures. Energy-efficient stock needs to be built up slowly through new construction and strict building regulations, but even now new construction seems to be less energy-efficient in the Russian Federation than in Western countries.

In the Russian Federation energy saving measures that are not too costly, such as renewing windows and installing energy and water meters, are the most common. They might increase energy efficiency; however, attention must be paid to the overall circumstances. When, for example, changing windows there is a danger that the indoor climate deteriorates and mould problems increase due to a lack of ventilation. When windows are changed, the ventilation and heat systems of the whole building should be checked and regulated. The instalment of individual heat and water meters in flats also has

to take into consideration the state of the pipes in the building.

New flats are sold when the load-bearing structures and outer walls are ready. All the finishings and infrastructure inside the flat are done or bought by the buyer. This reduces the sales price of the flat but actually increases the costs of construction, maintenance and repair. Plumbing and heating equipment are consequently often very diversified and their quality, security and energy efficiency can be low. Roofs and heating systems must be regularly repaired to keep the building usable. Valuable technical knowledge about repairing Soviet-type apartment buildings is available, for instance, in the Baltic countries. Solutions to technical problems in renovating, for example, concrete panel buildings and modernizing district heating systems are well known in the neighbouring Nordic countries. This knowledge is also usable in the Russian Federation. The repair of the Russian housing stock should, however, take into account the country's economic, technical and cultural circumstances and not simply import methods developed for quite different situations far away.

C. Tenure structure

The tenure structure has changed greatly as a result of privatization. By the beginning of 2002, 22.3 million residential units, i.e. 61% of the housing stock subject to privatization, had effectively been privatized (see table 11).

Table 11. Privatization of housing units
(shown as accumulated results from the beginning of privatization)
(by the beginning of each year)

Year	1990	1995	2000	2001	2002
Number of privatized housing units (thousands)	53	12,479	17,351	18,538	22,339
Total dwelling space (million sq. m)	2.5	608.3	842.0	903.2	-
Privatized residential premises (% of total premises subject to privatization)	0.2	36.0	47.0	50.0	61.0

Source: The Russian Statistical Annual Edition 2003, Goskomstat, p. 200.

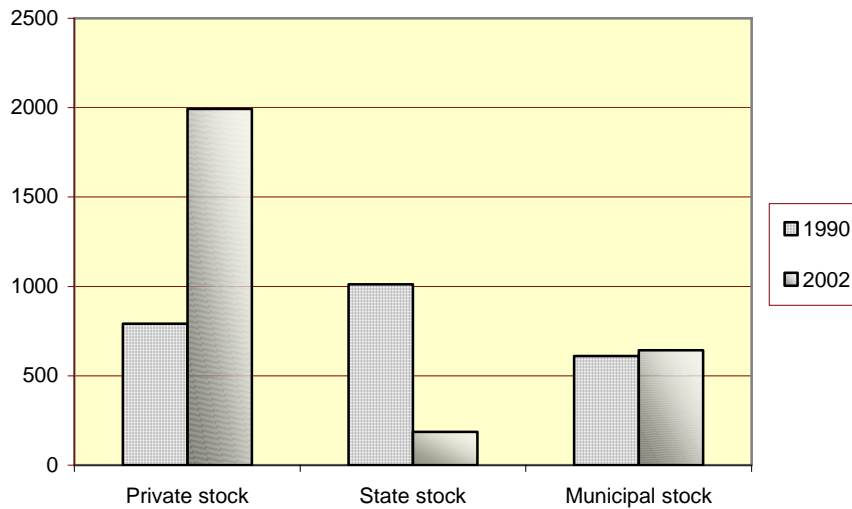
While in 1990, 33% of the total housing stock was privately owned, in 1995 it was 53%, in 2000 65.3%, in 2001 67.7% and in 2002 69.9%. Of the privately owned dwellings in 2001 50% had been privatized cost-free, 40% had been purchased by private citizens, 6.7% belonged to building cooperatives and 3.3% were in the hands of various other legal entities. much in recent years.

The share of the municipally owned housing stock has not changed Municipalities owned 25% in 1990, 30% in 1995, 26.5% in 2000, 24.1% in 2001 and 22.5% of the total housing stock in 2002. About 6.5% of the total housing stock was in State ownership in 2002. The share of State-owned housing has decreased rapidly. It was 42% in 1990, 10% in 1995, 6.3% in 2000 and 6.8% in 2001.

Table 12. Ownership of the housing stock
(m²)

Year	1990	2001	2002
Total housing stock	2,425	2,822	2,853
Private stock	791	1,910	1,993
- of which in citizens' ownership	641	1,809	1,897
- State stock	1,011	193	186
- Municipal stock	611	680	643
- Public stock	12	2	2
- Mixed ownership	---	37	29
Urban housing stock	1,720	2,045	2,069
Private stock	353	1,245	2,069
- of which in citizens' ownership	260	1,191	1,265
State stock	765	162	157
Municipal stock	594	612	575
Public stock	8	1	1
Mixed ownership	---	29	22
Rural housing stock	705	777	784
Private stock	438	669	679
- of which in citizens' ownership	381	618	632
- State stock	246	31	29
- Municipal stock	17	68	68
- Public stock	4	1	1
- Mixed ownership	---	8.0	7.0

Source: The Russian Statistical Annual Edition 2003, Goskomstat, p. 200.

Figure IV. Ownership of the housing stock

After peaking in the mid-1990s, the annual rates of privatization of the housing stock gradually fell till 2000. The share of privatized housing in different areas does not differ much. In Moscow 53% of the housing stock is subject to privatization, i.e. can be privatized by the tenants by the special privatization law, which is above the Russian average. The relatively low share of privatized housing in St Petersburg (43% of dwellings subject to privatization) can, for the most part, be explained by the large share of communal flats (i.e. dwellings being shared by more than one household). Privatizing rooms in such flats was until recently constrained by the necessity to get permission from the other households.

D. Households in need of new housing and housing improvements

The number of households in need of housing or better housing conditions registered by the local

authorities has substantially dropped during the past few years. By the beginning of 2002 the number of households registered by local authorities for the purpose of housing allocation had come down to 4 million, i.e. 10% of the total number of households down from 20% in 1990.

By the beginning of 2002, the share of households which had been on the waiting lists for new housing for more than 10 years was 37.7% of all households on the waiting list (compared with 13% in 1990 and 33.8% in 2000). During 2002 about 229,000 households (5% of all registered households) were housed, compared to about 1,296,000 households (13% of registered households) in 1990 (see table 13).

It is estimated that there are approximately 4.2 million homeless people, of whom half have been without a fixed abode for more than two years.

Table 13. Housing allocation

Year	1990	1995	2000	2001	2002
Number of households provided with dwellings or having improved their housing conditions (thousands)	1,296	652	253	242	229
- in % of households registered for housing allocation	13	8	5	5	5
- in % of all householdes	3.0	1.0	0.5	0.5	0.5
Number of households registered for housing allocation by year-end (thousands)	9964.0	7698.0	5419.0	4857.0	4428.0

Source: The Russian Statistical Annual Edition 2003, Goskomstat, p. 201.

The public housing allocation system with waiting lists is losing its role in the provision of dwellings. However, at the same time, the secondary market and rental market systems are not yet working

efficiently. The changing of flats between households seems complicated and households have difficulties to meet their housing needs.

Chapter IV

INSTITUTIONAL FRAMEWORK

Introduction

During the drafting of this chapter the institutional framework of the Russian Federation's housing sector underwent some major changes, in particular with regard to the institutional responsibilities of the federal Government. The analysis in this chapter is based primarily on the institutional set-up as it existed until March 2004, but will also give an account of the changes effected since then.

A. Institutions involved in housing policy implementation

There are three levels of government in the Russian Federation, each its own with competencies.

Federal institutions

The federal institutions are responsible for the State's unity and Constitution, its sovereignty and territorial integrity. State power is exercised by the President, the Federal Assembly (the Federation Council and the State Duma), the federal Government and the federal courts.

The State Duma does not have a separate housing committee. Its key housing-related units are the Committee on Industry, Construction and Technology and the Committee on Civil, Arbitrage and Process Law. Depending on the topic, the Committees on Property, on Social Policy, on Economic Policy or on Local Self-government may be involved in the discussions.

The Government of the Russian Federation consists of 14 ministries, 34 federal services and 28 federal agencies (March 2004). Ministries develop policy and regulatory documents. Federal services provide control functions. Federal agencies are the real "executive" bodies. The Government prepares and submits bills for federal legislation and the federal budget to the State Duma and ensures implementation of the budget by submitting relevant reports. The federal Government plays an important role in generating

financial resources through taxation, especially through the federal distribution of taxes, which are collected locally and distributed among the three levels of government either in accordance with rules laid down by legislation or regulated through negotiations. The federal Government has also created a system of tariffs for housing and utility services that are to be followed by local authorities when charging households for the relevant services.

The key federal institution for the housing sector until March 2004 was the State Committee for Construction, Housing and Municipal Economy (*Gosstroy*). Since 9 March 2004, it has been the Federal Agency "Gosstroy" under the Ministry of Industry and Energy. The Federal Agency has executive authority for inter-industrial regulation in construction, architecture, urban planning, housing policy and public housing.

The responsibilities of the State Committee for Construction, Housing and Municipal Economy were complex, covering all major aspects of planning and construction, but also of the built environment.

The State Committee had about 450 full-time specialists employed in the head office. In addition, it had under its authority a system of about 52,000 organizations all over the country and at all levels of government. There were about 50 institutions for research and development, and also about 40 institutions for education and training, consultancy and licensing, as well as a specialized State library on construction and architecture, a museum of architecture, exhibition halls, etc.

The State Committee was the initiator and the main responsible body for the major housing-related and federally targeted programmes without, however, having any vertical power on housing issues. The State Committee did not have the authority to command from top to bottom and support these commands with relevant funding. The State Committee's competence was only 'collaborative' or 'recommendatory' in particular with regard to the heads of regional

administrations. The State Committee established the Central Council of State Housing Inspections – a system of inspectorates to monitor locally the quality of housing construction and utility services. To date, State housing inspectorates have been created by 82 regional administrations (“subjects of the Federation”), but only 40 of them are administratively independent. The others are still part of the local housing management structures. The national housing reform generally aims to devolve the major responsibility for implementing federal housing policy from the federal to the lower levels of government.

The changes in government structure effected in March 2004 were still evolving at the time of finalizing this study. It was therefore not possible here to say with certainty what the new institutional set-up would look like or to judge what impact this would have on housing policy design.

Regional institutions

Executive power in most regions is exercised personally by the highest elected official called head of administration, governor, president or sometimes chairman of the government. The structure and the role of the regional governments are similar to those of the federal level in particular with regard to the distribution of resources and the execution of power. The competence of the regional governments includes duties that cannot be performed by municipal governments, such as developing infrastructure, but also regional housing programmes. The regional government approves the budget proposals of the municipalities, which in the case of new public housing construction is broken down into every single project. In many cases different ministries (or committees or departments) deal with construction and housing within the regional governments.

Local self-government institutions

Local self-governments, which are the municipal entities, represent a rather new component in the country’s power structure. According to the 1993 Constitution, their institutions are not institutions of State power and should act independently and be answerable to the local population. The underlying idea is that the local self-governments

may be organized independently without any interference from the higher authorities. However, this does not mean that the State completely abstains from regulating their structure and competence. The Constitution recognizes and guarantees their rights, but also establishes some basic responsibilities for them. Currently, there are 13,383 local self-governments, of which about 1,300 are urban.

Local authorities are the main executive agencies that provide housing and utility services. About 8,500 municipalities have their own housing stock and are thus responsible for its management and maintenance. The major competencies of the municipalities in housing are:

- Administering, maintaining and operating municipal housing and non-residential premises;
- Planning and developing the municipal territories;
- Creating the conditions for developing dwellings and buildings of public importance;
- Organizing, administering and developing the municipal electricity, gas, heating, water and sewage utility companies;
- Providing heating fuel to residents and municipal institutions (oil, coal, timber, etc.);
- Building and maintaining municipal roads;
- Operating emergency fire services.

In the foreseeable future municipalities are expected to continue to play a predominant role in housing. They are the major bodies for operating and maintaining the housing stock, and for providing the most important utilities through their local service companies. Although municipalities allocate about 40-60% of their annual budgets to housing, their financial and operational autonomy in housing is quite limited. They do receive considerable support from the budgets of higher levels.

The federal legislation and institutional guidelines tightly regulate the major processes in housing. The federal authorities set the legal framework

and decide on housing reform. Each municipality has to implement the housing reform locally. The law gives local self-governments the authority to determine the most suitable administrative structure for managing their local housing and utility service provisions within the budgetary limits and the targets set.

Within the administrative structure of the local self-governments, the city council typically sets the housing management guidelines for the local government administration, where the deputy head – due to the importance of housing for the local policy and budget – is quite commonly responsible for housing matters. The administration has to cover three major issues:

- Developing new public housing and public buildings, incl. major repair of existing buildings;
- Management and maintenance of the existing housing stock, and administering the waiting lists;
- Providing utility services for the city (e.g. electricity, water, sewage, heating, etc.) and managing and maintaining public facilities on the territory of the municipality (schools, saunas, public buildings, etc.).

Municipalities also have departments of architecture, land committees; so-called bureaux of technical inventory and sometimes also branches of the State housing inspectorate.

B. Civil society

It is vital for households to get information and advice on access to the services that they require to meet their housing needs. There should be help desks and advisers to answer residents' questions about their homes, but also to advertise other sources of information. At present NGOs play a predominant role in raising awareness about housing issues and about the roles of different institutions.

Due to the enormous size of the country, the list of its non-governmental housing-related institutions can never be exhaustive, but based on their mission and membership they may be classified into six major groups:

- Professional associations and trade unions;
- Federations of commercial companies acting on the housing market;
- Associations of municipalities;
- Research and educational organizations;
- Housing movements;
- Homeowners' associations.

Professional and commercial associations

Housing-related professional associations and trade unions unite specialists to defend their professional rights, as well as to influence the sphere of their professional activity – housing policy, architecture and design, land administration, and real-estate transactions. Some examples with long traditions are: the Russian National Urban Society, the Union of Architects of Russia, the Union of Designers of Russia and the Russian Society of Civil Engineers. Among the trade unions, the Trade Union of Workers of Local Industry and Municipal Enterprises should be mentioned.

As the housing market has become commercial, the companies involved in it are interested in protecting their business interests and creating fair rules for business. The Builders of Russia Union (founded in 1990) incorporates over 360 organizations from nearly every region of the Russian Federation. At the same time there are also about 25 associations, unions and societies for construction companies working locally in the different regions of the country. These institutions are active not only in developing the issues that are directly related to the construction sector, but they have also been involved in tackling customers' debts, mortgage lending, organizing tenders and contracting, and issues related to licensing. The National Union of Housing and Municipal Enterprises, the Russian Guild of Realtors, the Russian Society of Appraisers, the Association of Russian Banks and the Association of Mortgage Banks pursue similar aims.

Associations of municipalities

It is important for the country's federal structure that local self-governments can promote and

protect their joint interests both federally and regionally. Consequently, municipal entities have created organizations that operate throughout the country, within a single region or within several regions that share economic interests. Most of these organizations are fairly new and they all suffer from limited financial and professional resources.

The most important of the national level organizations are:

- The Union of Russian Cities: established in 1991; incorporates the 90 biggest cities, mainly regional capitals (excluding Moscow and St Petersburg);
- The Union of Small Towns of Russia: established in 1991; membership consists of the heads of administration of the cities with fewer than 200,000 inhabitants;
- The Association of Siberian and Far-Eastern Cities.

To merge the efforts of local self-governments, 52 of their unions founded a nationwide association, the Congress of Municipal Entities of the Russian Federation, which was registered in 1998. Today the Congress is the most important national association for Russian local authorities and is seen as the key actor in their future developments. Only the regional associations or unions of local governments, not the local authorities themselves, are members of the Congress. The Congress has a special standing commission to promote housing and municipal reform and it organizes discussions, conferences, training courses and exhibitions in close cooperation with many research institutes and private and municipal utilities and maintenance companies. A major discussion forum with some 300 participants about best practices in local government housing reform took place in spring 2003.

Research/ educational institutions and organizations for public information

Housing has become a professional field of activities requiring research and development, but also training. Those who want to be educated in built-environment-related professions can choose amongst more than 100 universities and colleges for higher education, some 300 specialized

training centres for professionals and more than 500 schools for skilled workers. Most of these educational institutions are publicly run. Moscow State University of Civil Engineering, founded in 1921, is the leader in civil engineering and built environment. There is also the Moscow Institute for Advanced Professional Training in the Housing and Municipal Economy. Specialized higher educational institutions in all the larger cities and in the regions provide education for engineering, real-estate issues and public management.

There are no public educational institutions specialized in condominium management. However, during the past two or three years several training centres in Moscow, Novosibirsk, Novgorod, Khabarovsk, Ulan-Ude, etc. have started new condominium management training schemes supported by Western donors, especially the United States Agency for International Development (USAID). Some housing NGOs also provide training in this field – e.g. the Housing Chamber of Moscow, ‘Domouprav’, the Institute of the Non-governmental Sector in Novosibirsk, but also in other cities.

One of the major media outlets for professionals is the monthly ZKH (Housing and Municipal Economy), which has been published by Gosstroy since 1998. Each monthly edition consists of two volumes, one with discussion papers and advertising, and another with official documents and reviews.

Moscow’s weekly housing bulletin Chain of Apartments is hugely popular. Though officially a Moscow-based paper, it highlights the major housing problems in the country and has sections for official documents, housing reform, homeowners’ associations, etc. Its Web edition is also widely read.

One of the best well known research bodies is the Institute for Urban Economics created in 1995. Its main goals are to develop and introduce new approaches to housing problems. Some of its most important activities are :

- Research into the social and economic problems of urban areas;

- Contribute to the drafting of legal and regulatory documents on housing reform;
- Assisting to the preparation of strategic concepts, practical approaches and implementation schemes for pilot programmes to reform the urban economy;
- Providing methodological and technical assistance to different institutions for drawing up and implementing urban economy programmes;
- Training government officials, staff of banks and private companies;
- Disseminating experience and recommendations through the media and publications.

Its 'Transition to Smart Growth: Improved Local Governance and Economic Development' programme aims to:

- Strengthen local self-government in the Russian Federation;
- Strengthen local government capacity to develop and manage municipal resources;
- Encourage local governments to operate in a sustained partnership with their communities;
- Increase the policy development skills of local and national officials and community leaders.

Two other institutions in this category should be mentioned:

- The Leontief Centre (St Petersburg) is an international centre for social and economic research; and
- The EUROGRAD Institute (St Petersburg) aims to provide wide theoretical and practical assistance to local authorities in an effort to foster the potential development of their towns and to implement municipal reforms.

Housing movements

Housing movements represent and defend the rights of different social groups in the housing sphere. In the Russian Federation, housing movements are a new social phenomenon, reflecting the dramatic and rapid changes in the country's social, economic and political climate. The first officially recognized Soviet neighborhood organizations resembling grass-roots community groups were called 'committees of social self-management'. They appeared in Moscow in 1988. Their activities included direct social assistance and the distribution of Western humanitarian aid, greater control over the actions of local authorities and over the delivery of services in the neighbourhood, representation of local interests at municipal agencies, defence of citizens' rights in relation to housing, and organizing collective voluntary work to improve living conditions.

In the new social and political climate, different housing problems are superimposed on the old housing concerns mainly related to poor services. A lack of information, coupled with uncertainty, has contributed to the mushrooming of different movements highlighting particular housing problems. For example, in recent years, some 20 local community groups and hundreds of other grass-roots groups have been created in Moscow alone. They have been strongly involved in different community activities, including the defence of housing rights of different social groups, such as people with poor housing conditions, the homeless, applicants for free municipal flats, members of housing cooperatives, etc. These activities have changed their character from protest organizations to real movements attempting to work constructively in cooperation with the authorities on different levels.

Given the country's size and diversity, different regions may have completely different problems to tackle. Therefore, not all movements that are crucial to some have a central body on the national level. Table 14 includes only a small selection of movements with very different backgrounds.

Table 14. Housing movements

Movement	Activities
Forum of Migrants	<ul style="list-style-type: none"> • Provides support to migrants returning to the Russian Federation and to homeless people. • Is the largest of its kind. • Has representatives in 53 regions. • Provides publications, advice and training.
National Forum for Affordable and Decent Housing, founded in 1991.	<ul style="list-style-type: none"> • Advocates partnerships in housing. • Experts provide consultancy throughout the country on housing finance, residents' self-management, collaboration with maintenance companies, defense of housing rights. Umbrella organization for inexperienced, but active housing partnerships in Moscow. <p>Provides training courses and high-quality publications about housing.</p>
Inter-regional Union of Tenants and Flat Owners, registered in 2002 (former Union of Owners of Flats in Municipal, Cooperative and Industrial Housing Stock, created in 1994)	<ul style="list-style-type: none"> • Developed a wide network of associations of flat owners in many Russian cities. Actively resists housing and utility service monopolies. • Raises awareness about the problems in the housing sector through seminars and workshops.
Public Council on Housing Policy, set up in 1994	<ul style="list-style-type: none"> • Created with the support of the Moscow City Duma. • Part of a representing body housing NGOs in Moscow. • Has great public influence as its activities are supported by several housing-related professionals.
<u>Nochlyezhka</u> (Night Shelter) in St Petersburg	<ul style="list-style-type: none"> • Charitable foundation to help the homeless. • Provides consultancy and surveys. • Supplies food for people in need.
Russian Union of Youth Housing Cooperatives	<ul style="list-style-type: none"> • Forum for discussing the housing problems of youth and young families. • Has been active for about 30 years. • Has several policy makers as active members. • Initiators of the special housing programme for young families in the Russian Federation.

Source: The Russian Statistical Annual Edition 2003, Goskomstat, p. 201.

In recent years, several housing committees, and “staircase” councils have been formed in municipally managed apartment blocks due to the fear of terrorism, vandalism and concern about the deterioration of common areas. These voluntary organizations are good examples of residents – either owner-occupiers or tenants in municipal flats – joining forces to tackle common problems. These housing committees include a great variety of voluntary associations, partly inherited from the Soviet period but adjusted to today’s realities, and partly created as a reaction to radical changes in housing policy, social structure and tenure structure.

The immediate motivation was the series of bomb blasts in several apartment buildings in Russian cities in the autumn of 1999. It became clear that the common spaces of the shared buildings and the yards were ownerless. On the local level (‘one block, one house’), staircase associations and housing committees, but also street, micro-region and community self-management committees have been formed to improve the quality of housing maintenance and living conditions.

Homeowners’ associations

With the transfer of ownership title to a large number of tenants, new forms of organization for the privatized property became necessary, as the new owners had to take over the management and maintenance of the housing stock. Housing reform policies foresee an increasing role for homeowners’ association. They are expected to be the main institutional form of housing organization and management for privatized apartment blocks (for further information on homeowners’ and condominium associations, see chapter VII.).

C. International organizations

The United Nations Development Programme has been active in the Russian Federation since 1993.

Its three most important project areas are the environment, governance, and sustainable livelihoods and economic development. All are contributing to developing human capabilities and improving the standard of living.

USAID has operated in the Russian Federation since 1992. USAID/Russia’s goal has been to support the establishment of a market-oriented and socially responsible democracy through the adoption and use of democratic norms. Of special concern have been the activities related to local governance, focusing on improving the responsiveness of local governments.

The World Bank is one of the Russian Federation’s largest sources of development assistance. About 70 projects are either currently running or have recently ended. These projects have targeted different aspects of energy saving or building renovation – thus either directly or indirectly improving living conditions.

UN-Habitat Executive Bureau in Moscow has been active through a number of projects such as the round table for assuring the sustainable development of Russian cities in 2002. It has also run projects in different regions to raise public awareness about sustainable development.

The international organizations active in the Russian Federation do not, as a general rule, provide direct help to municipalities and households for individual housing improvement projects. Their projects are targeted more at generating a suitable environment where the responsible institutions and actors can implement their housing strategies. The international organizations also aim at providing education, training and know-how.

Chapter V

LEGAL FRAMEWORK

A. The general legislative principles of housing reform: the Constitution, the land and the Housing code

The Constitution and ownership of property

Article 9 (para. 2) of the Constitution of the Russian Federation declares that ‘land and other natural resources may be in private, State, municipal and other forms of ownership.’ In addition, article 36, paragraph 1, declares that ‘citizens and associations of citizens shall enjoy the right of having land in private property.’ This right was further affirmed in parts 1 and 2 of the Civil Code, which is explicitly based upon the equality of participants in economic relations, the inviolability of property, freedom of contract, the inadmissibility of arbitrary interference in private matters and the guarantee of reinstatement of violated rights and their judicial protection. Yet until the passage of the Land Code of the Russian Federation in October 2001, the legal regulation of landownership relied heavily on presidential decrees and their promulgation was accompanied by the eruption of institutional conflict rather than consensus.

While existing in theory, private land property lacked an operational framework. Constitutional regulation does not have an exhaustive character; it has to be developed and specified by other legislative acts. Point 3 of article 36 of the Constitution asserts that ‘the conditions and procedure for the use of land shall be determined on the basis of federal law.’

In 2001 the adoption of the Land code helped to introduce general principles for real estate development. Its provisions cover: the unity of land and improvements; land as an object for commercial transactions; the classification of land into seven categories with regard to land-use policies; the demarcation of State property and the registration of federal property in the cadastre and real property rights in the registration system. However, these provisions have not yet been put into practice.

Until the Land Code came into force in October 2001, continual disputes arose due to the separation between ownership of land and that of buildings. As a result it was impossible to maintain a unified cadastre. Only with the enactment of the Land Code were building and land rights unified and was a federal programme created for the accounting of all objects of real estate on the basis of the land cadastre. The big problem remains to coordinate this system of registration. The Land Registry was created at the federal level but the actual management is under the regional authorities. As a result there are 89 systems of registration throughout the country. This network does not exchange data with the land cadastre.

Although the Land Code clearly affirms that land should be privatized, there is considerable municipal resistance to this. In accordance with the Land Code, individuals and entities can acquire land. If there is any problem, an application can be made to the courts to enforce this right. The implementation of this right is rendered inoperable by the lack of delimitation between federal government and municipal authorities. The result of this incomplete delimitation of property between federal and municipal land is the lack of transparency around investment schemes and an insufficient legal basis to develop a land market. Land and utility services are monopolized.

Ownership of housing and rental agreements

Following the introduction of the Law on the Fundamentals of the Federal Housing Policy in January 1993, housing relationships began to be regulated according to the different types of rights to immovable property that existed within the housing sector. These rights were codified in chapter 18 of the Civil Code. Chapter 18 eliminated a number of restrictions on acquiring residential premises into ownership, and restrictions on the use and disposition of such dwellings. However, in reality few of the

relationships in the housing sector, both the rights and obligations of owners and tenants, and the rights and obligations of maintenance and utility service providers, resemble contractual relationships as regulated by civil law.

With regard to the right to use State-owned and municipally owned residential units, the Civil Code introduced significant innovations into the rights and obligations arising under a rental agreement. Under a rental agreement for residential premises, the owner is responsible for providing the tenant with residential premises for the purposes stipulated by article 671. The next article specifies 'a social rental agreement' (art. 672). The notion of rent covers, drawing from both these articles, 'social rent', which is regulated mainly by housing legislation, and the 'rent' of residential premises governed mainly by civil legislation.

By law the tenant is responsible for the payment of housing and utilities charges. In accordance with the Law on the Fundamentals of the Federal Housing Policy (art. 15), a tenant who fails to pay for housing and utilities within six months may be evicted under a court procedure. The tenant should then be allocated another home which meets the sanitary and technical requirements of a hostel. The Civil Code reaffirms this provision for the termination of a rental agreement and the eviction of the occupants if they are unable to pay the rent (art. 687). However, the 1983 Housing Code does not contain such a provision, although the failure to pay rent is a widespread problem.

Eviction is allowed only exceptionally. The Civil Code provides that the premature termination of a rental agreement is possible only through a court procedure, in compliance with article 35 of the Constitution. In contrast, again, the Housing Code stipulates that the termination of a rental agreement and eviction are permitted by an administrative decision.

The obligation on the owner to use the dwelling in accordance with its purpose is spelled out article 288 of the Civil Code. One of a few grounds for the owner to be deprived of the property, directly specified by legislation, is its improper use (art. 293 of the Civil Code). In the case of such an infringement, the court, on the basis of a claim brought by a local self-government body, might

take a decision about the public sale of the residential premises with the compensation of the owner after the deduction of the court's cost. Thus the policy aim of preserving the housing stock is achieved by establishing the legal responsibility of the occupant to maintain the occupied residential premises in proper condition and to repair the dwelling, as stipulated by articles 678 and 681 of Civil Code, and article 142 of the Housing Code, and the responsibility of the occupant to provide for proper maintenance (art. 676 of Civil Code and art. 141 of the Housing Code).

Incompatibility of different legal acts

As illustrated above, the problem of the failure to implement the norms of civil law has resulted from the lack of definition within legislation, and contradictions between different levels of legislative acts. For example, there has been no 'legislative codification' of the constitutional principle that 'social rent' is applied only to low-income groups. Although legislation has introduced the notion 'State-owned and municipally owned stock for social use', there is no legislative definition of its allocation and use which complies with the constitutional principle, contained in article 40, of social efficiency. Perhaps most crucially the terms of the 1983 Housing Code need to be brought into conformity with newly enacted federal laws. As the most glaring example, what in the Housing Code is defined as 'rent' means 'social rent' within the Civil Code. In addition, in the Housing Code the notion of 'State-owned housing stock' includes residential premises owned by municipal bodies. Again, in contrast, the Civil Code as well as the Law on the Fundamentals of the Federal Housing Policy provides for separate notions, 'State-owned and municipally owned housing stocks.'

This incompatibility of the 1983 Housing Code with the development of market-oriented relationships has been partially obscured by the fact that new approaches have been provided by other federal laws. With their enactment the practical implementation of the Housing Code has narrowed. A number of problems that demand the introduction of a modernized housing code continue to exist, however. The 1983 Housing Code provides all citizens with the right to housing free of charge on the basis of a rental

agreement. This provision was grounded on norms of the 1977 Soviet Constitution. The 1993 Constitution of the Russian Federation, however, defined a citizen's right to a dwelling differently. Its article 40 stipulates that low-income households, as well as certain categories of citizens specified by legislation, are entitled to the provision of residential premises free of charge or at an affordable rent.

Housing privatization

Housing privatization remains one of the important factors of reforming the housing sector but replicates the approach of the Soviet-era Housing Code. The basic principles of housing privatization can be summarized as the voluntary acquiring of dwellings into ownership, the possibility to acquire the residential premises free of charge only once. The citizens' right to privatization derives from the social rental housing agreement for residential premises. In accordance with the Law on the Privatization of the Housing Stock, the tenant occupying residential premises under a social rental agreement can acquire in ownership the premises within the State-owned and municipally owned stock, with the consent of his family members. The right to privatization of a dwelling occupied under a social rental agreement is restated in the Law on the Submission of Amendments and Annexes to the Civil Code and the 2001 law on the Privatization of the Housing Stock.

Many believe that the privatization of the housing stock should continue, and that it should be free and without any time limitations. Those who support the continuation of the existing policy argue that any alteration would violate citizens' rights. The right is considered as a fundamental social guarantee. However, some believe that free privatization must be stopped, and this position is finding support in the new draft housing code.

The retention of this principle of free privatization ensures that municipalities do not have the possibility to make forecasts about the future volume of their housing stock and to develop a long-term policy for its use. Gosstroy has maintained that the issue of setting a deadline for the transfer of housing into the ownership of the occupants free of charge, raised by regional governments and municipalities, derives from this

perceived need to develop a long-term policy with respect to the housing stock that they own.

There is a necessity to amend the Law on the Privatization of the Housing Stock, to establish the right of regional governments to set deadlines for the privatization of the housing stock free of charge. This will allow regions to accommodate regional peculiarities within a long-term strategy in respect of their social housing stock, a stock which would remain in municipal ownership and would not be subject to privatization. This change is also necessary to preserve sufficient volumes of subsidized housing for low-income households. In addition, legislative restrictions should be introduced to stop the privatization of housing held under social agreements. The Law on the Privatization of the Housing Stock needs to be amended to expressly restrict the right of free privatization of houses subject to social rental agreements. This measure would eliminate one of the major constraints on the development of a rental market.

The end of the free privatization of apartments would encourage the creation of homeowners' associations. As long as buildings have mixed public and private apartments, tenants will not feel obliged to assume responsibility for the whole building, as the non-privatized apartment tenants will rely on the government for repair and maintenance work. The local government therefore remains responsible for the entire building, since there is no clear division of the common spaces among private and public tenants.

B. The delimitation of power and property: establishing the authority of national, regional and local government

It is crucial to identify the roles of federal, regional and municipal authorities in housing. The weaknesses in the delimitation of power and responsibilities between different levels of government and institutions has so far been one of the main impediments to reform. In the current political discussion two possible directions for reform have clearly been posited in opposition to one another. The first advocates the completion of privatization and the reduction of the role of municipal authority to the construction and maintenance of housing for special groups identified within legislation. In this scenario the

State would be reduced to a regulator and a provider of mortgage credits. In the municipal economy the sources of housing and utilities services would remain municipal property whilst the maintenance of networks would be undertaken by commercial companies. The consumers of such services should be homeowners' associations. The second policy advocates the termination of the privatization process and the continuation of the role of municipal authority as a de facto commercial entity.

Housing sector reforms are closely linked to fundamental changes in the functions of government authorities. An open market for services and transparent procedures for regulation of natural local monopolies presume the establishment of 'rules of the game' by taking appropriate legislative and regulatory action. Regulatory and institutional reforms will be needed to redefine both local government's role and that of private enterprises if efficiency in service delivery is to improve and if enterprises are to attract private capital for investment purposes.

At present the housing and the municipal sector has become a victim of institutional tension due to the instability and unpredictability in inter-budgetary relations between regional and municipal authorities. This relates to the amount of funding available for the housing and utility service providers, and tax sharing between regional and municipal authorities. There is a lack of transparency in the finances of the municipal economy so that there is more than usual room for argument over the municipalities' real capacity to fund federal initiatives. Federal legislation needs to be introduced to ensure that federal funding is effectively used to meet federal targets.

In accordance with the Law on the General Principles of Local Self-Government of August 1995, local authorities are the main executive agencies for operating and maintaining the housing stock and for providing most municipal services. The federal authorities have provided the legal framework and instructions on housing reform: each municipality has to implement the housing reform locally itself. In practice the Law gives the municipal authority the power to determine the most suitable administrative structure to manage the local housing. The

administration has to cover the development of new housing, and the management and maintenance of the existing housing stock.

The next phase of housing reform needs to focus on incentives for the implementation of the housing policy at the local level. The functions and scope of competence of the State authorities, local self-governments, market players and individual households should be clearly defined so that the efforts of the State authorities are concentrated solely on the functions specific to them. Particular attention should be paid to the role of the housing maintenance and municipal services enterprises, as today they continue to function largely in a non-market system, and under severe budget restrictions, with ambiguous allocations of roles and responsibilities.²⁴

Incentives for good management of the housing maintenance and municipal services enterprises are weakened by the legal features of these enterprises, including the financial relations between the enterprise and the owner-municipality as defined in the Budget Code. The incentives for enterprise management to optimize the enterprise's use of its assets is weakened because the management knows that proceeds from the sale of unused assets, or the rental of assets, would not be retained by the enterprise.

At present, the vast majority of enterprises that provide housing and municipal services have the legal form of *municipal unitary enterprises*. The Civil Code defines the unitary enterprise as a commercial organization, but one upon which ownership rights over the enterprise's assets are not conferred on the enterprise. Instead, the unitary enterprise manages these assets on behalf of the owner (the municipality) under the right of economic management. The resultant deficiencies

²⁴ The key problem areas facing the sector are: low levels of cost recovery throughout the system; large-scale subsidization of housing and municipal services in a non-sustainable system, exacerbated by the sharp drops in local government budgets and contractions in the real incomes of the population during the transition crises; rapid deterioration of the existing housing and utility infrastructure stock due to inadequate maintenance and repair, resulting from a general lack of funds; and extreme monopolization and centralization of the sector.

include the interference in enterprise management from local politicians, lack of transparency in operations, the inability of enterprise management to optimize the use of assets because of the lack of ownership control over them, and general concerns about the quality of the management. Furthermore, the management of such enterprises has to contend with the contradiction between the enterprise's function as a commercial entity providing economic services and the use of the enterprise as a vehicle for the delivery of ill-targeted social protection. Housing maintenance and utility services cannot be placed on a sound fiscal footing and operated on a commercially viable basis until the system of widespread and arbitrarily applied subsidization is explicitly financed or eliminated.

Once this has been completed, a concerted attempt can be made to place the entire system on a clear contractual footing, between municipal authority and service provider, and between service provider and consumer. At present no clear contractual relationship exists between the supplier and consumer as the municipality has to pay for the provision of services. The attraction of private companies to competition for maintenance of the housing stock is obstructed by the fact that "financial" settlements with contractors are made predominantly in the form of mutual offsets and local government securities.

An additional impediment that needs to be addressed is the problem that all contracts for maintenance are executed in a standard form which remains unchanged from year to year. The contracts, as a rule, fail to stipulate a fixed volume and list of services required from the contractor. The contractor is simply obliged to maintain the housing 'according to the standards.' Then in turn the customer does not assume any obligations for the amount and timelines of payments for a contractor's work. In practice, there is no enforcement mechanism when people do not pay maintenance charges. Although the legislation stipulates that if the tenant does not pay within six months he may be evicted, this procedure does not extend to property owners.

An important basis for any cooperation between municipalities, the suppliers of maintenance services and the consumer of those services is the establishment of housing management

associations. Management responsibility for the building can be transferred from local government to the tenants, and costs can more easily be shared out to users in a building. As is detailed in the following section, financial incentives for establishing and registering such associations should be implemented, the process of implementation needs to include the overcoming of current municipal authority reluctance to transfer land to condominium associations. To erode this municipal opposition once land has been valued, the real property taxation system should be reformed. Real property tax revenues should be distributed to a maximum degree to the municipal authorities, thus giving them a revenue basis for local development needs.

C. Homeowners' associations and condominiums

Privatization has failed to give owners in multi-unit apartment buildings effective management authority. The housing stock therefore effectively remains public housing from a repair and maintenance perspective, regardless of the percentage of apartments that are privatized. The main reasons for the slow development of homeowner management of the housing stock are: defects in the regulatory basis and inadequate support from the local administrations; complicated registration procedures; unresolved ownership issues with respect to non residential premises and land plots; and the fact that municipal authorities do not subsidize the maintenance of condominiums and provide no compensation for the payment for municipal services as mandated in the federal law.

The further growth and development of homeowners' associations calls for legislative and regulatory improvements at the federal and local levels. These improvements should address: the securing of land plots in condominiums for homeowners; the improvement of procedures for the registration of property and ownership rights in condominiums; and the granting of rent and utility subsidies to needy condominium owners.

The land held under a condominium may be owned by the homeowners in accordance with the Land Code. The Land Code, however, provides no mechanisms to implement such rights. This prevents condominiums from using the land, the

municipal authority retaining effective control. The members of the condominium cannot register the right of ownership to the land plot that they collectively own if the municipal authority does not allow them. To resolve this problem by reducing conflicting interests over the property the Ministry of Justice must delimit land in terms of the land cadastre.

At present the homeowners' associations are effectively prevented from raising funds through the use of condominium property. A condominium is classified as a non-commercial organization and should remain as such. However, as has been illustrated by a series of court cases, the municipal authority needs to be prevented from using condominium property to the disadvantage of a homeowners' association. As a legal entity, the homeowners' associations should be encouraged to use land for the benefit of the owners in a condominium.

As has been suggested throughout, the resolution of inter-budgetary problems will better facilitate the implementation of policy. Municipal authorities do not establish separate bank accounts for the taxes received for the registration of homeowners' associations in order to use these resources for the associations themselves. An additional problem is that the tax level for the registration of these associations is high, regardless of the wealth of the legal entity.

The establishment of collective managements bodies, such as homeowners' associations, for condominiums should remain a policy priority. When amending legislation to facilitate the development of such associations, those associations must be more than just a legal body possessing the legal authority to act on behalf of all the owners of a condominium. Legislation should be amended so that a condominium, as a property complex, is able to contain a variety of forms of property ownership. Both the rights of tenants and owners should be incorporable. Furthermore, legislation should be amended so that owners of large apartments with contrasting financial means are able to limit their liability for capital repair. Such amendments should be introduced along with those that facilitate the development of housing insurance.

The obligations and responsibilities of both owners and tenants can only be developed in a way that encourages their participation in collective property management if the liabilities of such participation are perceived as bearable. For contractual relations to develop between the suppliers of services and consumers, an owners' association must be able to enter into contractual agreements, to benefit from them and be liable under them. If an association becomes a legal entity, all participants must become jointly responsible for its liabilities. If this is not the case, no lending to secure maintenance is possible, as there is no satisfactory collateral for loans to the association. This is why a form of limited liability was suggested in the previous paragraph. This should be complemented by the provision of a well-targeted and transparent housing benefit system. Only then will both owners and tenants actively participate in the management of the property.

D. Legislation on mortgaging

If a policy is pursued of subsidized affordable mortgages, this will be a significant instrument to help households to improve their housing situation. A mortgage system will only work, however, with the improvement of the mechanisms for the State guarantee of the owners' rights, consisting of the right to free privatization and sale, rent, leasing and mortgage of the dwelling.

It should be possible to terminate the right to a mortgaged home even if it is the family's only one. At present, in accordance with article 446 of the Civil Procedure Rules, the foreclosure of a mortgaged property is not possible if it is the mortgagor's only residence. The grounds for termination would necessarily include those cases when a mortgagee was not in a position to fulfil his obligations under a mortgage agreement. At present, the number of restrictions on the termination of the right to mortgaged residential premises makes the practical application of the above provision impossible. As a consequence, the development of long-term mortgage financing for house purchasing is severely restricted.

This is not the only reason, however, why banks do not become involved in mortgage financing. There are other reasons. It is, for example, impossible to foreclose on default if the rights of a household to occupy the premises under a rental agreement are registered. All the persons residing together with the tenant under such agreement, even if they are not members of his family, share his rights and obligations (art. 677 of Civil Code). Protecting the rights of tenants is important. However, the protection should be effected in such a way that it does not make mortgage lending practically impossible.

There are amendments needed to the Laws on Bankruptcy and on Mortgages to further clarify the rights of the creditor and the borrower. In the most recent version of the Law on Bankruptcy, of December 2002, creditors received third priority upon the bankruptcy of the debtor. For creditors whose claims are secured by a charge, however, article 134 provides for separate satisfaction from the pledged asset. In practice, however, consistency in the implementation of the new bankruptcy procedure is yet to be clearly identified. It must be clearly stipulated by law which creditors are to be satisfied from the sale proceeds if the property is sold and in what order this will take place. In addition, there remains considerable contradiction within the legislation itself, such as differences in the order of satisfaction of creditor claims between the Law on Bankruptcy and the Civil Code.

Finally, a purchase of property using a mortgage requires the financial details of the transfer to be declared. In addition, the notary charges 1.5% of the value of the transaction. These unattractive features of purchasing property using a mortgage are compounded by the fact that the real estate rights registry takes over a month to effect registration. As long as the purchaser, however, does not have proof of registration and evidence of title he cannot receive the mortgage finance from the bank.

In such circumstance, especially in the absence of bank financing, the use of public funds for mortgage financing is an interesting alternative. Such a mechanism was evidenced in Ivanovo, where the potential purchaser makes an application to the municipal administration for finance. The purchased flat is placed under the

legal ownership of the municipality. The citizen buys the apartment with the money raised from his old apartment and the money provided by the municipality. If the purchaser does not keep up with the repayments, the municipal authority can initiate a court case to evict him.

E. Financing new construction

The allocation of land for new construction as well as the protection of land plots under objects already privatized are regulated by the Land Code. It prescribes that the owners of buildings have the right to form a land plot, and register the land plot necessary for servicing the building on an ownership or lease basis.

In the Land Code there are two different procedures for the creation of new land plots. Firstly, for the establishment of a land plot either in ownership or under lease: the so-called ‘granting of a land area for construction without the preliminary coordination of the location of the construction.’ In this case the appropriate body establishes the boundaries of the plot based on open planning documents; it decides issues connected with permitted use and issues of the technical condition of the infrastructure. There is then a public announcement of tender conditions. The plot of land is included into the land cadastre and a tender / auction takes place.

Secondly, when a person wants to construct a certain real estate object: the so-called “granting of a land area for construction with the preliminary coordination of the location of the construction”. That person applies to the appropriate public authority. In this case there is no town planning documentation. The appropriate public authority chooses the land plot, although different service organizations are involved in the consideration of locations. When one location is chosen, the land plot is established. All bodies must agree on the selection of this land plot; the decision is to be signed by representatives of both the federal and municipal governments. The approved selection is presented to the municipal authority, which decides on the implementation of the decision. The constructor must then acquire the required permits from the municipal authority. The land is granted on the basis of a leasing agreement.

The practical implementation of these rights to construction contained within the Land Code have been blunted by the fact that the system of urban planning and land use remains characterized by complicated administrative procedures, by the uncertainty of rights to the plot until all the final decisions have been made, and by a lack of specific procedures for allocating rights to land plots intended for development.

This lack of consistent policy is in particular reflected in the procedure of transferring land rights. Land is transferred for a long-term lease or ownership when the investment and construction project is closing rather than when it is starting. This is the main obstacle hampering the development of mortgage financing of construction projects. No legally enforceable rights exist for the co-investors until the project is completed and the land is registered.

New legislation and procedures, elaborating and facilitating the rights contained in the Land Code, need to be issued to serve as the basis for establishing rights and obligations in the construction of real property. Most importantly, these rights and obligations should be implemented in accordance with the legal zoning requirements to be introduced by municipalities.

F. Registration of immovable property

Until 1998 the legal regulation of the definition and registration of real estate rights varied according to the types of real property. Rights to land plots and land shares were guided by presidential decrees and registered by local land committees. Rights to residential property were guided by the Law on the Privatization of the Housing Stock, rights existing 'from the moment of registration with local executive authorities'. Rights to privatized non-residential real estate were governed by the Law on the Privatization of State and Municipal Enterprises and registered by sellers in a relevant property fund or privatization committee.

Many of the problems attributed to these different systems were substantially reduced by the creation of a federal registry on real estate rights by the Law on the State Registration of Real Estate Rights and Transactions. Documentation can be submitted by an individual, a legal entity

and an organ of municipal or federal authority. The registration of condominium property, however, still encounters difficulties. Associations of homeowners have been deprived of the opportunity to register their rights to common elements of their condominiums because of both technical complications and the refusal of local administrations to transfer the ownership of land to the associations.

The goal of the registration of rights to land must be to benefit private, collective and State interests in the protection of their ownership rights. To achieve this goal it is necessary to:

(a) Amend the effective civil legislation to ensure a free transferability of real property and the protection of bona fide purchasers of property rights;

(b) Include specific provisions for registration of land rights for collective or municipal purposes;

(c) Develop land management legislation;

(d) And provide for the State guarantee of registered rights in order to protect the parties of transactions in real estate.

Finally, it remains difficult to obtain the necessary documents from the federal registry and inventory authorities. The relevant legislation must be improved to properly regulate this area of services as at present no standard requirements for cadastre and technical registration documents are in place.

G. Urban planning

The concept of legal zoning was introduced by the Town Planning Code. The Code defines legal zoning and binds municipal authorities with the responsibility to design land use and development rules and introduces them in practice. Indeed, the success of town planning reform relies on increasing the motivation of city administrations to develop their own legally binding land use and development rules. Decisions on zoning plans and related developments should be made by the municipality. The municipality should be responsible for the issuance of building permits on the basis of the approved planning zones. Although the Town Planning Code was introduced in 1998 there remains a need to clarify and simplify zoning procedures and control,

implementation, and changing of zoning plans within urban municipalities.

In reality there is still the retention of previous non-market town planning principles based on command administration. There is no working system for differentiating lands by ownership types, and as has already been outlined, disputes between regional and municipal governments about the right of the latter to dispose of land within city boundaries; and the refusal of certain regional administrations to recognize any other forms of landownership except permanent use and short-term lease. There is opposition of municipal authorities to the introduction of legal zoning as they fear that this will decrease their flexibility in generating revenues from the disposal of land.

New legislation on legal zoning should be introduced. The aim should be to alleviate the ambiguity of the current system in defining the owners' competence to use land plots by way of transition to legally binding town planning regulations based on the legal zoning principles. The drafting of recommendations on legal zoning for regional and municipal authorities, i.e. a framework for local land use and development rules, should be undertaken immediately.

There should be a review of the procedures for land allocation for development purposes to secure long-term rights of developers and investors at the inception of the investment project. The process of construction and the raising of finance would be facilitated both by the formation of an easily accessible database on all real property units for which privatization is

permitted which should disclose information about the permitted type of use and town planning requirements; and the simplification of procedures used for expert examination and approval of town planning and design documents. When construction has been initiated regulations must secure transparency in the issuance of building permits.

This latter point cannot be underemphasized. There is a need for the clarification of the procedure for dealing with construction applications. There is a need for one procedure to grant title to land and a second procedure granting the right to construction. Furthermore, a classification for a range of construction projects needs to be developed to differentiate between those works that do not require any permission and those that require the full building permit procedure. These changes would reduce the problem of the lengthy and unpredictable process for the issuance of initial permits and certificates for construction projects. At present documents must be approved by more than 40 authorities and, due to lack of information on permitted types of land use, many applications for land allocation are rejected.

The ownership, use and disposition rights over property should be clearly defined by civil law. The construction of a reliable cadastral and registration system is an essential precondition to this development. It must reveal all legal relationships attaching and stemming from the land, and establish enforceable rights through the act of legislation.

Chapter VI

FINANCIAL FRAMEWORK

A. The current situation

1. Investment in housing

Total expenditure and trends

In 2001, the Government invested R 360 billion in local authority housing. In 2002, that amount was expected to rise to R 540 billion. In 2001, R 170.6 billion (47.7%) was covered by user fees and R 129.1 billion (35.5%) from budget funds. The deficit of R 60 billion (16.8%) was dealt with as follows: Services that had already been supplied (electricity, water, heating) were simply not paid for. This led to rising losses among producers. Some services foreseen in the tariffs were not supplied. These include, above all, fundamental renovations to buildings. This results in properties and their installations deteriorating at an ever-increasing rate.

Cross-subsidizing constitutes a further problem for financing. Electricity and gas, in particular, are supplied to customers at below-cost prices. The suppliers then demand excessive prices for supplying other services to finance this. This means that providing cheap services in one sector leads to higher prices in others.

According to Russian experts, for 2002 there is evidence of a rising trend in the cover from user fees.²⁵ There are also signs of a shift in government expenditure from the municipalities to the regions. In the residential construction sector, there are clear signs of an increasing trend in private investment and a decline in government investment. Although the number of completed houses virtually halved from 1990 to 2001, the proportion of private financing more than doubled in the same period. The proportion of private investment is also increasing according to the working groups on housing policy and the development of mortgage credit of the State Council of the Russian Federation. According to

²⁵ Using older data: Sivaev, Sergey: Housing Sector Reforms; in: Kosareva, Nadezhda B. / Struyk, Raymond J.: Urban Management Reform in Russia, 1998 – 2000; 2001, Pages 114 – 134 (115, 116).

their data, the volume of state-financed housing fell from 76.0 million m² in 1987 to 33.8 million m² in 2001. By contrast, the volume of privately financed housing rose from roughly 3 million m² in 1987 to around 13 million m² in 2001.²⁶ However, the volume of mortgage loans remains low:²⁷ the sum of US\$ 50 million equates to 0.1% of GDP.

Potential sources of funding

There are a number of potential sources of funds for the housing sector.

Tariff structure and social subsidies

Restructuring the tariff system for local authority services (electricity, gas, etc.) and putting an end to cross-subsidizing are likely to free up public funds. How far the various costs can be allocated to consumers needs to be decided for each sector. In this connection, a system of aid would need to be introduced for low-income households to enable them to pay the rising fees. This will prevent equal subsidies going to all households, including those whose income is sufficient. In addition, subsidies could be reduced or even abolished for individual households whose income rises.

Housing development funds

Housing development funds, which are dealt with in greater detail in chapter XI, could be financed from government income (in particular, regions and municipalities) from the sale of land or rights to land. They could – as will be shown – assume a central role in developing housing finance.

Taxes

Finally, the introduction of a property tax

²⁶ State Council of the Russian Federation – Working group on housing policy and the development of mortgage credit: Illustrated materials; Moscow, February 2003; diagram 3.

²⁷ Data from: Stupin, Ilya / Chajnikov, Juriy: Resultat zybkiego kompromissa; Ekspert #26(381), July 14, 2003.

(housing, land etc.) could be considered as a further option. This will also be dealt with in chapter XI.

2. Instruments and institutions

Due to the lack of legal foundations, various models of property finance have developed in practice. The basic structures are outlined below.

Co-investment model

This form is used for housing construction by private investors and is widespread. An investor acquires a lease on a piece of land for 49 or 99 years from the town or municipality. Since the new Land Code has not yet been implemented in most regions, the investor cannot acquire ownership of the land. The investor plans to erect a multi-dwelling unit on the leased land. As compensation for the lease, the town or municipality frequently receives a specific rate of the finished flats. The finance is usually organized as follows: future owners of the flats (so-called co-investors) initially pay some 30% of the value of the –yet unfinished– flat. They make regular payments to the investor during the construction. As security, the co-investors are awarded a claim against the investor for completion of the flat. The financial means (down payment and subsequent installments) can be raised as a loan from banks. However, until completion of the flat and its registration in the uniform state register of property rights the bank has no collateral. The bank cannot have a mortgage registered until the flat is registered. Sometimes banks demand higher interest rates until the mortgage is registered, in addition the claim by the co-investor/borrower against the investor can be pledged. However, there is no collateral in the event of the investor/property developer going bankrupt. As a result, banks admit that they become involved in projects of this kind only if they know the property developer and have worked successfully with him in the past. This naturally makes it difficult for new property developers to enter the market.

Besides the risks for the financing bank, there is a risk for the co-investor/borrower. During the building period and until completion of the flat's registration he has to trust the developer. It is

unclear what would happen to the borrower in the event of bankruptcy or fraud on the part of the developer.

Furthermore, the legal procedure of purchasing ownership of the flats seems unclear. The financing is sometimes supplemented by the option of saving up equity (for the first instalment of 30%) with the banks that will subsequently provide the finance. However, these savings options relate only to concrete projects. The saver must stipulate at the beginning (when the contract is concluded) why and for which specific project he is saving.

These forms of finance are used only for new residential construction, not for renovating existing housing. In addition, they are only accessible to high earners.

For co-investment contracts it is absolutely necessary to improve the civil law legislation on real estate, registration and mortgages. Moreover, for this technique, it is especially important to have a law on property developers. Regulations are needed on the transparency of their financial status and management, as is an efficient and supervised system of protecting co-investors from the risk of fraud or bankruptcy of the developer. The current system based on acquaintance can then change into a transparent market system.

Regional programmes

Following the 1998 crisis, when banks withdrew from the property financing, some regions and towns or municipalities developed their own mortgage projects. These were and still are largely financed from budget funds.²⁸ Institutions were set up to work with the Federal Agency for Housing Mortgage Loans (AHML) as were institutions to obtain funding through issues on the capital market (e.g. Irkutsk Regional Mortgage Agency).^{29,30}

²⁸ More detailed information: Pastukhova, N. S. - Rogozhina, N. N.: "Principal changes in long-term residential mortgage lending in Russia" in: Kosareva, N. B. / Struyk, R.: "Urban Management Reform in Russia, 1998 – 2000"; Page 135 (148 – 158).

²⁹ www.ipoteka.irk.ru.

Most regional programmes are based on budget funds. However, these programmes may strain public budgets since there is no clear legal demarcation between loan programmes (via banks, agencies or other legally independent institutions) and development instruments. In the event of recurrent economic instability, this may constitute a risk since there is no cushioning via banks, agencies, etc. as market participants and financial intermediaries. Budgets are also substantially exposed to the risk of interest rate changes and from time to time to the risk of credit defaults. Finally, the regional programmes are of minor significance in terms of volume because of the public sector's constrained financial position.

By and large, the programmes tend to be small because of the lack of budget funds. There are various reasons for the government's willingness to become involved at the respective level:

- (a) To deal with regional housing problems;
- (b) To strengthen the economy with capital inflows. In this connection, budgets are to be used in addition to private savings and other private sources;
- (c) In addition, there is a demand for transition systems for property finance until the macroeconomic situation stabilizes with a reduction in interest rates.

Budgetary support is provided through, for instance:

- (a) Interest subsidies to selected banks (offsetting the difference between market interest rates and actual lower preferential interest rates of the subsidized loans);
- (b) Loans from the budget at below-market rates;
- (c) Establishment of in-house (on balance) lending and funding institutions.

The regions are starting to use more market-driven models for housing finance, mainly based on development funding institutions to attract capital market resources (e.g. Samara, Irkutsk, Orenburg).

³⁰ In recent years credit funds providing loans without own capital as defined under banking law and providing new loans direct from the repayments (the Sarov model) have been used in some towns, but they have become less important and are not discussed here.

Federal Agency for Housing Mortgage Loans

In 1996, the Government established the Federal Agency for Housing Mortgage Loans (AHML)³¹ to create a secondary market. It was modelled after the United States agencies Fannie Mae and Freddie Mac. In 2002, its share capital was increased to 690 million roubles (US\$ 23 million). Subsequently, AHML adopted a more active role: new standards for mortgage finance were drawn up; and AHML started cooperating with regional agencies. In the meantime, it has concluded agreements on cooperation with 60 regions in which it assumes responsibility for funding mortgage loans and sets the framework for the regional programmes. Its aim is to achieve a structure in which it acquires mortgage loans from regional "operators", which it then funds via mortgage securities for which it obtains a guarantee from the Russian Federation. These government-backed securities are then purchased by pension funds. AHML has not received a banking licence from the Central Bank. The Federation's guarantee covers capital and interest on AHML debentures for their entire term. The maximum amount of the federal guarantee is stipulated annually in the Federation's budget. Until 2008, the assumption of guarantees totalling R 9 billion is envisaged. Thereafter, the guarantee will expire, according to current plans.

Moscow Mortgage Agency/Delta Credit

Apart from AHML, the Moscow Mortgage Agency and Delta Credit bank also specialize in mortgage lending.

Moscow Mortgage Agency

In 1999, the Moscow city government established the Moscow Mortgage Agency (Moskovsoye Ipotetshnoye Agenstvo (MIA))³², which has in the meantime received a banking licence. Its main task is to organize a secondary market in Moscow to fund mortgage loans. Fundamentally, it therefore belongs to the group of regional programmes. However, it should be dealt with separately because of its highly developed system.

³¹ www.ahml.ru.

³² www.mia.ru.

MIA acquires mortgage loans from associate banks, which are funded by issuing debentures secured by a charge on the mortgage assets. In addition, MIA has obtained a guarantee from the Moscow city government for its debentures. The Moscow city guarantee covers only capital on the debentures, not interest. MIA is mainly involved in commercial credit in roubles since it has difficulty competing with AHML products in the residential construction sector in roubles because of its federal guarantee.

Delta Credit

The Delta Credit bank³³ (established with funds from the United States-Russian investment fund Tusrif) is currently one of the most active players in the residential mortgage market. More than 10 banks in Moscow and St Petersburg cooperate with Delta Credit in the residential construction finance sector in United States dollars.

Banks in general

Banks view the long-term mortgage business as promising. However, the interest of banks, such as Sperbank, Vneshtorgbank, National Mortgage Company, the Austrian Raiffeisenbank and EuroTrustBank, in mortgage lending is growing. An interesting example is the recently created City Mortgage bank (Gorodskoj Ipotecnyj Bank)³⁴, a joined bank of Trojka Dialogue (leading Russian investment bank) and Rosgosstrakh (one of the country's biggest insurers). The Bank is going to sell its credits nationwide through branches of Rosgosstrakh.

At the same time, more and more banks are using mortgages to secure loans. Several banks use a three-sided purchase-sale and mortgage agreement, which is concluded between the seller of the property, the buyer/borrower and the bank/lender. Ownership of the property can be assigned virtually simultaneously and the mortgage on the property is created through agreements of this kind.

General observations

Elements of modern property finance are in

principle present in the systems outlined (saving up to create equity, bridging finance at the start of construction, long-term mortgage finance of purchase, funding via the capital market, government subsidies to promote residential construction). However, successful further development will depend crucially on clearly demarcating the various systems legally and systematically and adapting them to the demands of the market.

B. Current problems and challenges

1. Civil and enforcement law

Separation of land and buildings

The main problem in civil law remains the separation between land and the buildings on it. This makes lending by banks particularly difficult in the initial phase of the financing, when there is no building that can be registered and consequently mortgaged. The Land Code, which came into effect in 2002, provides for solutions but there is still a general lack of regional implementation laws.

Enforcement of homeownership, eviction of the previous owner

Under the Civil Code the registered owner of a mortgaged property cannot be evicted from the property by means of foreclosure. While the lender (usually a bank) can – on the basis of the Law on Mortgages – bring an action for eviction, it cannot enforce this judgement. There are also reports that in some cities the local authorities are entitled to accommodate homeless people in any property.

Position of the mortgage in bankruptcy

On 2 December 2002, the new Law on Insolvency (Bankruptcy) came into effect. It contains new regulations on the distribution of a bankrupt's estate.³⁵ One of the main criticisms of the old 1998 Law on Insolvency (Bankruptcy) was the unusually poor position of creditors whose claims were secured by charges. They were satisfied only

³³ www.deltacredit.ru.

³⁴ www.gorodskoi.ru.

³⁵ See Wedde, Rainer: Neues im russischen Insolvenzrecht (Changes to Russian Insolvency Law); WiRO 2003, 195 – 200 on this subject.

third (of five ranks) and no separate satisfaction from the pledged asset was possible. Under the new Law there are only three groups of creditors (art. 134). In the first place – as is generally the case in insolvency law – the costs of the proceedings are satisfied. This is followed by the first group, namely creditors to whom the debtor is liable because of death or injury. The debtor's employees and author's copyrights follow in the second group.

All other creditors are satisfied in the third group; there is no longer any differentiation according to claims secured by charges, budget claims and off-budget claims (art. 137). For creditors whose claims are secured by a charge, however, article 134 (4) 2 provides for separate satisfaction from the pledged asset. Compared with the previous legal situation, this change constitutes massive progress. However, a number of questions remain open: in the first two groups registration of claims is also possible after the actual registration period ends, which means that disbursement of the proceeds to the secured creditors will be delayed. The relationship vis-à-vis the costs of the proceedings is unclear: can the pledged assets also be used to settle these? It is also unclear who realizes the pledged asset. From a legal viewpoint, it is interesting that the order of satisfaction in the liquidation of a legal person in article 64 of the Civil Code was not changed, in that it still provides for five groups (as the old Law on Insolvency of 1998); this order also applies to insolvency proceedings via article 65 of the Civil Code.

Registration

Under article 2 of the Law on the Registration of Property Rights and Transactions, every disposition over property (purchase, creation of a charge, etc.) must be recorded in the uniform state register of property rights. However, the significance of this registration remains unclear. As a result of this there have been different interpretations between the Supreme Court and the Highest Court of Arbitration.

There were problems with registrations that were effected following the privatization of housing where there were mistakes in the privatization proceedings. It would seem that the Supreme Court used the mistakes as an opportunity to

declare the privatization invalid – contrary to the records in the uniform state register and the sales that had taken place subsequently. In similar cases, the Highest Court of Arbitration decided that the purchaser could rely on the record in the register.³⁶

Notary's fees

Official recording by a notary is needed to conclude the creation of a mortgage. The notary's fees amount to 1.5% of the loan. This constitutes a major impediment for many contracting parties since this means that the provision of collateral by means of a mortgage is made far more expensive.

Conclusions

The position of mortgages as a means of providing collateral for loans must be improved. The following regulations are recommended for this purpose:

(a) Option of evicting the owner from the property that has been sold by auction. (At the same time social security provisions need to be in place for providing alternative accommodation to the owner);

(b) Further improvement in the position of mortgages in insolvency (full right of separation of the mortgaged (pledged) real estate from the general bankrupt's estate and realized only in favour of the mortgage (pledge) secured lenders);

(c) Complete public trust in the uniform state register.

2. Banks and the financial market

Commercial banks and other mortgage lenders

The main problems for banks and other mortgage lenders are:

(a) Credit risk, essentially the risk of enforcement (sale of the property and eviction of the previous owner, see above legal problems);

(b) An absence of long-term funding options. Today, banks are essentially dependent on their short-term deposits for funding long-term loans, making it difficult to manage their assets/liabilities;

(c) Currency risk. Moscow and St Petersburg

³⁶ OWC (Ost-West-Contact) supplement 7/2003, P. 25.

banks, in particular, provide loans in hard currency (especially United States dollars) at fixed rates. However, the vast majority of borrowers have earnings in roubles. In the event of strong fluctuations in the exchange rate (devaluation of the rouble), the banks run the risk that borrowers will no longer be able to repay the loans;

(d) Interest risk. Regional lenders largely refrain from dollar-denominated loans but provide loans in roubles at variable rates. If rates rise sharply, there is a risk that borrowers will not be able to pay.

(e) Low incomes. Individuals declare only part of their income officially to the tax authorities. Their aim is to cut their tax bills and, in particular, their social insurance contributions. As a result, it is difficult or impossible for lenders to obtain a reliable picture of their clients' creditworthiness. Given that Russian tax rates are low, this problem is largely psychological, arising primarily from the fear that income tax will be raised following disclosure of all earnings. The only solution is a tax policy that is stable and trustworthy in the long term.

AHML – Current problems and possibilities for further development

There are considerable doubts concerning AHML activities in terms of both its business plan and its structure as a whole. Under its current business plan, AHML takes over mortgage loans in roubles from regional operators (regional agencies, etc.), which themselves have acquired the loans from banks.³⁷ Account must be taken of the fact that each of these participants in the system receives fees in this connection. This makes it far harder to make the loans cheaper for borrowers.

A further risk – resulting from the one-sided guarantee for AHML – is the risk of a government-established or sponsored monopoly emerging. These monopolistic institutions have a long and mixed history in a number of countries. Government monopolies generally offer explicit or implicit public guarantees and related contingencies. At the same time they are more

exposed than competitive private banks to policy interference. In several countries these monopolies have slowed the entry of private banks into mortgage finance. Such an outcome in the Russian Federation would be detrimental to the objective of producing more housing units.

The system of government-backed agencies, like AHML, in a country in transition is likely to be a problematic vehicle for trying to build up a non-monopolistic free market system and can lead to significant burdens being placed on the government budget. The preferential treatment by the Government of AHML could drive other providers away from the housing finance market. In addition, the transfer of credit risk in the mortgage market to the Government constitutes a considerable potential threat to stability and growth for any country in transition, which is still weak financially and burdened with a backlog of infrastructure investment.

There is also the risk that the policies governing AHML do not adequately fit into the overall housing policy context. By subsidizing the lender (AHML) instead of borrowers, there is a risk that the desired housing policy effect will not be achieved and that significant budgetary problems can be expected in the future instead.

It is to be welcomed that AHML plans to subject its activities to the new Law on Mortgage Securities. This is an important step in the development of equal opportunities for all competitors in the market. It is also positive that AHMLs' guarantees are limited to 2008 and that their amount must be stipulated by law each year in the federal budget.

For the future, consideration should be given to the direction in which AHML develops. In principle, there are two options: privatization and conversion into a private financial institution or development into a federal housing development fund.

In the event of privatization, AHML could continue its current business model (purchase of mortgage loans from regional operators and the provision of funding for them) albeit without a federal guarantee. In this context conversion to a specialized credit organization would be recommended. As a result, AHML would be

³⁷ Semenyaka, Aleksandr N.: Mortgage lending as a key factor for the decision of the housing problems"; Conference "Mortgage in Russia"; Moscow 3 April 2003 .

subject to banking supervision – instead of merely securities and investment regulation. This would introduce further security, which would be an advantage for bondholders.

In contrast to privatization and conversion into a private financial institution, consideration should also be given to converting AHML into a federal housing development fund. This would enable it to discharge the duties of promoting residential construction at a federal level – in addition to similar activities of regional funds. This could be supplemented by the responsibilities of a federal housing regulator, which would serve as a central federal unit to develop and implement a federal housing policy. In this case, however, AHML would have to give up all its lending business and withdraw completely from the market.

Banking regulations

Another problem for mortgage finance is the lack of banking regulations. As shown above, savings models and funding systems based on securities are used today but, since there is no legal provision, various problems occur. For instance:

(a) Uncertainty for investors in funding securities and savers in the savings systems;

(b) No statutory standardisation of the schemes for savings, own capital and mortgage funding systems. This leads to a lack of transparency and does not facilitate effective investment decisions;

(c) A lack of flexibility since banks and other institutions will provide finance only for specific projects where they know the investor in order to help get over the legal problems.

The following areas should therefore be regulated:

(a) Saving with savings and building societies (Bausparen);

(b) Mortgage lenders and funding through mortgage securities (improvements in the Law on Mortgage Securities)

(c) The law on property developers;

(d) The credit bureau.

C. Developing the financial system

This section looks at proposals for developing the financial system, with a focus on using mortgages to secure loans and developing the financial instruments needed.

1. Developing mortgages to provide suitable collateral for a loan

The Law on Mortgages (Charges on Property) was introduced in 1998. It represents a major step towards a system of securing property finance. However, it must be supplemented with an effective system of using mortgages to secure loans. International experience has shown that the following is a concrete legal precondition for the introduction of mortgage lending.

Clear and secure laws on property rights

The ownership, use and disposition rights over property should be clearly defined by civil law. This includes the definition of property, the secure regulation of ownership and other rights to property. Apart from the owners' rights, third parties' rights, in particular, those of tenants and lessees, should be stipulated precisely.

A reliable cadastral and registration system is a precondition. As experience in other countries in transition that have introduced mortgage lending and in Western Europe shows, a practicable register must fulfil the following criteria:

(a) Complete cadastral recording of the plots of land and other properties;

(b) A register (land register) that shows all the legal relationships clearly;³⁸

(c) Constitutive (establishing a right) effect of registration;

(d) Mandatory registration for new rights;

(e) Public faith in the accuracy of the registration;

(f) Ongoing updating of the register;

(g) Professional qualification of those maintaining the register;

(h) Adequate personnel and material resources for the register's authorities;

(i) Official liability rights against the government if the register's officials have acted incorrectly.

³⁸ The requirements of a modern land register were summarized by Professor Hofmeister in a comparative legal study "The modern land register", which was issued in 1992 by the Austrian Society for International Cooperation in the Notary's Office and the Austrian Ministry of Justice. This work was also translated into Russian.

Problem-free creation and enforcement of loan collateral

Only those mortgages which are not reduced in value by preferential rights are suitable as a basis for short- and long-term property finance. Therefore, the following points are to be taken into consideration:

- It must be stipulated by law which registered and unregistered creditors are to be satisfied from the proceeds if the property is sold and in what order. The situation has improved thanks to the new Law on Insolvency (Bankruptcy) but is still not resolved unequivocally;
- The claims that are not recorded in the register but are to be satisfied from the sales proceeds are to be restricted to those that relate to the piece of land, e.g. land tax or land development costs. Situations where general tax claims or tax claims unrelated to the land that are not recorded in the register can rank ahead of registered rights to the land must be excluded;
- An insolvency fund into which a proportion of employment income is paid should be established to protect employees and their claims. In the event of bankruptcy, employees' claims will be satisfied from this fund. They would then no longer participate in the insolvency proceedings;
- There must be no charges that make the sale unattractive for the creditor. It should, for example, be possible to evict the owner who fails to pay up. At the same time, effective government instruments must be in place to protect individuals against homelessness.

Rapid feasibility

Property transactions should be swift and at reasonable cost. Taxes, registration fees, notary fees and other expenses should not be so high as to make property unnecessarily expensive and prevent the development of a market. Moreover,

the fact that property transactions can be carried out quickly must be guaranteed. This relates above all to speedy official recording by the notary and registration.

2. Generating funds

Regional/municipal level

Funds for housing

In particular, sales of land and rights to land should be used to remedy the lack of capital at a regional and municipal level. This could raise large sums, especially in view of the privatization of land that is imminent under the Land Code. Public landowners are already selling rights (leases) to investors who are constructing residential and commercial buildings on the land.

Today, the funds which the regions or municipalities receive seem to flow directly to the regional or municipal budget. All, or in any event some, of these funds should be aggregated in a fund for the local or regional government, which could be used to promote housing ("housing development fund") and administered separately from the rest of the budget.

If necessary these funds should be created as new institutions or within existing institutions. The aim is to have reliable and sustainable income for the development of the housing sector. This is a precondition for developing and implementing a public assistance system for households to improve their housing conditions. Beside the question of the institutional organization, it is necessary to improve the efficiency of the existing subsidiary systems, a better targeting of the resources and a higher level of budget transparency.

The improvement and reorganization of the public subsidiary system can be successful only if there is also an improvement in the legislative environment, a removal of administrative barriers, and more interest of banks in mortgage lending.

Use of the housing development fund

The fund should be used to:

- Establish financing institutions tailored to market demand. As described above, many regions are developing their own mortgage programmes, which include both savings elements and mortgage lending and in some cases funding from securities. Since private banks' interest in residential construction remains low, the public funds should not simply be used for open or hidden subsidies or a "social mortgage" but to establish a property finance system that is compatible with market conditions and in which support is provided for social target groups;
- Promote social housing construction³⁹ for social target groups. Today, all borrowers are subsidized via the various regional mortgage programmes without social target groups being reached sufficiently effectively. This situation must be improved by separating the financing institutions and the development institutions.

Taxes

The option of introducing a property tax (on housing, land, etc.) should also be considered. This might be based on the principle of the assessed value of property, a system used, for example, in Germany. This system takes into account potential rental incomes and construction costs. This assessed value of a property lies well below its market value, which generally fluctuates. The tax rate is set by the municipalities.

Consideration could be given to converting today's normal rents for leasing land into a property tax. This would bring more real estate into the circular economic flow through the privatization of land (and encourage the development of a market) and, by bringing together land and the buildings on it, would solve many practical and legal problems which are preventing the development of a property and lending market.

³⁹ "Social housing construction" has to be understood as public assistance for the purchase, renovation or building of houses/flats to particular segments of society that cannot afford a mortgage without this assistance.

The regions and municipalities would not be disadvantaged by such a tax.

Federal level

The measures discussed above should be supported at the federal level through an appropriate fund to promote housing and housing construction. This can be fed from the Federation's income from the sale of its own property or rights to property. A levy on the production, sale and export of oil and gas to generate funds to this end is also conceivable.

3. Capital markets (pension funds)

According to the Law on Investment of Funds to Finance the Savings Portion of the Employment Pension of 24 July 2002 and the Law on Non-government Pension Funds of 7 May 1998, government and private pension funds may invest some money in securities (government securities and mortgage securities).

The former Law limits investment in securities, apart from government securities, to diversify risk: investments with one issuer and the group associated with it should not exceed 5% of the portfolio. In terms of the quality of securities that may be acquired by the pension fund, the latter Law provides that the investments should guarantee the preservation of the pension contributions and the diversification and liquidity of the investment portfolio.

Mortgage securities should therefore be structured in such a way that they do not need a government guarantee because their legal structure and standardization makes them so secure. Otherwise, buying these securities would also be only an (indirect) investment in government securities. Therefore, risk would not be diversified nor would pressure on the government's budget ease. In addition, the right to issue should not be limited to one issuer since in that case it would be impossible to comply with investment limits and it would be difficult to ensure the securities' liquidity. With only one issuer there would also be no opportunity for pension funds to diversify.

4. Development of institutions

The mortgage-based financing system that is to be developed in the Russian Federation must fulfil

various requirements. It must be suitable for all types of property finance (purchase, construction, renovation) and for both residential and commercial property.⁴⁰ In addition, it must combine the various features such as saving up equity, long-term lending using the capital markets and the option of cooperation between the various institutions and the option of government assistance. Three or four different institutions should be established for this purpose:

(a) Mortgage lenders whose funding is based on securities (attracting institutional investors, especially pension funds).⁴¹ These mortgage lenders can provide mortgage loans themselves or acquire the loans from other institutions;

(b) Institutions for saving up equity for construction finance;

(c) Development funds for housing construction (this can also be effected via the proposed housing development fund). The development funds must, however, be deployed in a way that is competition-neutral, i.e. also for borrowers who obtain their finance from private lenders. The development of these institutions will open several business and cooperation opportunities for the institutions involved;

(d) Possibility of introducing a system of public sector lending, in particular refinancing public credit guarantees to the borrower.

Several municipalities and regions could cooperate with private banks to establish and develop these institutions. The privatisation of these institutions should be given as a binding goal for their subsequent development.

In the following, several aspects which relate to the four institutions mentioned will be discussed:

⁴⁰ Also agricultural land

⁴¹ The World Bank's proposal that mortgage agencies should receive banking licences in order to conduct lending on this basis goes in a similar direction (World Bank: Developing residential mortgage markets in the Russian Federation – Final report ; December 1, 2003; No. 53). Moreover, without further special legislation in this area (above all laws on mortgage securities and saving with savings and loans associations) the granting of banking licences does not seem sufficient.

(a) Introducing a mortgage security, usable by institutional investors without State guarantee

The question of competition between covered bonds as special bank debentures and mortgage backed securities (MBS) (to which the "mortgage share certificates" and especially the mortgage obligations issued by mortgage agents correspond in the new Law on Mortgage Securities⁴²) is currently one of the most debated in Europe. Neither is better. Both have their own role. The covered bond serves as a means to procure original capital, that is to fund assets. By contrast, MBS are a means of selling assets to relieve bank balance sheets of risk and to release shareholders' equity. Covered bonds and MBS complement each other with their different characteristics and purposes. The markets in which they are placed are correspondingly different. MBS are securities that pass the risk to the investor. They are therefore suitable for investors who are capable of and willing to assess the investment risk individually. However, the focus of the securities on this target group is not required if, as was the case of the major United States agencies until a few years ago, there is a general government guarantee against default.

MBS

In Europe, there is no government liability of this kind. Instead the quality of the payment flows, which are passed on from issuers not only economically but also legally in the case of MBS, is checked by rating agencies. The interest rates

⁴² Articles on the new Law on Mortgage Securities: Djemushkina; Ekaterina:

- Opredelenije pravogo statusa ipotetschnoj zennoj bumagi; Rynok zennyh bumag (RZB), No. 24 (255) 2003, p. 32 – 39.
- Konzeptual'nye podchody k opredeleniju pravogo statusa ipotetschnoj zennoj bumagi; RZB No. 1-2 (256 – 257) 2004, p. 67 – 72.

Lassen, Tim: Wiedereinführung Pfandbrief-ähnlicher Wertpapiere in Russland (Reintroduction of Pfandbrief-type securities in Russia); Immobilien & Finanzierung 2004, p. 120 – 124.

Weiland, Hans-Otto / Lassen, Tim: § 18.5: Mezhdunarodnaya Ekspertiza Zakona „Ob ipoteschnych emissionychnykh zennykh bumagach“ in: Agapkin, V. M. / Chernyak, A. V. / Chernyak, V. Z. (publ.): Zhile – kompleksnyj vzglad; Moscow 2001, p. 722 – 740.

for MBS are geared to the interest rates prevailing on the capital market at the time of issue and the securities' rating. It is normal for MBS to be divided into various risk tranches.⁴³

MBS are complex transactions requiring a great deal of documentation and the costs of this kind of transaction are correspondingly high. If a special purpose vehicle (SPV)⁴⁴ is involved (corresponding to a mortgage agent under the new Russian law), further transfer costs will be incurred.

In the Russian Federation, the introduction of MBS-like structures through mortgage bonds issued by mortgage agents is being considered. Mortgage agents are joint-stock companies without their own staff, which are managed by a parent company that must not be a bank and which receive their assets, on the basis of which they issue mortgage bonds, from the parent company.

It should be noted that it is not easy to achieve the resistance to insolvency demanded for SPV structures.⁴⁵ In addition, the decisions on the allocation of assets to SPV are not made by the issuer but by the entity transferring the claim by selecting the transferred loans. All actions of relevance to the supervisory authorities do not take place with the issuer but elsewhere. Furthermore, since SPV have no staff, it is not clear who would be responsible for certain supervisory measures.

⁴³ This procedure – if possible by two rating agencies – is also suggested by the World Bank (World Bank: Developing residential mortgage markets in the Russian Federation – Discussion draft, May 8 2003; No. 53, 54). However, this increases the cost further and makes the loan more expensive for the borrower.

⁴⁴ SPV = special purpose vehicle. Legal entity, normally without own staff, where the assets are transferred to. The SPV issues securities (depending on the assets mortgage-backed securities (MBS) or asset-backed securities (ABS)). The aim of granting a special legal entity is to try to obtain a bankruptcy-remote structure in case of bankruptcy of the institution (bank or agency) founding the SPV.

⁴⁵ Reason, Tim: Securitization: False Security? in: CFO Magazine, 16 June 2003.

In a more advanced capital market with more specialized and sophisticated investors, MBS will have their role as a part of structured housing finance. As in other European countries through MBS the risk of credits higher than 60% or 80% of loan to value may be sold to the capital markets.

Mortgage share certificates

The mortgage share certificate is a registered security which confirms:

- (a) Its holder's share in the total title to the mortgage cover;
- (b) The right of the person issuing the paper to demand appropriate fiduciary administration;
- (c) The right to receive funds from the fulfilment of liabilities for which the claims create the mortgage cover.

The structure seems to follow that of the investment funds in the Law on Investment Funds. Claims secured by mortgages are allocated to the fund as securities. In line with the structure of the investment fund, the aim is to introduce an anonymous aggregate group of creditors with respect to a large number of mortgage loans, which will then be administered on a fiduciary basis. This does not seem entirely harmless under property law.

As far as is clear, the investor in share certificates carries the full default risk on the mortgage loans. There is also no government guarantee for the paper.

From the viewpoint of investors, mortgage share certificates do not seem very attractive because of their complicated structure, which may deviate from general property law, and the lack of security (the purchaser carries the full credit risk).

Consideration could be given to using the options envisaged in the Law on Investment Funds to create and develop property funds instead of mortgage share certificates (art. 33, para. 2). In the EU, these property funds are important associates of mortgage and commercial banks as borrowers.

Moreover, the possibility that security investment funds act as investors in bonds with mortgage cover and consequently a further institutional investor appears – in addition to pension funds –

should be promoted. They could be included in article 33, paragraph 1, of the Law on Investment Funds as a new type of security.

In this way, complementary rather than competing instruments would appear. Competition between different providers, not different systems (here types of security), is necessary for the stability of the market.

Covered bonds

On the other hand, mortgage banks and covered bonds are optimal instruments for developing and servicing wide and effective capital markets thanks to their extremely simple and transparent structural features and the security that these allow – at least if the specialist bank principle is adopted.

For this reason, the legislation should focus first on the covered bond (in the new Russian law: a mortgage obligation issued by banks) as it is the instrument most likely to persuade a broad range of investors (domestic and international) to invest in the residential finance market. Through investors' willingness to acquire this comparatively low-yield but secure instrument, cheap funds will be obtained for the housing finance market.

Covered bonds are also increasingly used in countries where common law applies. In 2001, the Asset Covered Securities Act was introduced in Ireland, for example. In 2003, securities were issued in the United Kingdom under the HBOS programme, which is similar to the covered bonds in other European countries but based on a contractual rather than a legal foundation.⁴⁶ In future, it is expected that covered bonds will be used increasingly in countries that previously made greater use of MBS tools (such as the United Kingdom, Spain and the Netherlands).^{47,48}

⁴⁶ See for example: Damerow, Frank / Barbour, Iain / Hostalier, Katie: HBOS Covered bond – Transaction overview, Commerzbank Securities, 22 July 2003.

⁴⁷ In the Netherlands the Banking Association drafted a mortgage bank act to introduce a legal environment for mortgage bonds, based on the principle of specialized banks.

The banking role of covered bonds

Lending funded via covered bonds can constitute a stable base only for externally financed investment; only with this restriction can they guarantee the quality that justifies faith in their security.

Covered bonds offer mortgage banks the option of promising the investor very low redemption rates for very long loan terms without delay on the evidence of the loan collateral and also of fixing the interest rate for the duration which corresponds to the long-term maturity of the covered bonds providing the funding.

The most important preconditions for acceptance on the capital market emerge from the correct structuring of the following elements:

(a) A simple and readily comprehensible structure for the financing model stipulated by law;

(b) Statutory and supervisory requirements, which counter risks to the mortgage bank's creditworthiness;

(c) An effective system of government monitoring of the security of covered bonds and mortgage banks;

(d) The expectation that the mortgage banks will regulate prices in the interests of investors.

Securities fulfil this particularly if:

(a) The issuing bank does everything in its own business interests to maintain its reputation and the quality of the securities including market-making (as accepted market practice);

(b) Issuers do not assign their loans but fund them on balance through the issuance of their own securities so that they are liable under the covered bonds; and

(c) The bank's shareholders' equity and other risk cushions serve to protect the securities.

⁴⁸ Engelhard, Fritz: Sector Report: Don't stop, and don't be afraid to start; HVB Credit Research Covered Bonds, 21 August 2003, Page 3.

Minimum standard for covered bonds under EU law (Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) art. 22, para. 4)

Covered bonds are not subject to uniform regulations throughout Europe. Nevertheless, EU law sets a minimum standard for covered bonds and comparable securities with which certain alleviations to the supervisory requirements for financial institutions and insurance companies are associated. The EU regulations and the privileges for mortgage bonds in EU law will be discussed as an example of the necessary minimum requirements and the possibilities to attract national and international money by privileging the mortgage bond as investment instrument.

The preconditions for UCITS, article 22, paragraph 4, are:

- (a) A financial institution's debentures;
- (b) The fact that because of statutory provisions to protect the holder of these debentures they are subject to special regulation that monitors the cover funds. This supervision is not geared to the financial institution's stability but to protecting investors;
- (c) By law, income from issuing these debentures must be invested in assets that adequately cover the liabilities arising under the debentures for their entire term;
- (d) Preferential right of the covered bond holder in the event of the issuer going bankrupt to be satisfied before all other creditors from the assets recorded in the cover register (preferential right in bankruptcy).

Privileges for covered bonds

Because of this guarantee, covered bonds attract a number of privileges under EU law:

- (a) They may account for up to 25% of assets in an investment fund instead of a maximum of 10%;
- (b) They may account for up to 40% instead of a maximum of 5% of "committed assets" in the case of life assurance companies and investments in covered bonds;
- (c) They do not have to be included in the

large exposure limit;

(d) Liabilities under covered bonds do not have to be included in the deposit protection insurance;

(e) Covered bonds are automatically admitted as tier I securities for money market policy operations by the European Central Bank.

This also helps institutional investors since they can acquire the securities without lengthy checks knowing that they will be able to liquidate them at market rates at any time.

Issuers

Under the UCITS directive, the issuer must always be a financial institution. It is irrelevant whether the issuer provided the loans on whose basis it is issuing the security itself or whether it purchased them from other institutions.

The aim is to include a fundamental element of investor protection: financial institutions are subject to general banking supervision and the special provisions for financial institutions such as the rules on equity, solvency, large exposure and annual accounts and consolidation.⁴⁹ This is supplemented by the requirement for "special public supervision to protect holders of covered bonds," where the quality of the cover funds is monitored. This supervision is not geared to the stability of the financial institution but to investor protection.

Specialization

The specialist bank principle is a particularly important aspect of mortgage bank law. A specialist bank is a lending organization that is subject to general banking law but is limited by a specialist law to specific areas of operations (its main business being mortgage and public sector lending funded by covered bonds). A specialist bank has its own staff and its own management board. Its business is long-term. A special purpose vehicle (SPV or Russian mortgage agent) for MBS is not a specialist bank.

⁴⁹ Bellinger, Dieter: Commentary on Art. 22 (4) of the UCITS directive; in: European Mortgage Federation (publ.): Mortgage Banks and the Mortgage Bond in Europe; 3rd ed. Baden-Baden 2001; point 4.6.

The specialist bank principle is the outer wall protecting covered bonds. In Germany, for example, no "Pfandbriefe"-issuing mortgage bank has gone bankrupt since the introduction of the Mortgage Bank Act (1 January 1900).⁵⁰ The additional walls protecting covered bonds are the quality of the cover funds (above all the mortgage lending value) and the preferential ranking in insolvency of covered bond holders in the event of a mortgage bank becoming insolvent. Because of their statutory specialization, mortgage banks are institutions with a portfolio that is overwhelmingly made up of very low risk loans. This contributes significantly to their protection from bankruptcy. The rating agency Moody's and covered bond analysts view the specialist bank principle as an important aspect of their security ("outer protective wall").⁵¹

The macroeconomic reasons for the specialist bank principle are:

(a) The direct link between the liabilities side (mortgage obligation) and the assets side (cover assets), whereby funding is guaranteed via the capital market. This means efficient, risk-oriented pricing and an efficient allocation of capital. In addition, it is a competitive system: simply because several banks that are regulated by the same specialist law compete with each other. Long-term funding is the precondition for long-term lending.

(b) The concentration of their main business brings important economic benefits for mortgage banks:

- (i) Low funding costs;
- (ii) Specialist knowledge and experience in their main business, highly qualified staff;
- (iii) Necessary special market experience;

⁵⁰ Lassen, Tim: Lehren aus der Hypothekenbankkrise (Lessons learned from the mortgage bank crisis), Immobilien & Finanzierung 2003, p. 652 – 654.

⁵¹ Meisner, Norbert: The Market for Covered Bonds in Europe; Deutsche Bank, 4 March 2003, p. 2. Anhamm, Christoph/Langer, Heiko/Goth, Klaus/Kaplan, Peter: Liquid European Covered Bonds; 3rd ed. ABN AMRO September 2002, p. 4. Moody's Investors Service: European Covered Bonds: Moody's Rating and Analytical Approach; September 2002, p. 9.

- (iv) If applicable, manageable company size, short decision-making channels;
- (v) Flexibility by the bank, proximity to the market;
- (vi) Cost-effectiveness and a good cost/earnings ratio (in Germany 30.5% in mortgage banks, 68.8% in universal banks);

(c) The high security standards imposed by law are the basis for covered bonds as a homogenous securities class. With the specialization of mortgage banks, the appeal of covered bonds also increases for major international (institutional) investors. At the same time, the relatively widespread standardization of mortgage bank business makes for a high degree of transparency in the covered bond market. No additional government guarantees are needed for covered bonds. The capital market benefits from the fact that the highly liquid covered bond is used as a benchmark for pricing other products.

The specialist bank principle is the precondition for effective and sensible specialist supervision by the banking supervisory authorities, which leads to increased security for investors.

Valuation

The security of covered bonds is crucially dependent on the quality of the assets serving as collateral, which is related to the preconditions under civil and enforcement law (see above), and the banking industry security criterion for the individual mortgage loans. The valuation is the basis for this.

The cover must ensure that the claims arising under the covered bonds for capital and interest can be met irrespective of the performance of the issuing bank, i.e. even in the event of foreclosure and insolvency. This presupposes that all risks can be avoided with the assets needed as cover. For mortgage loans this means that:

(a) While the borrower's personal ability to pay is important at the beginning for assessing his creditworthiness, it must not make any difference to the security;

(b) The security must result entirely from the economic and legal quality of the mortgage; and

(c) Consequently, reductions in the value of

the mortgaged property that occur during the term of the loan do not reduce its suitability – even partly – as cover.

For funding mortgage loans via covered bonds a valuation “add on” is needed. A decisive point in the decision to take a mortgage credit in the cover pool is not only whether the borrower has the ability to pay the credit back, but whether the real estate will secure the mortgage bonds even if the borrower defaults. To secure the long-term mortgage bonds in these cases the open market value – as today’s value – is not sufficient. Many European countries use the “mortgage lending value”.⁵²

In a recently published study⁵³ the Bank for International Settlements (BIS) found that “the use of current market price is important in generating the cyclic movement of property prices. This occurs despite the fact that expansion of bank credit increases market supply and will eventually cause the property price to fall. The long-term negative effect of bank credit implies that the banks should adopt a valuation method that anticipated market developments.”

The mortgage lending value⁵⁴ is not an estimate of the future value or price of the real estate. It is a value-at-risk approach to manage the risk exposure of the bank and it is linked to banking supervisory issues.

The concept of mortgage lending value is based on the following principles:

- A prudent assessment of future marketability;
- Identification and elimination of speculative elements;
- Normal and local market conditions;
- The long-term (sustainable) aspects of the property;
- The current use and alternative appropriate uses of the property;
- Transparent and clearly stated valuation methods;
- Valuations should be carried out by valuers with an appropriate level of competence and following any country-specific rules;

Thus the mortgage lending value is in some ways close to the definition of market value, but introduces, inter alia, a notion that could be described as “smoothing” of market trends, rents and yields. The sustainability of the mortgage lending value may require adjustments to, or discounting of:

- (a) The actual rental income of the property,
- (b) The market capitalization or discount rate,
- (c) The property administration and management costs.

(b) Saving with a savings and building society

The mortgage bank system, which is used for funding via the capital market, might also be supplemented by a system of saving with savings and building societies, which allow the formation of equity.⁵⁵ The national economy also benefits substantially from this:⁵⁶

(a) In the form of nest-egg saving it leads to the formation of equity without which a construction project and its actual financing would not be feasible;

(b) The subordinated loans to be secured, i.e. in excess of 60% of the mortgage lending value may be provided (after allocation of the savings

⁵² for mortgage lending value see: Kerl, Volkher: Sut’ i znachenije ponyatiya „zalogovaya stoimost’“; in: St. Petersburg State University for Economics and Finance / University Potsdam: Tendentsii razvitiya nemetskoy bankovskoy sistemy i opyt dlya Rossii; St. Petersburg 2002, p. 320 – 350.
Rüchardt, Konrad: Mortgage Lending Value; Frankfurt am Main 2003.

⁵³ BIS Working Papers No. 150: Davies, E. Phillip and Zhu, Haibin: Bank lending and commercial property cycles: some cross country evidence; March 2004, p. 19.

⁵⁴ See The European Group of Valuers’ Associations (TEGoVA): European Valuation Standards 2003; 5th ed. London 2003; S6.04 – S6.11 (p. 72 – 77) (TEGoVA on the internet: www.tegova.org).
The Russian Society of Appraisers (www.mrsa.ru) is a member of TEGoVA.

⁵⁵ World Bank: Developing residential mortgage markets in the Russian Federation – Discussion draft; 1 December 2003; point 58.

⁵⁶ Mints, Viktor: Doplata ot Dyadi; “Ekspert” No. 19, 26 May 2003.

agreement) preferentially by savings and building societies;

(c) The savings system achieves the formation of capital through consumer restraint and – as a side effect – has a positive impact on inflation;

(d) The continuous flow of earmarked savings deposits and bank loans has a stabilizing impact on the economy as a whole;

(e) The savings and building society system promotes a constant demand for construction finance that is relatively independent of current interest rates;

(f) Smaller home loan and savings agreements are often used to modernize property for which no external finance would otherwise be available at acceptable interest rates;

(g) The saver learns the habit of saving and depositing money, which will give a favourable impression if he subsequently borrows money from a mortgage bank;

(h) The saving – over longer periods – of capital and the provision of credit at tolerable interest rates also allows households with more moderate or average incomes to raise construction finance.

The reasons for the specialist bank principle apply also to savings and loan associations.

In recent years, a plethora of informal systems have been set up. Customers have put their money into these banks. Either these banks have gone bankrupt or they have taken the customers' deposits for other investment projects and thus have not been able to meet the commitments from the savings and building contracts.

A specific law would therefore protect customers' deposits against the misuse of funds and improve confidence in this type of institution and the Russian banking sector as a whole. In addition, an act on savings and building banks would ensure the stability of the savings and building system since the bank has to fulfil certain requirements to start operations. Such an act would for example regulate minimum savings periods, the waiting period, allocation of loans (after the customer has completed the savings period), securing of the savings and building loans, etc.

The functionality of savings and building systems is not subject to premiums. It is up to the design and the objectives of the national housing policy

whether a government provides a premium for savings and building systems. As experiences in Germany, Austria, Slovakia and other countries with their savings and building systems show, their premium schemes have been an efficient tool to encourage especially low- and middle-income groups to save. Through this mechanism, these groups have been able to get access to credit, which would otherwise not have been feasible for them. Moreover, these schemes have been an incentive for them to tackle their own housing problems and to feel more responsible for their own property because they have invested their own funds in the house.

(c) Development of funds for housing construction and business opportunities

When mortgage banks and savings and building societies are introduced, the precautions to which the two systems are subject initially constitute a major hindrance to competition. Commercial banks that are free to choose the risks they incur will first attempt to draw all business to them. They can risk 100% finance and will fight against cooperation with the mortgage banks. Experience has shown that this frequently leads to their having problems and also impedes the establishment of a long-term, fixed-rate financing base that is in the general interest. Therefore, government assistance should be focused on persuading banks to cooperate.

Cooperation in terms of time

Lending to buildings under construction is, for security reasons limited or not at all permitted for mortgage banks. Therefore the borrower needs a credit from other lending institutions for the construction period. The mortgage bank can refund or take over the credit after completion of the building. Under normal circumstances the credit, now secured by a mortgage on the completed building or the land, will be eligible for covered bonds.

This is solved by a loan agreement between the owner and the bank providing bridging finance. It contains the promise of bridging finance and the agreements needed to secure the bridging finance. It also stipulates that the amounts subsequently paid out by the mortgage bank are not to go to the owner but to the bank providing the bridging

finance up to the level of the bridging finance.

The owner's own resources

For all credit decisions in mortgage lending, banks must ensure that the risk for the upper parts of the credit is borne by the borrower. This applies to both commercial buildings and residential construction (newly built or renovation of existing housing stock). This ensures that the investor checks the profitability of the project carefully because of his own risk.

In practical terms, full use of the traditional scope for lending of the two groups of specialist institutions leads to 50% of the investment costs being provided by a mortgage bank with covered bond funds and a further 20 to 30% by the savings and building society whose security ranks second in the land register. The owner/borrower must provide the remainder from his own resources.

Also MBS as a risk transfer instrument can be added here to find investors for the higher parts of the credit.

Link with development measures

As already mentioned, the need to provide government assistance may arise if the borrower's income is low or for social policy reasons such as the construction of property to improve the infrastructure.

Fundamentally, the financing structure is similar to that in the previous example. However, part of the resources to be provided by the borrower will be financed by a loan guaranteed by the government (Federation, regions, housing development funds).

The government-backed loan may also be provided by a mortgage bank and funded with covered bond funds, if – as happens in various countries – the issue of public covered bonds, which are covered by government-backed loans, is permitted.

Government assistance

It is expedient to assign the implementation of development programmes, that is the allocation of development funds and the decision on guarantees in accordance with the government's guidelines, to an institution specially created for this purpose (development institute).

Apart from the guarantees described above, an interest subsidy should be introduced as a second instrument that allows large sectors of the population to raise loans. An interest subsidy of this kind could be created via covered bond funded housing loans. As a result, loan conditions that borrowers could pay would be possible.

On the other hand, covered bonds would be promoted as an important capital market instrument. In addition, this subsidy does not subsidize the system, rather it is linked to the borrower's personal circumstances. With the increase in financing options among the population and falling interest rates, this gives the option of withdrawing this subsidy without jeopardizing the covered bond system.⁵⁷

Experience has shown that an adequate housing supply cannot be achieved, at least not at the speed required, without government help. This is particularly true when the need is acute, as was the case in Europe after the Second World War, but it can also develop in rich economies. The United States, which has invested billions of dollars in subsidizing residential construction for many decades, is an example of this.

Borrower protection

It has been shown again and again that dubious or barely solvent entrepreneurs also offer to plan and implement new construction projects for interested parties or to reconstruct or renovate buildings. The contracting parties are often prepared to transfer the amounts needed to cover the construction costs to them prior to completion. It often emerges subsequently that the entrepreneurs are going bankrupt or have disappeared before the buildings are completed or any warranty claims for defective building are met.

⁵⁷ Hungary: Moody's Analysis July 2003: Land Credit and Mortgage Bank (FHB), Page 6 – 8.

A tried and tested means of protecting the owners of buildings from major losses of this kind is to force the entrepreneur to provide sufficient security by law and with the threat of punishment. This can be effected by paying the purchase price in compulsory instalments to a bank account to which the contracting party has no access or through a bank guarantee.

(d) Introduction of the public sector loan and the public sector covered bond ("public asset covered bond")

As already indicated on numerous occasions, consideration can be given to introducing public sector covered bonds and public sector lending in addition to the mortgage covered bond ("mortgage asset covered bond"). The mortgage bank provides loans to government institutions instead of mortgage backed loans to entities under civil law. The background is the government's security as a borrower. Since this can be problematic, such an instrument should be limited to loans to the Federation and the regions. However, the instrument would offer the government the opportunity to obtain low-interest loans without having to deal with the sale of paper it has issued itself on the capital market, which would be dealt with by the mortgage banks when selling covered bonds.

5. Government assistance for housing

No country can manage without actively supporting the construction or acquisition of housing. Housing policy is part of social policy.

When formulating the government's policy on assistance for housing, as much use as possible should be made of existing financial instruments or those requiring development (e.g. covered bonds, MBS). However, care must be taken that the use of development funds is open to all market participants (e.g. all mortgage banks, all lenders) and preferential treatment must not be given to individual lenders, e.g. because they are owned by the government.

*Aims of the assistance*⁵⁸

Assistance for residential construction includes all government measures aimed at providing housing for the population on an appropriate and long-term basis. A distinction should be made between measures to increase the housing stock and measures that aim to retain the existing stock for a broad stratum of the population. Generally the aim of the development measures is also to reduce housing costs for tenants or for owners of an owner-occupied house or flat.

Assistance for residential construction must also take account of the fact that it is a very complex issue in both economic and technical terms and is difficult to regulate with generally applicable laws.

- The demands on residential construction must dynamically follow changes in the way people live together and the general living conditions.
- Rental housing must be managed in accordance with economic requirements if it is to be protected from a decline in the fabric of the building.
- With family homes and owner-occupied flats, the priority is that the owner can bear the burden placed upon him by the property.

Here, too, the fundamental economic principle that no investment is compatible with sustained losses applies. Any assistance must also be targeted at taking account of this aspect in addition to the actual procurement of housing.

Extent of the assistance

Assistance for housing construction is intended to reduce the housing costs for rented property, owner-occupied houses and flats to socially acceptable levels. That is why it should be provided only to the level necessary to ensure housing in line with the constantly changing living conditions.

⁵⁸ This section is based on a lecture by Dr. Reinhard Daniel (Retired Head of the Ministry of Social Affairs in Lower Saxony) on 27 June 1996 on the subject "Social Residential Construction in Germany".

Equally important is the level of interest on the loans to finance the new construction or the redevelopment of existing housing. Since interest rates are shaped autonomously in the market and may fluctuate sharply, the only option remains to reduce unbearable burdens with government funds. This can be effected in various ways:

(a) The causal costs are reduced through targeted subsidies for the benefit of the borrower (the subsidies, however, may be given directly to the borrower or through the lending institution) (objective assistance); or

(b) Part of the full burden on the person using the housing is reduced through personal subsidies (subjective assistance);

(c) Both procedures may also be used cumulatively, in particular to take individual account of particular social hardships (unusually low income, large family, etc.).

Methods of assistance

Assisted housing construction finance consists of a combination of government help with the owner's own funds and loans from banks, savings and building societies and insurance companies. This combination can take various forms.

Assistance for property

One aim of assistance to property is to reduce the debt service. In this context, government aid would consist of soft government loans to owners or interest subsidies to lenders.

Government construction loans, which are granted in place of loans carrying normal interest rates or interest subsidies on bank loans, are possible. Interest subsidies are granted on bank loans in order to cover the interest accruing on loans raised in the market in whole or in part.

For the owners of rental housing and the owners of owner-occupied houses it makes no difference whether they obtain an interest-free government loan or the State pays the interest payable on a bank loan for them. However, it does make a major difference to the government's budget.

Construction loans are intended to pay the costs related to construction and must be available during the construction period since they are drawn down in line with construction progress without it

being possible to control this to any great degree. They constitute an immediate burden on the government's budget – in terms of both the entire principal and the entire interest burden.

Interest subsidies do not have to be paid until interest is due, i.e. every six months or every quarter. Usually they are not paid until the building is ready for use. The volume of initial government expenditure is therefore relatively low so that large amounts of construction can be quickly financed in cooperation with financial institutions.

When using interest subsidies, it should, however, be noted that this will place a burden on future budgets. While the interest due will diminish annually or after a certain period and a time limit can be placed on the interest subsidies, this does nothing to alter the fact that liabilities for the future will accrue. Assistance for residential construction should therefore not be provided using time-limited interest subsidies alone in the long term.

A second aim of property assistance would be to substitute for own funds, which the owner either does not have or cannot access. The help consists in guaranteeing subordinated loans for the lender.

In cases where assistance is appropriate, it is not possible to provide the financing solely from bank loans. Considerable amounts of own resources, which are unlikely to be available in such cases, are often a prerequisite for banks. Savings and building contracts provide opportunities for creating own funds, as they enable the borrower to obtain a loan of up to 80% of the land, construction and ancillary construction costs once the face value of the contract has been saved. However, there remain gaps in the financing – particularly for people with low incomes. To close the gap, government guarantees to banks have proved relatively simple and low-risk in Western Europe – at least for owner-occupied housing and for flats constructed or acquired for owner occupancy.

Accordingly, a financing package for the borrower can be built up as follows: a loan from a mortgage bank of up to 60% of the mortgage lending value,⁵⁹ a loan from a home loan and savings association for the credit portion from

⁵⁹ As limit for refinancing mortgage credits through covered bonds.

60% of the mortgage lending value up to 80% of the costs. The borrower receives a bank loan for the missing part of 10 – 20% for which the government assumes a guarantee. The rest, however, has to be covered through own funds. If public asset covered bonds are introduced, the mortgage bank providing the loan can fund this guaranteed part in the capital market with long-term, low-interest securities. As mentioned above, in this structure MBS can be integrated as risk management tool. MBS can be issued by mortgage banks or commercial banks.

Assistance for people

This is intended to support the tenant or the owner of an owner-occupied property who cannot afford the rent or mortgage payments with his income (housing benefit), or to act as a general incentive for creating housing for personal use by constructing owner-occupied houses and flats (owner-occupancy bonus).

Support to the tenant or homeowner who cannot afford the rent or the mortgage payments (housing benefit)

Housing benefit has a social function above and beyond its significance to the housing industry. In terms of assistance policy, its advantage lies in that it can be more precisely adjusted to meet social requirements and it is currently under discussion as an alternative to property-related assistance. In its existing structure its role is not to

replace actual assistance for housing construction but is only intended to help hardship cases that remain despite the provision of assistance.

The homeownership incentive is intended to increase borrowers' ability to repay the funds borrowed thanks to government subsidies in the first years after the construction of owner-occupied houses and flats constructed for own use.

Organization of assistance for residential construction

The organization of assistance for residential construction should include all levels within the government. The federal Government, regional governments and local authorities, i.e. districts, towns and municipalities, should be involved in the measures. Their roles and responsibilities should be clearly defined. In Germany, for example, the federal Government creates the legal framework; financing is the responsibility of regional governments. Scrutiny and decisions are largely left to local authorities. The federal Government has become involved in the provision of earmarked financial aid.

All regional governments have largely transferred their responsibility to special "housing construction development offices," which are responsible for administering development funds and subject the applications for assistance from the local authority to banking-type scrutiny.