

FINAL REPORT

**ENTERPRISE LAND SALES
IN
ST. PETERSBURG AND NIZHNY NOVGOROD, RUSSIA
1994-1995**

**USAID CONTRACT NO. CCN-0005-C-00-3107-00
SUBCONTRACT NO. 5C2CO038.R02**



PLANNING AND DEVELOPMENT COLLABORATIVE INTERNATIONAL

September 12, 1997

Price Waterhouse
Office of Government Sales
1616 No. Fort Myer Dr.
Arlington, VA 22209

Attention: Ms. Michelle Baker

Subject: Close-out of Task Order 20-0096-PW "Russia Enterprise Land Sales"

Dear Michelle:

Please find enclosed the Final Report, Memorandum of Accomplishments, and a Guide To Enterprise Land Sales In Russia. The aforementioned documents provide in detail responses to the following:

- An Executive Summary of the Project's Accomplishments or Failings
- A Description of the Project's Activities from its Inception
- A Narrative on the Significance of these Activities
- Comments and Recommendations

Accordingly, this completes the action items requested in your July 17, 1997 fax.

Should you have any questions or require further information on this subject, feel free to give me a call at (202) 944-2598.

Sincerely,

Lawrence LaValle
Sr. Contracts Administrator

15758-055-5

PRICE WATERHOUSE OGS
 ITEMIZATION OF COSTS
 CONTRACT # CCN-0005-C-00-3107
 TASK ORDER #20
 Russia Enterprise Land

Task Order date: 9/28/94 through 5/31/96

Final Invoice

CATEGORY	INCURRED CURRENT PERIOD	INCURRED TO DATE	BUDGETED	REMAINING BALANCE	%
EXPAT DAYS	0.0	109.5	1008.0	898.5	89%
LOCAL DAYS	0.0 0		1580.0	1580.0	100%
TOTAL LOE	0.0	109.5	2588.0	2478.5	96%
DIRECT LABOR	\$0.00	\$15,301.08	\$25,382.40	\$10,081.32	40%
FRINGE	\$0.00	\$1,530.11	\$2,538.24	\$1,008.13	40%
OVERHEAD	\$0.00	\$14,306.51	\$23,732.54	\$9,426.03	40%
G&A	\$0.00	\$7,784.43	\$12,913.30	\$5,128.87	40%
TRAVEL/ODC'S	\$0.00	\$36,344.50	\$41,908.00	\$5,563.50	13%
CONSULTANTS/SUBS	\$0.00	\$1,780,535.42	\$1,807,400.83	\$26,865.41	1%
TOTAL CONTRACT COSTS	\$0.00	\$1,855,802.05	\$1,913,875.31	\$58,073.26	3%
FEE .045	\$0.00	\$83,511.09	\$86,124.39	\$2,613.30	3%
CPFF	\$0.00	\$1,939,313.14	\$1,999,999.70	\$60,686.55	3%

*All expenses were incurred during the period of performance.

1. Description of the Project

The Enterprise Land Sales (ELS) pilot project was conceived as an important element in USAID's overall strategy to develop a commercial real estate market in Russia. Although land associated with summer homes (dachas) and garden plots had been privatized before 1994, land under commercial and industrial enterprises had not been privatized. Former state enterprises that had been privatized through tender or auction procedures since 1991 owned their buildings and equipment, but not their land. Many of those enterprises were having difficulties obtaining investors or capital without ownership rights to their land. In addition, the Soviet system of land allocation had produced land use patterns in which many lower value uses occupied higher value sites. By promoting the establishment of a commercial real estate market, USAID hoped (1) to move valuable assets out of the hands of government and into the private sector, (2) to provide enterprises another asset to use in attracting investors and capital, and (3) to promote more efficient land use patterns through the relocation of industrial uses to less valuable sites.

In July 1994, Russian Federation President Boris Yeltsin issued Decree 1535, which clearly and explicitly gave privatized enterprises the right to acquire ownership of the land that they occupied from the governments of oblasts and other subjects of the Russian Federation. Unfortunately, although the intent of the Decree was clear, some of its provisions were unclear and others conflicted with other sources of Russian law. During the months after the Decree, almost no local governments moved forward to develop enterprise land transfer systems.

The goal of the ELS project was to identify local governments that wanted to transfer land to their enterprises and to provide professional legal and real estate advice about how to develop an efficient and workable system to do so. In the fall of 1994, PADCO won the right to implement the ELS project for USAID. Specifically, PADCO was instructed to (1) identify two cooperative local governments that wanted assistance and were likely to act on the advice given them, (2) work with those two local governments to develop efficient administrative systems and legal documents and procedures to transfer enterprise lands, (3) identify viable privatized enterprises that wanted to obtain ownership of their land and had the legal right to do so, (4) assist those enterprises in preparing legally sufficient applications to purchase their lands, (5) assist the local governments in processing the applications and transferring the enterprise lands to the enterprises under acceptable terms, and (6) assist enterprises that obtained ownership of their land in reselling it in the secondary real estate market, or in planning for such resales to third parties.

2. Project Timing

The ELS project was originally intended to run six months -- from November 28, 1994 through May 28, 1995. Because of various delays beyond PADCO's control, the ELS project was later given a no-cost extension through September 30, 1995. A further extension through January 31, 1996 was requested to allow for the printing of the ELS manual.

3. Participating Local Governments

The City of St. Petersburg and the Nizhegorodskaya Oblast were selected as the two participating local governments for the ELS project. St. Petersburg is Russia's second largest city, has the legal status of Subject of the Russian Federation, and does not report to a surrounding Oblast government. The governmental seat of Nizhegorodskaya Oblast is in the city of Nizhny Novgorod, which is Russia's third largest city. The ELS project team began its work in St. Petersburg in early December, 1994, and began its work in Nizhny Novgorod in mid-February, 1995. The later start in Nizhny Novgorod was caused by

delays in obtaining USAID and Russian Privatization Center ("RPC") approval for the selection of that site, and was one of the reasons that a no-cost extension of the project was later requested and granted. Project work continued in both cities until the end of the pilot project on September 30, 1995.

4. Contractor Staffing

Laura Davis, the PADCO Project Manager and an experienced real estate attorney, managed the pilot project and supervised the technical content of the pilot project. Four American professionals with experience in real estate law, development, and appraisal were selected for the project, and were later divided into two pairs in order to cover the two project cities. The American expatriate team members assigned to St. Petersburg were Alexis Victors (real estate developer) and Donald Elliott (real estate lawyer). The Americans assigned to Nizhny Novgorod were Gerald Gaige (real estate appraiser) and Robert Odland (real estate lawyer). A project office was established in each city, and Russian professionals and support staff were hired to implement the project. In St. Petersburg, Russian staff included two real estate professionals, three lawyers, one real estate translator, and four support staff. In Nizhny Novgorod, Russian staff included two real estate professionals and three support staff. Near the end of the project, the Nizhny Novgorod office hired an additional ten Russian real estate professionals in order to train them for the ELS project rollout.

5. Project Activities

5.1 Assistance to Local Governments

In both St. Petersburg and Nizhny Novgorod, project staff spent large amounts of time meeting with key government officials and staff in the Land Committee (KZRZ), the Property Committee (KUGI), the Property Fund (the official seller of land parcels), and the Chief Architect's Office (KGA). In Nizhny Novgorod, such meetings occurred with representatives of those committees in both the oblast and the city governments. The intent of these meetings was to help the governments to simplify and expedite their land transfer procedures and forms. Common topics included:

- Reducing the number of required application documents from enterprises;
- Reducing the number of committees that need to review the applications;
- Reducing the complexity of the application and processing forms;
- Insisting that the government not prohibit the sale of any land unless it was explicitly listed in Federal law as a type of land that could not be sold;
- Insisting that the government not require an approved and documented boundary survey as a condition of land transfer -- since this practice was prohibited by Decree 1535;
- Encouraging the government not to require that the property go through a procedure to confirm the enterprise's lawful occupancy of the site prior to transfer;
- Encouraging the government to have all required committees process the application at the same time, rather than sequentially;
- Encouraging the government to set lower prices for land transfers; and

- Encouraging the government to accept staggered payments for land.

5.2 Assistance to Privatized Enterprises

In both project cities, the team spent significant time identifying privatized enterprises that were willing to participate in the ELS program and likely to benefit from it. In St. Petersburg, the search began with a list of approximately 50 enterprises obtained from the city administration and the RPC. Twenty-five of the enterprises were interviewed, the 10 best prospects were identified to USAID and the Russian Privatization Center, and four enterprises were chosen as official participants. In Nizhny Novgorod, the selection of eight participating enterprises was made through an informal tender process. Criteria for screening and selection included the legal capacity of the enterprises to purchase land (which requires that at least 75 % of the stock be in private ownership), sophistication and motivation of enterprise leadership, the quality of the land parcels occupied by the enterprise, the ability of the enterprise to raise the money required to purchase its land, and the willingness of the enterprise to consider resale of its parcels in the secondary market. Both offices provided assistance to numerous other enterprises as time allowed. A total of 800 enterprises were assisted directly and indirectly in St. Petersburg, and a total of 27 enterprises in and around Nizhny Novgorod. Some of the Nizhegorodskaya Oblast's participating enterprises were from the small adjacent city of Bor, where at the outset of the project city leaders were more receptive to the ELS approach than in Nizhny Novgorod itself.

Once the enterprises were selected, American and Russian team members provided assistance to each enterprise on the following topics, among others:

- Evaluating which parcels should be purchased, and in what order;
- Collecting and preparing documents necessary for a complete land transfer application;
- Solving legal problems created by the lack of necessary documents or prior transfers of buildings to other enterprises;
- Discussing potential reuse of the properties being purchased;
- Encouraging the enterprise to sell under-used parcels in the secondary market;
- Researching the applicable purchase price for the parcels being purchased; and
- Meeting with city officials to obtain answers to unique legal or real estate situations not anticipated by federal or local law.

5.3 Training of Russian Nationals

Project teams in both cities considered the training of Russian nationals to be one of the most important project activities, because trained nationals will be able to have a dramatic impact on the creation of a commercial real estate market long after the pilot project's completion. The two project offices conducted on-the-job training activities for a total of three Russian lawyers, 15 Russian real estate experts, and two specialized interpreters. Russian professionals conducted or participated in meetings with local governments and enterprises, attended formal and informal training sessions, and drafted or translated many of the documents and forms used in the project. In addition, the St. Petersburg office conducted an all-day seminar in April 1995 on real estate transfer procedures and the importance of real

estate as an enterprise asset. Approximately 90 enterprise and government officials attended. The Nizhny Novgorod office conducted a similar session during the spring.

5.4 Project Manual with Model Regulations and Forms

Based on its experiences in both project cities, the ELS team drafted a comprehensive manual about how to create a successful, legal, and sustainable enterprise land transfer program. The manual addressed ambiguities in the Federal legal framework for land transfers, methods to simplify administration and processing, answers to common questions raised by enterprises, and examples of enterprise land privatization efforts. In addition, a full set of model legal regulations and forms was developed to assist in the rapid implementation of this program in other cities. These included enabling regulations, application forms, committee review forms, sales price calculation forms, and sales contracts for both developed and undeveloped land. All materials were designed to portray the fastest and simplest system consistent with the current requirements of Russian law, and were developed in both English and Russian.

5.5 Coordination with Other USAID Projects

Throughout the pilot project, the ELS team contacted representatives of other USAID programs involved in land reform or legal reform projects, and attempted to coordinate ELS activities with those projects. In particular, the team worked with representatives of the Real Estate Information Systems (REIS) projects (conducted by Arthur Andersen and Chemonics), the Land Information Resource Center (operated by Chemonics and the Leontief Center in St. Petersburg), and the Legal Reform Project (conducted by the Rural Development Institute and the Harvard Institute for International Development). Coordination included attending and/or speaking at public events for other projects, inviting representatives of those projects to attend and/or speak at ELS events, and ensuring that at least one official enterprise participant in the ELS project was located in the pilot project neighborhood for the REIS project.

6. Unanticipated Complications

During the course of the ELS pilot project, the team experienced at least three unanticipated complications that slowed down the project. Those complications are listed here so that future project teams might be briefed on these and similar issues.

6.1 Ambiguity About Land Sales Prices

Between July 1994 (when Russian Federation President Boris Yeltsin signed Decree 1535) and June 1995, the method of calculating the official sales price of land changed three different times. The resulting uncertainty about how much enterprises would have to pay -- and how much governments would receive -- for the land made both sides reluctant to move forward with land transfers. The first change in November 1994 by Russian Prime Minister Victor Chernomyrdin increased land sales prices by 300% and allowed governments to increase the resulting prices even further. As a result, many enterprises believed they could not afford to buy their land, and were uninterested in joining the ELS project. The second change in February 1995 was based on a letter interpretation of the law by the Chairman of the Russian Federation Property Committee, and opened up the possibility that many enterprises would be able to buy land at even lower prices than they could in July 1994. Enterprises became much more interested in buying their land, but many key officials within local governments indicated that they would not recognize the legal authority of the letter. Finally, in May 1995, President

Boris Yeltsin signed Decree 478, which clarified the issue and resulted in prices somewhat lower than those a year earlier for most enterprises. At this point, both enterprises and local governments became more willing to move forward with land transfers, since it was unlikely that a Presidential Decree on so sensitive a subject would soon be revoked or amended.

6.2 Competition and Tension Between Local Governments

After arriving in Nizhny Novgorod, the ELS team in that city soon discovered that although the Nizhegorodskaya Oblast government was anxious to move forward with land sales, the Nizhny Novgorod city government was not. Further, although Federal law provided that most authority to sell land in the area belonged to the Oblast government, the same Federal laws provided that applications to purchase land had to go through city government committees for review. Finally, the city government took the position that its Property Fund had the right to sell land within its boundaries, even though Federal law stated otherwise, because the government whose Property Fund sold the property stood to receive a much higher percentage of the sales revenues. In May 1995, Decree 478 removed one of the incentives for competition by allowing each level of government to receive a fixed share of sales proceeds regardless of which Property Fund was the official seller of the land. Still, tension between the two governments continued throughout the pilot project, and slowed the project down substantially.

6.3 Deeply Entrenched Local Government Bureaucracies

Although the ELS team had expected difficulties in dealing with the various branches of local governments, it had not expected the degree of inflexibility and resistance that it found. In some cases, powerful committees opposed the entire idea of enterprise land transfers. In other cases, committee chairmen and vice-chairmen supported the program, but subordinates with line authority to accept and process applications remained unconvinced and were very slow to act.

7. Project Successes

The ELS pilot projects in both St. Petersburg and Nizhny Novgorod achieved significant success, and substantially advanced the cause of creating a commercial real estate market in Russia.

7.1 Improvements to Land Transfer Procedures

In one or both of the project cities, ELS team members were successful in:

- Cutting months off of the application processing time for land purchases;
- Reducing the number of duplicative reviews of the same facts in different committees;
- Reducing the number and types of documents needed to establish eligibility to buy land;
- Urging the adoption of an expedited purchase procedure for enterprises without land surveys;
- Urging narrow interpretations of categories of land that could not be sold;
- Separating the land transfer process from time-consuming programs to re-confirm the enterprises' right to occupy the land and to establish a detailed land cadastre file for each property; and

- Urging broad interpretations of the city's ability to accept staged payments for land.

7.2 Completion of Land Transfer Applications

As a result of ELS project assistance to privatized enterprises, 13 of the official enterprise participants in St. Petersburg submitted applications to purchase a total of 41 parcels of land. Nine other enterprises assisted on an unofficial basis also submitted applications to purchase land. By the end of the pilot project, there were over 800 completed applications to purchase land parcels pending in St. Petersburg.

Since the beginning of project work in Nizhny Novgorod in February 1995, the 15 official enterprise participants in that city and the Nizhegorodskaya Oblast have submitted a total of 27 applications. One completed application to purchase enterprise land had been accepted by the Oblast government before the end of the pilot project.

7.3 Transfers of Enterprise Land Parcels

By the end of the ELS pilot project, the city of St. Petersburg had transferred ownership of 17 different parcels of land to enterprises, and had issued certificates of titles for those parcels.

As of September 30, 1995, the Nizhegorodskaya Oblast had transferred title to one site. Several of the enterprises in the ELS project had applications pending in the review and approval process at that point, and the team expected several of those parcels to be sold.

7.4 Training of Russian Nationals

As a result of the ELS pilot project, at least fifteen Russian real estate experts, three Russian lawyers, and two real estate translators have received direct training from expatriate team members. That training has covered basic real estate concepts, the value of land as an asset, basic land valuation techniques, the Russian Federation law on land ownership, and the legal requirements for operating an enterprise land transfer program. Many more real estate experts and lawyers working for the enterprises being assisted by the ELS teams have received more limited training in those topics.

Memorandum of Accomplishments in the Enterprise Land Sales Task Order: Enterprise Land Sales Project in St. Petersburg and Nizhniy Novgorod

1 Background

Pursuant to the July 22, 1994 Presidential Decree #1535 permitting private and state enterprises to sell excess land holdings, a pilot project was created in the fall of 1994 titled the Enterprise Land Sales project. This Decree allowed privatization and land sales. Presidential Decree #478 dated May 11, 1995, further supported the privatization process by reducing the purchase price for land making it 10 times the land tax rate.

The need for the project is demonstrated in the fact that some cities have, without understanding of the fundamentals of creating real estate markets. Most local governments have not responded to the President's decree #1535 requiring this sale because they had no mechanism and no documentation with which to accomplish the transfer. The local governments have seen the land as their "last asset" and want to be sure that the sale of land into private hands does not create future problems. This careful and cautious approach is painfully slow when the governments are unassisted by experts. This stagnation effect also gives rise to more speculating and positioning on the part of the city as the process is created for land transfers. So far, the lack of support in the form of federal legislation telling the city committees "how to" accomplish these sales and their fear of the consequences of mistakes, has frozen them into inaction. Even from the most cautious officials, the reaction has been to express their reservations about selling land and to ask us to help them to avoid mistakes. The cities have an extreme desire to retain enough control over land use to be able to do effective city planning. The cities also want to minimize any future problems with land which the city may need or residual land they may not be able to sell. They would like to see the solution to these perceived problems before they make the first move.

Since passing the presidential decree, a few cities in the Russian Federation - Saratov, Vladimir and Yaroslavl - began to convert land holdings to which enterprises had use right to freehold ownership. These cities have lacked a detailed and expert examination of exactly what is being sold. The cities have completed some transfers in a quick and haphazard fashion, thus creating the following problems:

- disputes to parcels;
- no adequate coordination with all of the committees charged with responsibility of land privatization;
- confusion related to the presence or lack of utility infrastructure serving the land;
- unresolved boundary disputes;
- discovery of unknown easements;
- confusion in the valuation procedures;
- unreliable restrictions as to the future use of the land;

- creation of unclear and useless legislation in the cities that ultimately confuse the situation, instead of fostering development of a working real estate market; and
- public opposition to the transfer process when done without correct market analysis and defense of interests.

Because of these problems, there is a strong case for the need for expert assistance in this conversion process, demanding western input and advise. The cities are only now realizing the potential benefits to their communities if land is transferred to enterprises, however, city officials tend not to look at the interests of the enterprises. There needs to be close dialogue between the enterprises and the cities in a forum created by this project in order for the enterprises to have their interests defended from the cities' desire to tax these transfers beyond reach of the developing land market. The expertise is needed in the following areas in order for the political momentum to continue supporting the development of the real estate market:

- selecting marketable parcels;
- explanation of the benefits to the cities in terms of revenue generation by volume of transfers, and not by a transaction fee generating mechanism;
- the market principles of a developing real estate market, spurring needed investment and capital improvements to the cities in a politically viable when implemented correctly, with experts in the field assisting this development; and
- needed cash input to the enterprises by utilizing their ability to lure investment. This can be done by using potentially transferable land holdings as security in obtaining credit from banks and using this interest as a vehicle for revenue generation for worker's salaries and other operating expenses of the enterprise.

This project is currently taking place in St. Petersburg and Nizhniy Novgorod, and has created a model for transferring clear freehold title to land from the city government to privatized enterprises.

2 Overview of Pilot Project Results

The pilot Enterprise Land Sales project technical assistance work began in St. Petersburg in December, 1994. The project was then extended to Nizhniy Novgorod at the end of February, 1995. The pilot project will continue (through a no-cost task order extension) through September 1995, in order to complete all the necessary technical assistance in the pilot cities. These pilot models are all being implemented and fine tuned with the focus on creating a replicable model.

St. Petersburg Successes:

The Team in St. Petersburg, consisting of foreign advisors and Russian experts, has:

- Met with over 50 enterprises, interviewing them in detail about the status of their rights to land parcels, their valuations of the land, whether the land was vacant or under utilized,

whether the enterprises had any possible joint venture partners, and whether the enterprise had approached the City government about purchasing land parcels to which they had a right.

- Selected five enterprises for the St. Petersburg pilot project (this was later increased to eight), although several more enterprises have been given informal help through the project, and many more have asked to be kept informed about the progress of the project.
- Convinced the City of St. Petersburg to agree to transfer title to land parcels in the areas of the city where the 8 project enterprises are located. All 8 enterprises are currently in the process of, or have received title to their land parcels. This represents a total of 25 parcels or 230 hectares. As a result of these successes, the City requested that PADCO work with an additional 8 more enterprises.
- Created a backlog of enterprises ready to undertake the process of obtaining title to the land themselves.
- Created a process by developing a methodology of title transfer. This methodology has actually streamlined the procedure for the transferring title from the City to enterprises, and all will speed up the privatization of land significantly. This process, which used to take more than 11 months in the draft regulations, now can take less than 4 months.

Systemic changes include:

- Persuading the City to eliminate mandatory referrals to the Board of State Inspection of Public Monuments as soon as the list of land parcels of "Historical and Cultural Importance of Federal Significance" has been finalized.
- Persuading the city to allow enterprises to file applications for privatization based on property boundaries contained in existing documents or the enterprise Privatization Plan, rather than waiting for the completion of a new cadastral survey.
- Persuading the City that cadastral information required for registration of enterprise lands prior to transfers does not need to include detailed information on easements and servitude, but can be limited to accurate boundary surveys and accurate legal information about the enterprise.
- Persuading the City to allow for piecemeal purchase of large land parcels and for staged payment schemes, in order to make payment terms for land transfers more affordable.

Facilitation successes:

- A total of 54 enterprises were contacted about participating in the project and obtaining transfer of the land. All 54 have been invited to a one-day seminar sponsored by PADCO where city officials will explain the detailed procedures, submission requirements and pricing approaches.
- From the group of 54 enterprises, 25 expressed an interest in meeting directly with PADCO to learn more about the process. PADCO selected the 10 enterprise most likely to be successful in the process, and RPC made a final selection of four enterprises to receive intensive

assistance from PADCO. As noted, the number of enterprises was increased to a total of 16 at the request of the City.

- As a direct result of the project, after processing applications for the first four enterprises, the City of St. Petersburg now has enterprise applications to privatize 615 parcels of which 200 have already been approved and are in the 30 day waiting period during which buy-sell agreements are being finalized. This represents a further success of the project, since the initial set of enterprises were industrial enterprises, while the 615 parcels includes a large number of commercial and service sector enterprises.

Nizhniy Novgorod Successes -

The most notable success in Nizhniy Novgorod has been to convert the city from an attitude of not wanting to sell land, to one of agreeing to sell land. This has created the climate necessary to activate land reform activities in the oblast and city. During the team's first four months, 180 major enterprises were contacted. Of that group 50 were directly interviewed by the team and an initial nine selected for in-depth assistance. Subsequently, another three enterprises have been added to the list. These 12 enterprises have approximately 30 parcels of land suitable for privatization. After the first few enterprises land applications have been processed, there is a backlog of at least 30 more enterprises with up to 100 parcels waiting to submit applications. The following are some of the results of the Nizhniy pilot project:

- Enterprise directors and shareholders have learned the benefits of owning their land and hired experts that can be used more effectively (and profitably operate their businesses).
- Russian real estate and legal experts have increased their experience and knowledge by working directly with project consultants. Their knowledge will provide the basis for urban land privatization in other oblasts and areas in Russia.
- Local privatization center personnel are increasing their knowledge and experience with urban land privatization project. Consultants have spent a large amount of time showing the municipal benefits of a private land market, and the value of land ownership, providing enterprises the reasons why they should support this project.
- Agreements have been reached with two local governments concerning the conduct of the project.
- Protocol Agreement signed by both local governments within 60 days of GKI/RPC designation of the project city.
- Local legislation for enterprise land sales was almost entirely written by the professional consultant team with criteria and input established by the local government. This resulted in the most effective possible land transfer legislation.
- A Russian city initially unwilling and unprepared to sell land as evidenced by the verbal expression of the Mayor and by its existing legislation, is now willing to accomplish this process.

- Coordination with more than 20 other donor organizations and privatization projects active in Nizhniy Novgorod region has increased the effectiveness of this project and those other activities.
- Training and background education concerning the value of urban land privatization has been conveyed to government officials and local real estate professionals through the appearance of project consultants at seminar events.
- Enterprise directors and shareholders have been informed of their rights to buy their land through personal contacts and seminars. Many were not aware of this possibility.
- The Nizhniy Novgorod city Land Resources Committee and Architectural Committees have agreed to process the first batch of 6 to 9 enterprise applications within one week's time and provide a 'conclusion' stating the parcels are suitable for privatization. Thereafter, enterprises can take these 'conclusions' to the Property Fund to process buy-sell agreements and if the agreements are concluded receive title to their parcels from the Land Resources Committee. The process is expected to take between 4-6 weeks if no problems are encountered.
- The oblast cities of Bor and Pavala have agreed to process enterprise applications, perhaps even faster than Nizhniy Novgorod spreading the impact of the project to other locations within the oblast.

LEGISLATION ISSUES:

The St. Petersburg project team reviewed both federal and local real estate laws and regulations, and submitted comments to the City government - thus influencing the laws and regulations currently in place. The issues addressed focused on speeding the process forward in order to more adequately serve the interested parties in a land transaction. The principle that revenue may be generated on a volume scale other than on a transaction scale was reinforced in the draft forms of regulations on land transfers.

St. Petersburg:

In the case of St. Petersburg, the legislation created a sales process that takes nine months to a year to complete and dispersed authority so widely that no sale was likely to ever take place without the personal intervention of some high level official.

Nizhniy Novgorod:

In the case of Nizhniy Novgorod, the draft legislation for the oblast was a mixture of related ideas that did not comprehensively address the problems. Recently, the team in Nizhniy Novgorod completed a thorough analysis of the enabling legislation allowing for such transfers. After three separate drafts, the oblast finally accepted many of the suggestions submitted by the team. In this way, the Nizhniy Novgorod team has played a vital role in the development of the real estate market there. In Nizhniy Novgorod, the project team actually wrote the oblast level

regulations. These are now being approved. The oblast government was not addressing enterprise land privatization at all in its regulations before the project, because the issues involved in the enterprise land privatization were unknown to the government. Our project fostered open dialog in the oblast about the benefits, and resulted in a new outlook for the developing land market in Nizhniy Novgorod.

The team has detailed experience with legislation in two cities in Russia; Saint Petersburg where legislation was recently passed, and Nizhniy Novgorod where it is currently being drafted.

Project Benefits:

The PADCO ELS Team presence solved this problem in that it gave city officials confidence to make some needed moves based on the team's experienced recommendations.

The PADCO ELS Team has been able to show city officials legal and effective methods of maintaining control by effectively managing the city responsibilities (protect quality of life and efficiency of city infrastructure) while still developing an active and healthy real estate market.

This project has created legislation that would have been adopted would have created more future problems for the local governments. If this project was not realized, the rest of the oblasts and cities of Russia would have experienced the same problems.

The trained and experienced Russian legal and real estate experts produced by this project will create assistance available for the local governments of Russia to begin to create a real estate market.

From our experience from talking with over 100 managers of Russian enterprises, most officials have little idea of how to use their land efficiently, even if the process to buy it from a local governments was possible. The factors involved in evaluating the highest and best use of land are unknown to them. The idea of using land as collateral to attract capital for use in improving their facilities or in developing investment possibilities is a wholly new idea for most cities. Availability to use land in attracting a joint venture partner, and gaining the capital and support necessary to create more jobs and greater profitability, are beyond reasonable expectations for most city officials in this young stage of land reform activities. This project has included training components to show enterprise managers how they may use their land asset to create positive economic effects for their business.

Extensive Relations with Government Officials and Enterprises

PADCO's St. Petersburg Team has had extensive meeting with City Officials. There is little resistance in the progress of this project amongst the officials at the Deputy Chair level of the State Property Committee, the Committee on Land Resources, and the Committee on Architecture and Planning. This support is strong. This political momentum of support for

reasonable sophistication in a land title conversion system would have been unsupported without this project - especially in the tough political terrain of St. Petersburg.

The Nizhniy Novgorod team has met with representatives with every land related committee of the City as well as the Vice-Mayor's office and the Legal Department, the Finance Department and the economics committees. All the problems anticipated in the sale of land to enterprises have been voiced by these committees. Some discussion of potential solutions has begun and has been very well received. Each land related committee has expressed support for the protocol agreement and the idea for creating a transfer of land rights mechanism and the acquisition of rights to land. The oblast Vice-Governor, has signed the protocol agreement and instructed his staff to directly involve the PADCO team in the drafting of land transfer legislation for the city and oblast. The Protocol with the city and oblast has just been signed a few days ago and the political progressive momentum is moving forward in the development of a real estate market.

Relations with large, and politically important enterprises in St. Petersburg and Nizhniy Novgorod have been cultivated with significant trust and sharing of important corporate information. The St. Petersburg team has worked closely with enterprises to create the correct transfer mechanism and offering technical assistance to the enterprises in the appraisal, value and marketability that are essential to the project.

There are tangible results brought about the PADCO Team's activity of identification of qualifying enterprises to participate in privatization of land. PADCO's St. Petersburg Team has identified 55 enterprises, met with 23 of them, and identified at least 16 large enterprises that qualified for participation in the project. These 16 enterprises include two shipyards, two electronics companies, a building products company, a turbine blade manufacturer as well as other manufacturers. All of them:

- are over 75% privatized;
- have well located tracts of under-utilized land;
- understand the economic uses of land as an asset; and
- are enthusiastic about participation in the project.

In addition, there are several smaller enterprises that also are good candidates for participation. The Local Privatization Center is pleased with the progress in this project, and agrees that these enterprises would be good participants.

In Nizhniy Novgorod, the oblast Vice Governor (V. Shupyro) has signed the protocol agreement and instructed his staff to directly involve the PADCO team in the drafting of land transfer legislation. This legislation is scheduled to be considered by the Governor and was made effective by the end of April. As a result of this high level support, the city will also participated and drafted coordinating resolutions.

ACCOMPLISHMENTS OF THE WORK

Economic Impact - From discussion with enterprise directors over the last four months, many Russian enterprises are positioned to take advantage of capital investment but cannot secure it because of the lack of a secure position in their land. This project is designed to produce positive economic impacts by giving the enterprises the security of land ownership, thus increasing the potential for capital investment in industry. The resulting industrial capital investment will be followed by increased employment, increased per capita income, and general economic growth of the community.

Creation of a Model and Russian Experts - The necessity for this project began with the lack of a detailed mechanism to implement the Presidential Decree #1535 relating to the transfer of land ownership rights to private enterprises. Solving the problems and putting such a mechanism in place in both St. Petersburg and Nizhniy Novgorod will be invaluable in providing experience for other oblasts and cities in Russia.

At the same time, the teams are creating Russian legal and real estate experts with experience in dealing with problems typical of developing and implementing local legislation for transfer of land ownership rights. Allowing the project to expire prematurely, will limit the experience and effectiveness of this roll-out team in assisting the rest of the local governments in Russia.

Transition to Value Based Property Tax System - It is an accepted fact that the local governments must increase their revenue from real estate from the current two to three percent of annual budget to something in excess of fifty percent. Project contacts with local officials show that an effective value based property tax system will be the key to this possibility. As this project involves the transfer of ownership rights to land, from the state to the private enterprises, the parcels involved are the logical beginning of this process. These parcels can be evaluated and assessed for property taxes by the city in accord with the best principles of market value estimation. The individual negotiation and sale of these parcels, through the mechanism established by this project, presents the chance for a logical orderly transition to a value based system of property taxation. If the project is allowed to expire, this opportunity will be lost.

Legal Development of the Land Transactions - The goal of this project, as stated in the task order, is to create program for Enterprise Land Sales using the current legislation existing in St. Petersburg and Nizhniy Novgorod. Fortunately, these officials in both cities have been extremely receptive to the team's input in the development of draft legislation. In fact, the regulations in Nizhniy Novgorod include our team's input. In St. Petersburg, the team has had the opportunity to review draft copies of Variants 1 and 2 of City's proposed Buy-Sell Agreement for Land Parcel. We reviewed those drafts, and we made significant comments and suggestions.

This cooperation is an invitation to play an even larger role in the writing of the legislation as well as supervising the success of the implementation of the transactions. This must be done with a focus on putting as many Russian enterprises as possible through the process of land sale.

NEXT STEPS TO COMPLETE SUCCESS:

Completing the acquisition of rights to the land interest is the main goal. Success in this Task Order is based upon the number of enterprises that use the legislation to do it but numbers are not the full story. The rights behind the interests of the enterprises must be recognized and defended from the city. The pricing issue is a volatile one, demanding careful explanation of the benefits by qualified land experts. Without this support the cities will undoubtedly price the land out the reach of the developing market.

We believe that the issue of enterprise land ownership should be separated from the issue of permitted uses of the land. If the allowable land uses are simply those that exist before the land transfer, then there is no need to restate them, other than possibly to push the transferability issue.

The fact that a landowner can apply to change the land use designation is a matter of law in the draft legislation. From the City's point of view, this is a significant development in the rights of the landowners. These kind of ideas need to be worked through to go further in the defense of the rights of land owners. Continuation of this project will indeed serve that purpose.

Specifying in normative law that each parcel of land includes everything on, under, or related to the land is the rational, feasible means of transferring the land. Avoiding the need to list water sources, utilities, trees, etc., in the agreement will make it simpler for the City government to prepare the agreement and will avoid the need to list all such items in future pledges, leases, or sales documents related to the parcel. It is a win-win situation for landowners and the City, if both interests are represented in the development of these rules. In general, we believe that it is much easier to list what is excluded from the owner's rights than to list all the elements that are included in those rights.

We believe that during the early years of enterprise land transfers the City should use the normative price of the land as the total sale price, and should not include appreciation coefficients or upward adjustments to the normative land price. We believe that this will actually result in more land transfers and more revenue to the City than if the land transfer prices are calculated with significant appreciation coefficients and upward adjustments.

A GUIDE TO ENTERPRISE LAND SALES IN RUSSIA

For Local Government Administrators and Enterprise Managers

**The Russian Federal Property Committee/The Russian Privatization Center
The United States Agency for International Development
Price Waterhouse/PADCO, Inc.**

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Foreword by St. Petersburg Mayor Anatoly A. Sobchak

St. Petersburg is undergoing an ambitious market reform process. As Mayor, I strongly believe that by encouraging the formation of market relations, St. Petersburg will develop a contemporary, civilized, and decent way of life for its citizens.

Land reform is one of the most important aspects of St. Petersburg's economic reforms. Land is our wealth, and we must ensure its rational and efficient use. In this regard, I am very pleased with the results of the enterprise land sales pilot project conducted in St. Petersburg in 1994 and 1995. Enterprise land privatization is an important step toward the establishment of private initiative and management of St. Petersburg's land.

Through enterprise land sales, the city of St. Petersburg has helped local enterprises to use their assets more efficiently and, at the same time, raised money for the city budget to finance socially beneficial projects such as the rehabilitation of engineering infrastructure.

I strongly encourage other cities and oblasts in Russia support an enterprise land privatization program and hope that they enjoy the same success that people of St. Petersburg have enjoyed.

A. Sobchak, Mayor, City of St. Petersburg.

Foreword by Niznegorodskaya Oblast Vice-Governor and KUGI Chair V. Shupyro.

Nizhny Novgorod has been dedicated to market reform ever since the formulation of our small-scale privatization program in 1992. We swiftly implemented the sale of state-owned businesses through cash auctions, and then moved forward with the privatization of large scale enterprises and the agricultural sector. The Oblast and City governments firmly believe that continued economic development is the key to a prosperous future.

These privatization programs have allowed the rebirth of our service industry and the restructuring of our ailing enterprises. We discovered, however, that business development is hampered by a lack of land ownership. Companies need land rights in order to attract foreign capital, obtain bank financing, and raise funds through the sale of excess parcels. The privatization of land will not only help our enterprises, but also support our municipal budget through sale proceeds and future tax revenues.

The Nizhny Novgorod Government, recognizing the importance of land privatization, developed a comprehensive legal and procedural system for enterprise land sales. This framework is now being used throughout the Oblast to deliver freehold title to enterprises. I encourage other government officials to utilize the materials in this manual, and wish them luck in adopting successful enterprise land privatization programs.

V. Shupyro, Niznegorodskaya Oblast Vice-Governor, Chairman of KUGI.

Foreword by St. Petersburg KUGI Chair M. Manevich

On May 16, 1995, the City of St. Petersburg closed its first enterprise land sale. This sale generated 3,800,000,000 rubles for 7,959 square meters of land and set a course for St. Petersburg to accomplish large scale land privatizations. We currently (August, 1995) have over 700 land privatization applications pending. This rapid success is the result of extensive work by KUGI and other city department officials to establish the procedures for such enterprise land sales.

We broke new ground in our work. KUGI drafted new documents simplifying the process of submitting information to the Property Fund. We also drafted a buy-sell agreement for the purchase of a land parcel.

We created a scheme that requires an enterprise to present to KUGI neither a resolution from the sanitary and epidemiological inspection committee nor a cadastral map. We require only a certificate of allotment of the land parcel to the enterprise and a privatization plan showing dimensions of the parcel.

Our work has not been easy. It required a major commitment from many departments in the City of St. Petersburg. We believe, however, that the results are more than worth the effort and we encourage other cities and oblasts throughout Russia to establish enterprise land sales programs.

M.V. Manevich, Deputy Chairman of St. Petersburg Government, Chairman of KUGI

Forward by Federal Property Committee Chairman Sergey Belyaev

Sergey Belyaev, Chairman of Federal Property Committee

INTRODUCTION

This manual is designed to acquaint government officials, enterprise management, and other interested individuals with the policy, practical experience, and technical aspects of privatization of land in the Russian Federation. The concepts, procedures, legal documents, and institutional arrangements contained herein were carefully tested in a successful pilot program conducted in St. Petersburg and Nizhny Novgorod from November 1, 1994 to August 15, 1995.

This Manual is organized into three sections -- one with background information for all readers, one for local government officials, and one for enterprise managers. We encourage, however, government officials to become familiar with issues important to enterprise managers and enterprise managers to become familiar with issues and procedures important to government officials. Cooperation between the business community and local administrations is paramount to a successful land privatization program.

Section I, "Background", discusses the importance to cities and enterprises of a land privatization program. Additionally it discusses the legal basis for land privatization, what land may be privatized, the sales price of land, and registration of privatized land.

Section II, "Local Government Procedures, Responsibilities, and Organization", discusses how local administrations can set up a legal and administrative system to privatize enterprise land. It includes information on the participation of various local government committees in the land sales process and discusses specific steps that these committees may take to process land privatization applications and issue certificates of ownership quickly and accurately.

Section III, "Information For Enterprises" contains information about various types of land use arrangements in Russia. Additionally it contains information about how enterprises may select the most advantageous parcels allocated to them for privatization, may file applications, and may determine potential market value in an overall land privatization strategy.

Finally, this manual includes appendices which present the text of model regulations and forms prepared for local governments in the pilot project, an analysis of the legal basis for privatization in the Russian Federation, and copies of the most important laws. Additionally, the appendices include a case study of a fictitious company, Balshoi Plastmas Zavod, working to complete the privatization of land allocated to it.

Due to the importance of land sales to Russian businesses and Russia's economic reforms, we hope that this information will be helpful to oblast, city, and enterprise officials and will help them to implement equally successful land privatization programs.

I. BACKGROUND

1.1 Real Estate Market Development in Russia.

The introduction of the right to private ownership of real property represents a major step in the development of a real estate market in Russia. The right to private ownership of land, fundamental to the ownership of real property, was established in the law "On Property in the Russian Federation" (December 24, 1990), in the Land Code of the Russian Federation (April 25, 1991), and confirmed in the Constitution of the Russian Federation (1993).

Since passage of these laws, real estate markets for privatized apartments, single family homes, commercial and industrial buildings, and garden plots have developed quickly. Markets for land under such structures, however, have been slow to develop. While land under single family homes and garden plots has been widely privatized, land under apartments and commercial and industrial buildings has generally not been privatized until 1995.

1.2. Legal Foundation for Enterprise Land Sales.

In 1994 the government of the Russian Federation took an important step toward the sale of enterprise lands and the creation of a commercial real estate market in Russia. Russian Federation Presidential Decree 1535 entitled "Basic Provisions of the State Program of Privatization of State Owned & Municipal Enterprises in the Russian Federation after July 1, 1994" (July 27, 1994) explicitly authorizes, and creates a procedure for, the sale of land from the government to enterprises.

Under Decree 1535 most privatized enterprises have the exclusive right to purchase or lease land that has been allocated to them. Legal purchasers include open stock companies set up through the privatization of state and municipal enterprises. These enterprises may purchase land, however, only "after the sale of at least 75% of their shares" pursuant to federal laws on privatization. Private owners of non-residential real estate objects may also purchase land allocated to them. These private owners may either be natural persons or legal entities.

Enterprises have the right to purchase all of the "developed" land, or land with improvements, that they occupy. Enterprises may also purchase "undeveloped" land that has been allocated to them at the same per unit price as developed land provided that the enterprise will: (i) develop the land within three years (federal law does not define what "develop the land" means.); (ii) sell the land within three years and return 30% of any profits to the government; or (iii) if the land is not developed or sold within three years, the enterprise must sell the land using auction rules established by the federal government and return 30% of any profits to the government.

The absence of completed documents on the boundaries of a parcel, its public servitudes, or

restrictions on its use cannot prevent registration of a land sales contract.

Presidential Decree 478 (May 11, 1995) allows enterprises to privatize land using "special liabilities" of the Russian Federal Budget Debt as a means of payment for their land. This use of special liabilities is meant to solve two critical problems: (i) making the purchase of land affordable, and (ii) paying to enterprises amounts owed by the Federal Government. As of the date of production of this manual, no formal procedure had been adopted concerning use of these special liabilities as consideration for the purchase price of enterprise land. We understand, however, that a Presidential Decree has been drafted and is in the signature process.

These and other Russian Federation laws (Russian Federation Constitution 1993) clarify that land may be transferred from a city or oblast to private enterprises without said city or oblast giving up the ability to set limits on the use of that land. The fact that an enterprise owns its land does not mean that it can use the land in any way that it wishes. Land ownership allows an enterprise to decide whether to keep the land, sell it, lease it, further develop it, or pledge it in any manner most beneficial to the company. An enterprise may not, however, use the land in ways that create unacceptable pollution, damage to other land owners, or violate restrictions set forth in established city land use laws.

1.3. Benefits of Enterprise Land Sales for City Development.

Enterprise land privatization will not succeed without strong support from the government in the oblast and city where the enterprise and its properties are located. It is therefore very useful for local officials to understand the many benefits to the oblast and the city from selling enterprise lands:

- Revenues. Local governments receive revenues from land sales, and such revenues may be used to provide government services or to build infrastructure. Pursuant to Presidential Decree 478, 37% of land sales revenue is distributed directly to the local (municipal or rayon) budget, 40% to the oblast (area) budget, and 6% to the local committees and property fund. The remaining portion of the revenue is distributed to the Federal government (Federal Budget, Federal Property Management Committee, Federal Land Committee, and the Federal Property Fund).
- Increased Tax Base. Internationally, most local governments derive a greater amount of property tax revenue from developed lands than from non-developed lands or other sources. Land in private ownership is significantly more likely to be developed with valuable improvements because an efficient owner will seek to maximize the return derived from his land. Enterprises will have more money to invest in valuable taxable improvements if they can purchase land for a reasonable price. Therefore, in many cases, benefits to local governments will be greater over time if land sale prices encourage large-scale land privatization.
- Tax Zone Stabilization. Real estate market development helps to stabilize market prices and

rents. When the market stabilizes, city authorities will be able to establish reasonable differentiation of land tax and property rental rates for different economic zones. This will enable finance officials to increase tax and real estate rental revenues.

- City/Oblast Finance. Privatization of enterprise land will have a major impact on the financial standing of city/oblast authorities. The definition of which land shall be regarded as municipal property and, conversely, as private property, will enable municipal authorities to use municipally owned land as collateral for debt securities and other municipal finance instruments. Increased budget revenues from land privatization will also improve local governments' access to financial markets.
- Jobs. Privately owned land is more likely to be developed with improvements, and construction of those improvements creates jobs. Support of enterprise development is the most efficient form of economic development in a city. The result of economic development is an increase in the amount and quality of jobs for residents in a city.
- Better Maintenance. Private landowners have a direct interest in maintaining, repairing, and upgrading their land and buildings because such maintenance increases asset value. Private owners will generally be able to maintain properties more efficiently, and to a higher standard, than local governments.
- Land Use Efficiency. Private landowners seek to put their land to highest and best use promoting more efficient land use. Users that do not need expensive land will tend to move their operations to low value land. This will free higher value land for new investment requiring expensive land. This efficient market behavior will generally occur much more quickly under private ownership than under public ownership.
- Increased Investment. Investors prefer economies with private land ownership. The ability of enterprises to own, pledge, or sell land will allow a greater number of investors to consider significant investments in those enterprises and in the cities where such enterprises are located. Cities with a high percentage of privatized land and with active land markets become known as areas with progressive and favorable investment attitudes.
- Tourism. Private ownership of land will encourage investment in tourism that might not occur otherwise.

1.4. Why Land Should Be Purchased by Enterprises.

The transition of land in Russia from public to private ownership is one of the most important steps in the country's transition to a market economy, not only because of the symbolic importance of land, but also for economic reasons.

- Major Asset. Land is one of the most valuable potential assets on enterprise balance sheets.

- Collateral for Bank Loans. Enterprises that own their land may have greater access to bank loans because banks are more willing to lend to those enterprises that can pledge their developed land as a guarantee of repayment. Banks are generally not satisfied with the pledge of temporary use or lease rights because their transferability is uncertain and their market value limited.
- Investment Opportunities. Investors are generally reluctant to invest money or contribute capital to an enterprise if that investment may be lost due to government cancellation of a land lease. Unlike inventory and production equipment, which can be moved and may have limited value, land and buildings are immovable and will always be valuable assets.
- Resale of Excess Parcels. After purchasing their land, enterprises may be able to consolidate their operations and sell unneeded parcels. This can earn additional money for enterprise operations and relieve the enterprise of the cost of managing unneeded property.
- Revenue from Leasing Land. Enterprises that own their land may be able to lease portions of their property to commercial tenants. Periodic lease payments can help to improve enterprise cash flows.
- Increase in Fixed Asset Value. Enterprises that own their land can increase the value of their fixed assets by improving the quality of the land. When land is improved, or property is defined and approved for an alternate use, the market value of the property typically increases more than the cost of the improvements, or the cost of reuse approvals.
- Relocation of Operations. Enterprises that own their land will be able to make more rational decisions about whether they need to be in a specific location. An industrial enterprise located in a central district, for example, could sell its land (for redevelopment to residential, office, or commercial uses) and use the money to buy less expensive land for relocation of industrial operations.
- Protection Against Future Lease and Sale Price Increases. By purchasing land now, enterprises will not be affected by increases in normative land prices or changes in government leasing policies in the future. Most real estate professionals believe that current purchase prices are quite low and will increase in the future.
- Protection Against Inflation. Unlike cash and many other assets, the value of land in real terms has historically stabilized or risen in spite of inflationary pressures. An increase in consumer prices usually results in an increase in the nominal market price of land.
- Competition with Foreign Enterprises. Land ownership will allow Russia's enterprises to compete on a more even footing with enterprises from other countries. Capital investments in Russia are currently subject to substantial additional risk associated with the inability of

an enterprise to own land and clauses in lease agreements allowing cancellation by the government.

1.5. Land That May Not Be Privatized.

Enterprise land may also be privatized unless it is listed as land not available for privatization. Presidential Decrees 631, 1535, and 176 list different types of land that may not be privatized. Most of the types of land excluded will not affect urban enterprises. A consolidated list of the non-privatizable land is contained in the model regulations located in the appendices hereto.

The following types of land may not be privatized:

- Land parcels in nature territories under special protection or used for special purposes, including: land parcels of nature reserves, nature monuments, national parks and parks for arboretums and botanic gardens;
- Land parcels of health improving character and historical/cultural lands;
- Land parcels explicitly listed in Presidential Decree 176 (February 20, 1995), and land parcels containing those objects of historical/cultural federal importance listed;
- Undeveloped land parcels contaminated with pollutants and/or exposed to biogenic pollution exceeding limits permissible under current law. Current law is unclear concerning the specific definition of polluted land parcels;
- Undeveloped parcels of the forest and water fund;
- Undeveloped parcels of agricultural lands;
- Lands designated for subsoil use and protection;
- Land parcels for public use in settlements (squares, streets, roads, embankments, parks, forest-parks, gardens, boulevards, reservoirs, beaches);
- Land parcels in seaports, river ports and airports of federal importance or allotted (reserved) for their future development;
- Land parcels in temporary use with no right for capital construction;
- Land parcels or real estate firmly attached to them which are burdened with disputes that have not been settled by a valid decision of the arbitrage court or by a signed agreement between the parties in the dispute.

- Other lands not subject to privatization under the law of the Russian Federation.

1.6. Master Plan of the City.

The city master plan is the main strategic document regulating development in a city. Maps made on the basis of a master plan show the boundaries of areas reserved for current and future streets, roads, utilities, and other infrastructure improvements. After the approval of a master plan, these reserved public right-of-ways become permanent restrictions on alternate use. Such restrictions must be taken into account when drafting land boundaries.

If a right-of-way crosses a land parcel, an enterprise has two options:

- 1) The land parcel may be split into two parts. The area encumbered by the right-of-way may be offered under short-term lease conditions if unimproved (no street) and the portion not thus encumbered may be sold to the enterprise.
- 2) The entire land parcel may be sold to the enterprise with restrictions imposed on the part of the land parcel required for a future public right-of-way.

Decree 1535 does not prohibit the privatization of land reserved for future streets, roads, utilities, etc., and enterprises are entitled to apply for the purchase thereof. The Master Plan must be formally changed before a property may be purchased without such easements for right-of-way.

1.7. Federal Guarantees of Owners' Rights.

The 1993 Constitution of the Russian Federation states that land may be held in private ownership (Article 9) and that citizens and their associations are entitled to hold land in private ownership (Article 36). The rights of owners are broadly defined as the right to "freely possess, utilize, and dispose of land and natural resources provided that this does not damage the environment and does not violate the legitimate interests of others."

At present most articles of the 1991 Russian Federation Land Code are not valid. In the absence of a valid land code, Decree 1535 outlines the rights of owners of land parcels.

The right of ownership of a land parcel is the right to any allowable use of this parcel, and buildings, facilities, and installations located upon it, in any way that does not conflict with restrictions set up by authorized agencies of local administrations. Such restrictions include those imposed in accordance with construction, fire-protection, sanitary, and environmental norms. Decree 1535 states that local administrations may not dictate the specific use of a land parcel. Purchasers must, however, comply with existing local regulations on land use by category, size, or coverage.

Decree 1535 states that the cities may not refuse to sell land to enterprises solely because boundaries of the land are not marked on the ground or on appropriate maps.

The enterprise has the right to sell, bequeath, give away, rent, exchange, mortgage, encumber, or contribute the land as initial capital to various business entities, and to do anything else with the land permitted by Russian Federation law. The law specifies that privatized land must include easements allowing for continued public use of public areas and utilities, for access to maintain and repair those areas and utilities, and for access to place boundary and survey monuments on the land. An owner of enterprise land has the right to use it for any purpose not prohibited within the appropriate functional zone of the city or not prohibited within 100 meters of the site.

1.8. Normative Price of Land and Real Estate Taxation.

Land taxes, established by the Russian Federation law "On land payments" (October 11, 1991), are an essential part of the enterprise land sales process. The current land tax rate (updated annually) is used in calculating the normative price of a parcel of land set for purchase and sale. The procedure for calculating the normative price of land is stipulated by the Russian Federation Regulation 1204 (November 3, 1994). Pursuant to this regulation, the normative price of a land parcel equals the current land tax rate multiplied by 200.

Regulation 1204 contains language that is not completely clear concerning adjustments in normative price. The law states that oblast/krai administrations may increase normative prices as contemplated in Regulation 1204 (200 times land tax rate) to an amount not to exceed 75% of the level of market prices in the immediate area of the subject land parcel. One major problem with this portion of the regulation is that no one knows how to define market price in the immediate area of the subject land parcel. Regulation 1204 goes on to state that city administrations may further increase or decrease the normative price (200 times land tax rate + oblast/krai adjustment) by as much as 25%.

The normative price set by Regulation 1204 turned out to be too high and confusing for many enterprises and slowed the land privatization process in pilot cities. In connection with this, the President issued Decree 478 (May 11, 1995) establishing the normative price of a land parcel to be the current land tax rate multiplied by 10 and abolishing the ability of oblast/krai, and city administrations to make the adjustments discussed in the preceding paragraph. This new formula applies only to privatized former state enterprises while the 200-times-tax-rate formula (plus adjustments, if any) still applies to all other enterprises.

The normative price of a land parcel calculated on the basis of Regulation 1204 and/or Decree 478 may be further increased. Decree 1535 allowed oblast/krai administrations to increase the purchase price of a land parcel by up to 3 times the normative price. These administrations, however, had to decide precisely which areas of the city this increase applied to prior to August 23, 1994. If administrations did not designate such areas prior to August 23, 1994, then all land parcels must be sold at their normative prices as calculated under Regulation 1204 and Decree 478.

Under current law ("On Land Payments", October 11, 1991), an average land tax rate for each city is set annually on the federal level by the passage of a law (most recently "On the Federal Budget for

1995", March 15, 1995). Local administrations may create different tax zones in their cities as long as the average rate of all city lands equals the federally mandated rate.

For example, in St. Petersburg there were 19 property tax zones in 1995, and each zone had a specific land tax rate. The rate equaled approximately 20,000 roubles per square meter in the center of the city, and approximately 122 roubles per square meter in the outskirts. In Nizhny Novgorod there were 112 zones and the land tax rate varied from 223 to 1,433 roubles per square meter.

The normative price of a specific land parcel will depend largely on the property tax zone in which it is located. The manner with which the city establishes tax zones may greatly affect enterprises' decision to purchase their land and the amount of money the city receives from enterprise land sales. Local administrations should carefully study this issue in order to balance land sales revenues with the affordable land prices necessary to encourage privatization.

1.9. Title Registration System.

It is essential that cities set up real estate registration systems in parallel with efforts to privatize land in order to record land parcel boundaries and property descriptions. These systems should be administered by city or oblast departments which register all interests in a certain piece of property and which guarantee the accuracy and accessible record retention of such interests.

The importance of a proper land/real estate title registration system cannot be underestimated. A title registration system will greatly facilitate the creation of private rights in real estate if it is simple, convenient, useful, and comprehensive, and allows buyers, sellers, lenders and others to establish with certainty their rights to a parcel of real estate.

A true land title system provides a mechanism for persons and organizations to easily determine ownership and the presence of encumbrances on a parcel of land (i.e.: allows an adequate title search). Without such a functioning system it is difficult, if not impossible, to attract investment from the private sector or to use real estate as security for investments.

Pursuant to the Presidential Decrees 1767 (October 27, 1993) and 2130 (December 21, 1993), the registrar of title to real estate shall be the committee for land resources and land management as organized on the local level throughout the country.

It is essential that rights of ownership transferred to enterprises be secured and that their ownership be registered in some official place. Cities should coordinate the activities of the architecture and planning committee and the local committee for land resources and land management. The architecture and planning committee, as a rule, possesses information about city plans and maps which allow the accurate definition of land parcel boundaries and the recordation of city land use restrictions. Under current law, the committee for land resources and land management is the state registration body responsible for documentation of property boundaries. The local committee for land resources and land management should maintain records of property boundaries, changes in

such boundaries, land transactions, land tax rates and normative prices of land parcels. The architecture and planning committee and the committee for land resources and land management should work in cooperation as a means for facilitating the transfer of land to enterprises.

II. LOCAL GOVERNMENT PROCEDURES AND RESPONSIBILITIES

2.1 Local Regulations

Russian Federal Law and Normative Acts set forth the main principles of land privatization. It is difficult, however, to carry out land privatization without adopting local regulations to handle procedural issues such as the interaction of different departments of the local administration in the enterprise land sales process.

In order to begin the process of land privatization in a city, oblast, republic or other territorial subdivision, the oblast, and then the local administration, should develop and approve a regulation on the procedure for selling land parcels. This regulation and its procedures should reflect the unique structure and traditions of the local government that developed it. The regulation should:

- list the documents necessary for filing during the application procedure;
- list the departments of the local administration involved in privatization, their authority, and interaction;
- set forth a procedure for disseminating parcel purchase information to enterprises;
- set forth a procedure for accepting applications;
- set forth a procedure for processing applications and obtaining conclusions from required local committees;
- set forth a procedure for settling disputes; and,
- set forth a procedure for registering the right of ownership of the land parcel.

Local regulations should include a chapter containing the provisions of federal law on enterprise land sales be included in the local regulation because such federal law provisions required for privatization are contained in different federal documents, are not systematized, and are difficult to comprehend. Collecting all appropriate federal law provisions in one chapter of a local regulation will eliminate many questions concerning federal law and will simplify the process of privatization.

In addition to the regulation, local authorities should develop a model buy-sell agreement for a land parcel, a standard form for the certificate of sales price of a land parcel, and standard forms for

providing enterprises with the conclusions of i) the committee for land resources and land management, and ii) the architecture and planning committee.

We have included in the appendices hereto, a simple set of model enterprise land sales regulations and forms. Although these regulations and forms may need to be modified to fit specific conditions in different local governments, they present a clear, uncomplicated approach to a complex issue. They simplify the application process, provide local governments with the information they need to keep track of land titles, and allow for rapid approval of land transfer applications.

2.2 Steps in the Enterprise Land Sales Process.

An efficient system for processing enterprise applications and issuing certificates of ownership requires the cooperation of the property fund, the committee for land resources and land management, the architecture and planning committee, the sanitary and epidemiological inspection committee, and the board of state inspection of public monuments . We describe in this section of the manual the process of enterprise land sales and the role of local committees in this process.

2.2.1 Property Fund.

Under Russian Federation law, the property fund that privatized the enterprise acts as the official seller of enterprise land. Thus, in some cases the oblast property fund will privatize the land, while in other cases the city property fund will privatize the land. In St. Petersburg, the city property fund (i) receives enterprise land transfer applications, (ii) circulates them to other committees for review and conclusions, (iii) drafts the buy-sell agreement for the land based on a standard form, (iv) signs the agreement on behalf of the city, (v) receives payment from the buyer, (vi) registers the signed agreement in its own records, and (vii) forwards information about the signed agreement to the committee for land resources and land management so that it can update its land records and issue a certificate of ownership. We suggest that applications be referred to the committee for land resources and land management and the architecture and planning committee as soon as possible after the completed application has been received by the property fund (In St. Petersburg, the law states that this will be accomplished in 5 days).

In addition to these technical duties, the property fund has two important roles. Upon receipt, it must review the application to verify that the buyer is a legal buyer and that the land in question may be sold under Russian Federation law. If the buyer has submitted a complete set of application documents showing that it is at least 75% privatized and that it owns the buildings on the land, then the legality of the sale with respect to these two items should be established.

The property fund should check that the parcel is not within one of the specific categories of protected lands listed in Presidential decrees 301, 631, 1535, and 176 or should submit the application to the state board of inspection of public monuments for an opinion. The property fund may also refer the application to the sanitary and epidemiological inspection committee for an opinion of the status of pollution on the property.

Once the property fund has sent the application materials to the committee for land resources and land management, the architecture and planning committee, and, possibly, to the board of inspection of public monuments and the sanitary and epidemiological inspection committee, and has received written conclusions about the land, it must decide whether those conclusions place the land in a category of land that cannot be sold. If the land is still eligible to be sold, the property fund must decide which of the conclusions, if any, are going to be included in the buy-sell agreement. In general, if restrictions and easements affecting the land are already recorded in the records of another committee, it may not be necessary to restate them in the agreement.

2.2.2. Application Documents.

The property fund should examine the following documents to determine an enterprise's eligibility to purchase enterprise land.

Evidence of Enterprise Status. Enterprises should submit four notarially attested copies of their enterprise foundation documents and their Certificate of State Registration, with all alterations and additions to the property fund which, should check these for validity.

Evidence of Stock Ownership. The general director and the chief accountant of the enterprise should sign and submit a certificate stating that at least 75% of the capital of the enterprise is not owned directly by any state or municipal enterprise. That certificate should be accompanied by an extract from the stockholder's register showing shareholders with at least 75% of the capital of the enterprise. These documents will allow the property fund to determine that the enterprise is adequately privatized in compliance with Russian Federation law on land privatization. It is not necessary for the property fund to research whether any of the stockholders of the enterprise are themselves partly owned by state entities, since the 75% privatization requirement only applies to direct ownership of the applicant. It is unnecessary for the property fund to confirm the stockholder list or the percentage of privatization with different federal or regional stock registries.

Evidence of Approval of the Purchase by the Board of Directors or Stockholders of the Enterprise. The enterprise should provide a resolution from its board of directors or from its stockholders giving the officers of the enterprise the authority to negotiate the terms of the purchase. Enterprises will differ on the approvals required for such authority depending upon specific provisions in their corporate bylaws.

Evidence of Building Ownership. The enterprise should submit a certificate signed by the general director and chief accountant certifying that the enterprise owns all of the buildings, constructions, and installations on the land it is applying to privatize, along with any other documents testifying to the same. The enterprise should submit copies of buy-sell agreements for the various buildings on the parcel and a copy of a privatization plan for the enterprise listing all the buildings, constructions, and installations privatized. Additionally, the general director and chief accountant should certify that the enterprise will not sell any of the buildings, constructions, or installations between the date of application and the date when the land is privatized.

Russian Federation law does not currently permit a "parent" or "holding" company to privatize land under buildings owned by its "subsidiary" or "daughter" companies. Each legal entity in the corporate structure must privatize the land under the buildings that it owns, regardless of whether this is what the enterprise intends as part of its strategic plan.

These documents should enable the property fund to confirm the facts of ownership without further research in the records of building ownership. As a matter of law, an enterprise may privatize only land beneath or otherwise associated with a building that it already owns. Thus, any privatization of land under a building that the enterprise does not own would be invalid, and would result in the enterprise having paid for something that it cannot privatize.

Parcel Map. Enterprises should submit the most detailed and accurate map of the parcel available on the date of application. If such map is an approved cadastral map or another map that meets city or oblast standards for completeness and accuracy, then the boundaries and area of the land transfer can be finalized accurately. However, in compliance with Decree 1535, local governments cannot require an enterprise to provide an accurate map of boundaries or easements, or accurate information about land use restrictions, as a condition of privatization. Since the local government is obligated to process and approve land transfers without accurate boundary information, the terms of such transfer must be able to be adjusted when accurate information is available.

The model regulations provided in the Appendices hereto, therefore, provide that if accurate maps or information on boundaries, easements, or land use restrictions are not available at the time of the application, then the buy- sell agreement for the land must include an additional provision requiring that such maps and information be produced within three months after the certificate of ownership is issued to the enterprise. Additionally, the agreement specifies that the boundaries, easements, and restrictions depicted on the parcel map, and the price of the parcel, be adjusted to reflect the accurate information when it is known, and that the agreement and certificate of ownership also be modified to reflect those facts.

2.2.3. Calculation of the Sales Price of the Land Parcel.

As discussed in Section 1.8 herein, the formula for calculating the sales price of a land parcel is determined on the federal level, the land tax rate being the basis for this calculation.

Pursuant to Decree 1535, an official document stating the sales price of a purchased land parcel should be provided to the buyer (clause 4.10) by the local committee for land resources and land management or by the property fund which should request such document from the local committee for land resources and land management.

The property fund should send an official request to issue a certificate of sales price to the local committee for land resources and land management. The request should state the name and status of the enterprise and the date for which the sales price should be calculated (it may be the date of registration of the application). After receiving such an official request, the committee for land

resources and land management should issue an official certificate stating the sales price.

Local procedures, however, should allow any applicant to obtain a preliminary certificate of the sales price prior to making a decision to purchase the land. Very few entities would be willing to agree to purchase a land parcel if they did not know the price. Enterprise management will also need such a preliminary certificate to obtain purchase approval from its board of directors and/or shareholders.

2.2.4. Registration of the Application.

When all required documents are submitted to the property fund, the purchaser's application for land purchase should be officially registered. The purchaser should be issued a certificate of registration with a registration number and a registration date (see Appendices). The registration date is important because Decree 1535 states that conclusions from local committees must be provided within two months and the registration date may be used as the beginning of this time limit. We recommend that oblast regulations require a shorter time period.

2.2.5. Conclusions from Technical Committees.

Committee for Land Resources and Land Management. In general, the existing records concerning which land has been allocated to which enterprise are maintained by the committee for land resources and land management. Additionally, records concerning easements and restrictions are often maintained by this committee.

The primary document necessary for committee for land resources and land management action should be a copy of the application stating the number of the land parcel registered in the land cadastre, or, if there is no registered land parcel, a map of the land parcel with indicated preliminary boundaries.

The conclusions of the committee for land resources and land management should include:

- previously registered information about the land being sold:
 - i) does information submitted match previously registered information;
 - ii) if there are registered documents concerning use rights, what type of rights are registered, and to whom are those rights registered;
 - iii) whether the land parcel to be purchased is the subject of a dispute;
 - iv) registered public and private use restrictions for each land parcel;
- use designation of the land where the parcel is located.
- the location of geodetic and boundary monuments and registered easements on the land parcel.

Additionally, as stated above, the committee for land resources and land management should provide the property fund with a standard form sales price certificate. This information should be provided to the property fund within one month after the date of registration of the enterprise application and, this information should be provided to the purchaser upon request.

Architecture & Planning Committee. Most information about the location of permitted buildings on, and uses of, land parcels is contained in the files of the architecture and planning committee.

The primary document necessary for architecture and planning committee action should be a copy of the application stating the number of the land parcel registered in the land cadastre, or, if there is no registered land parcel, a map of the land parcel with indicated preliminary boundaries executed on a topographic map with a table of coordinates attached to it. It is very possible, due to time limits place on the application process by Decree 1535, that final determination of parcel boundaries and exact locations of land use restrictions will occur after such parcel has been formally sold to the purchaser (see Section 2.2.2. above).

The architecture and planning committee should:

- write a conclusion on land use restrictions created by items in the master plan (Presidential Decree 1535);
- participate in establishing the boundaries of the land parcel, however, in some jurisdictions where parcel boundaries were clearly established when the enterprise was privatized, the committee need not re-establish such boundaries.:

The architecture and planning committee should receive and approve a map with final boundary information for the land parcel based upon: (i) archival and/or cadastral information concerning the registered boundaries of a parcel, (ii) topographic information, (iii) the location of utilities on the parcel, (iv) agreements between the enterprise and its neighbors concerning parcel boundaries, and (v) uses of land on or near the property as dictated by the master plan of the city.

If the map submitted to the architecture and planning committee is not accurate enough to finalize property boundaries, survey work should be performed on the basis of a draft of land boundaries drawn by the architecture and planning committee. After this survey has been performed, the architecture and planning committee should confirm that there is no inconsistency between the location of the boundary monuments placed on the ground during the survey and the red lines drawn on the preliminary map;

- check for any inconsistency between any information provided by the enterprise and the information in the committee's files; and
- write a conclusion concerning the location of existing utilities on the land and rules for

access to maintain, reconstruct, and repair the utilities.

We recommend that the conclusions contain only information that directly concerns the sale (eg: whether the current boundaries correspond to those registered in the architecture and planning committee records, or whether land on the parcel is reserved for future city infrastructure development). The conclusions of the architecture and planning committee should be provided to the property fund within one month after the date of registration of the enterprise application.

In order to simplify the process of enterprises determining restrictions placed on their land, we recommend that the architecture and planning committee develop a city-wide map that clearly shows land reserved for future city infrastructure development and therefore forbidden for sale. Such map should be approved by the local legislative body, registered in the records of the committee for land resources and land management, and made available to enterprises upon request.

Sanitary and Epidemiological Inspection Committee. Federal Law states that undeveloped land parcels contaminated with pollutants and/or exposed to biogenic pollution exceeding limits permissible under current law may not be sold to enterprises. Federal law does not, however, currently establish a definition for polluted land, so there is some doubt as to how this provision may be enforced.

In order to simplify the process of enterprises determining if their land is considered to be polluted, we recommend that city administrations work with the local sanitary and epidemiological inspection committee to produce a map of polluted lands in the city. Such map should be approved by the local legislative body, registered in the record of the committee for land resources and land management, and made available to enterprises upon request.

While the law may not permit polluted lands to be privatized, cities might be better off if they permitted development and eventual privatization as long as the purchaser agrees to clean up the pollution. In a great many cases, the enterprise having rights to the land probably caused the pollution so there is considerable social justice in permitting privatization and requiring that the polluting enterprise undertake environmental remediation.

Board of State Inspection of Public Monuments. Presidential decrees 176, 631, and 1535 contain lists of land under historic buildings that may not be privatized. We believe that it is unlikely that applications for the privatization of land under historic buildings will be submitted since important historic buildings cannot be sold, and the enterprise could not submit a certificate that they own such buildings. The property fund may, however, refer the application to the board of state inspection of public monuments for confirmation that no structures on the site are contained in the list in Decree 176. It is worthwhile to note that any approved restrictions on the use or demolition of less important historic buildings that can be sold are already binding on their owners as a matter of law, and would not affect the seller's ability to privatize the land.

In order to simplify the process of enterprises determining if their land contains historic buildings, we recommend that city administrations work with the local board of state inspection of public monuments to produce a map of protected lands and structures in the city. Such map should be approved by the local legislative body, registered in the record of the committee for land resources and land management, and made available to enterprises upon request.

2.2.6. Drafting the Buy-Sell Agreement.

Based on the conclusions of the foregoing committees, and on analyses of documents received from the purchaser, the property fund should draft the buy-sell agreement and sell the land parcel to the enterprise. Decree 1535, while somewhat unclear in its use of terminology, states that committee conclusions must be written within two months after registration of the application. We believe that the spirit of this Decree is that the application process should be accomplished and the property fund should sign the buy-sell agreement within two months after registration of the application. We strongly recommend, however, that the application be processed within one month after registration.

Federal law on land privatization does not specify the procedure for executing the buy-sell agreement. We have included in the appendices hereto a sample buy-sell agreement. Any such agreement should include the following:

- specific information on the parcel and the purchaser;
- if, at the time of execution, the purchaser does not have a duly made cadastral map of the parcel, an additional provision should be included in the agreement setting forth a time by which such map shall be produced and setting forth adjustments necessary to the certificate of ownership and the purchase price dictated by the final size of the land parcel;
- a provision, subject to mutual consent of the parties, allowing for amendments and addenda to the buy-sell agreement;
- a provision for settling disputes by a special commission staffed by representatives of local management departments involved in the privatization process;
- rights and obligations of the parties, including, dates for payment and performance of other terms and conditions;
- penalties and remedies for non-performance; such penalties should include a fixed amount of money per day until such non performance is corrected up to, and including, cancellation.

We do not recommend that a description of public and private restriction on the land parcel be included in the buy-sell agreement. Public restrictions are imposed on the basis of the city master plan, may only be changed by Duma action, and do not depend upon who owns a particular property at a particular time. Registered private restrictions are transferred to new owners automatically upon

transfer of the property.

We believe that it is sufficient to list in the buy-sell agreement all documents containing public and private restrictions and the locations where such documents may be found.

2.2.7 Signing the Buy-Sell Agreement.

After the buy-sell agreement has been drafted by the property fund, both parties should sign.

2.2.8 Payment of the Purchase Price.

After the buy-sell agreement has been signed the purchaser should make payment of the purchase price based upon the terms and conditions set forth in said agreement.

2.2.9 Issuance of the Certificate of Ownership, Registration in the Title Registration System.

Presidential Decree 1767 (October 27, 1993) states that the committee for land resources and land management is responsible for issuing a certificate of land title. Decree 631 (June 14, 1992) states that the right of ownership of the property transfers immediately upon payment of the purchase price. Consequently, after payment of the purchase price, the property fund should notify the committee for land resources and land management that they may issue the certificate of ownership which is subject to mandatory registration in the title registration system (see Section 1.9). We recommend that this should be accomplished within 5 days after payment of the purchase price.

III. INFORMATION FOR ENTERPRISES

This section contains information that we believe will be helpful to managers of enterprises wishing to privatize their land. We present discussions that will assist enterprises in preparing application documents and in making well informed decisions concerning land issues.

3.1 Forms of Land Ownership.

Under current Russian law, a land parcel occupied by a privatized enterprise may be either: (i) owned by the enterprise; (ii) rented from the government, or any other land owner, under long or short term lease conditions; (iii) used under perpetual permanent use conditions; or (iv) used under temporary use conditions.

3.1.1 Perpetual Permanent Use.

Perpetual permanent use conditions allow an enterprise to enjoy unlimited use of a piece of property forever without providing for the right to sell the land, lease the land (without government approval),

or to gain any benefit from the appreciation of the land's value. The right to use land under perpetual permanent use conditions was most recently addressed in the 1994 Civil Code of the Russian Federation (Chap. 17). The legality of this right to perpetual permanent use, however, is under question until the new Land Code is adopted.

Many enterprises currently possess rights to their land under perpetual permanent use conditions. The only real advantage to this (relative to ownership) is that an enterprise does not have to pay the purchase price associated with securing ownership rights to their land. Land taxes must be paid annually under perpetual permanent use. Rights under perpetual permanent use conditions are usually preferable to long term lease rights because land taxes are generally lower than lease payments.

There are several advantages to ownership rights in comparison to perpetual permanent use rights:

- the enterprise may sell all or any portion of the parcel, lease it, or use it as collateral against a bank loan under ownership but not under perpetual permanent use;
- owners of land held under ownership conditions enjoy profits from the appreciation of value of the land, whereas enterprises have no such benefit under perpetual permanent use;
- if land is condemned by the government, the only right available to the holder under perpetual permanent use conditions is that the government must provide another parcel. If the government condemns land held under ownership conditions, it must (i) pay compensation equal to the market price of the land, or (ii) provide a new land parcel and pay the owner any difference between the market price of the old parcel and that of the new parcel.

3.1.2 Private Ownership Vs. Long Term Lease.

In most cases ownership rights are preferable to long term lease rights. In cases where federal or local law does not allow privatization of all or part of a land parcel, however, long term lease conditions may be the only option available to an enterprise.

Long term lease conditions allow the lessee only to use the property for economic activities. The lessee may not sell the parcel. A parcel may be subleased only after consent from the owner. The lessee must pay rent and that rent may be increased from time to time. The right to use a parcel under long term lease conditions is restricted by time limits as set forth in Article # 272 of the 1992 Civil Code the Russian Federation. An owner may evict a lessee from a parcel upon expiration of the lease agreement.

3.2 How to Select a Land Parcel for Purchase.

An enterprise contemplating the purchase of its land should consider the following issues:

3.2.1. Should We Purchase All of Our Property and, if not, Which Portion Should We Purchase?

The answer to this question depends largely upon whether the enterprise is buying land for its own continued use or for a potential sale. Enterprises should confirm that parcel(s) slated for privatization have adequate size, shape, street access, rail or water access, parking, and utilities for their intended use or resale. Additionally, they should consider whether the location of the land is suitable for its intended use. If the market value of enterprise property is greater than the cost to acquire, then, an enterprise should purchase as much of such land as possible.

The success of a land acquisition program, especially when it is the first for a enterprise, depends greatly on the selection of desirable land parcels. Location is a very important criteria governing a parcel's appeal. Five other factors -- engineering infrastructure, physical conditions, size and configuration, environmental conditions, and changing development patterns -- also affect a parcel's attractiveness and thus should influence the selection of parcels for purchase:

- Engineering Infrastructure. Some land parcels have no current access to water, sewer, electricity, and other engineering infrastructure. Other parcels have potential access, but the costs for hook-up are prohibitive. Still other parcels have sufficient engineering infrastructure, but the overall infrastructure service for the area is inadequate.
- Physical Conditions. The existence of certain physical conditions can render a parcel unattractive. For example, wetlands, peat, and rock outcroppings can render portions of the parcels unbuildable or at the very least make development very costly.
- Size and Configuration. The size of a parcel must match up with the desired economic use. A large parcel is less desirable when the market does not demand uses that would occupy much of the parcel. The configuration of the parcel must allow the enterprise or a future purchaser of a property to construct appropriate buildings. Awkwardly configured parcels resulting in construction cost premiums or inefficient or unattractive building designs are problematic.
- Environmental Conditions. Environmental conditions not only affect the health and safety of workers and residents, but increasingly concern non-residents. Thus, enterprises should prefer to purchase land parcels without extensive environmental contamination, however, if enterprise land is contaminated, enterprises might consider determining the feasibility and cost of remediation and comparing such cost to the market value of the property to be purchased.
- Changing Development Patterns. Since the value of real estate is typically derived from its future use, the most successful developers analyze emerging development patterns for a city. Is the neighborhood where the parcel is located on the upswing? Is the city planning to expand provision of engineering infrastructure to the immediate area? Are there other areas in the city that are scheduled for major infrastructure investments?

3.2.2. Do We Have All Documents that We Need to Privatize Our Land?

Enterprises should collect all available maps, all documents evidencing official allocation of land to the enterprise, all permits for specific use, and documents showing the existence and location of utilities, easements, and restrictions on the land. Enterprises should obtain a resolution from its board of directors or from its stockholders, as required by corporate bylaws, giving the officers of the enterprise the authority to negotiate the terms of the purchase. Enterprises should also obtain original or accurate copies of all foundation documents, privatization documents, and the privatization plan (See Section 2.2.2.). It is often difficult for enterprises to define the legal status of their land. In many cases land parcels were allocated to enterprises in the Soviet period without properly executed documents so the present legal status of such land in doubt.

3.2.3. Do We Have Accurate Boundary Information and Are There Encroachments?

Enterprises should attempt to obtain accurate boundary maps, documents showing the allocation of land to the enterprise, maps with the location of easements, and determine if boundary disagreements with neighboring land owner/users exist.

3.2.4. Are There Claims by Third Parties Against Our Property?

Enterprises should pay any unpaid property taxes and should provide for the exclusion of sub-parcels containing buildings owned by other enterprises.

3.2.5. Do We Have the Funds Necessary for the Purchase?

Enterprises can often find the money to purchase their land through the use of enterprise savings, the sale of assets such as equipment or unused buildings, or bank loans. In some cases, it may be appropriate to lease some of the enterprise's other parcels of land to other users in order to get a stream of lease payments that can then be pledged to a bank to secure a loan.

3.3 Preparation of Technical Land Documents.

Unlike personal property, real property usually does not have natural boundaries. The boundaries of real property are determined by law and by agreements between entities or people and must therefore be properly described and registered on a map.

Russia is in the process of creating a land registration system on the basis of the network of local committees for land use and land management, however, there is currently no legal basis or procedure for establishing land parcel boundaries and the majority of Russian enterprises do not have proper land boundary information and/or documents describing the location of such boundaries. Defining land parcel boundaries is a creative process in which the interests of the enterprise, its neighbors, and the city administration are reconciled.

3.3.1. Types of Land Documents.

Pursuant to Decree 1535, an enterprise wishing to purchase its land must submit documents confirming the right to purchase, the principal documents being those that confirm the right of ownership of all buildings, constructions, and facilities located on the land. The boundaries of a land parcel are formalized through documents describing the land parcel and documents confirming the status of its contemporary land possession (short/long term lease or perpetual permanent use agreement). All documents confirming the right of land possession, land boundaries and describing the property may be referred to as "land documents".

It is possible that information concerning the boundaries of a land parcel already exists and is registered in the land cadastre and/or with the committee for land resources and land management. The boundaries of a "registered" land parcel must be marked on the ground. Existing land parcel boundary information may often be found in two types of documents: (i) a lease agreement or a certificate of perpetual permanent use registered with the committee for land resources and land management or, (ii) a "cadastral map of the land parcel" approved by the committee for land resources and land management.

An enterprise applying for purchase of a land parcel with existing boundary information should attach to its application documents confirming the land cadastral number, registered land size and the type of registered land possession .

The majority of land parcels in Russia have not been properly described and registered. Parcels described under "temporary use certificates", "cadastral maps", "drafts of land use boundaries", or "maps of land allocation" and not registered with the committee for land resources and land management or issued by agencies other than those responsible for maintaining land cadastre cannot officially confirm land boundaries.

3.3.2. The Land Boundary Draft.

If the boundaries of a land parcel have not been properly registered, the enterprise should participate with the architecture and planning committee in establishing such boundaries and should consider the following issues:

- boundaries of the parcel should allow the enterprise to continue operations in the substantially the same manner as prior to land privatization. Service lines and roads between buildings should be included in the parcel.
- the parcel should have frontage on a city street or road and there should be sufficient access from such street or road to continue enterprise operation in substantially the same manner as before land privatization.
- the enterprise should have access to any rail spurs or marine mooring facilities historically

used in connection with the parcel.

- whenever possible, parcel boundaries should coincide with natural boundaries or existing structures. It is often possible to use facades of buildings, fences, road, or rail spurs as parcel boundaries.

The enterprise should hire a licensed civil engineering or surveying company ("surveyor") to produce a draft of land boundaries. The surveyor should be provided with a preliminary map and a list of all buildings, constructions, facilities located on the land parcel.

The surveyor should perform the following tasks:

- apply to the system of land cadastre for information concerning registered boundary monuments or registered land parcels adjacent to the property;
- apply to the system of land cadastre and/or the architecture and planning committee for information concerning registered buildings, constructions, and/or facilities;
- apply to the architecture and planning committee or the local information archive for public restrictions and easement locations. The surveyor may wish to research archives for information concerning the existence of historical and cultural monuments on the property;
- apply to the committee for land resources and land management and the architecture and planning committee for information concerning engineering or surveying works performed on adjacent land parcels;
- survey the land parcel and its underground utilities;
- create a topographic map of the land parcel based on archival information or upon surveying works;
- participate in negotiations with adjacent property owners or rights holders concerning the establishment of land boundaries;
- make a draft of land boundaries, calculate the size of the land parcel, and assign coordinates for angle points; and,
- obtain approval of the draft of land boundaries from the architecture and planning committee prepare a final survey document, and mark the physical boundaries of the property on the ground.

Land use restrictions identified in the process of making the draft of land boundaries may be so problematic that it will become necessary to split the land into several land parcels. This often

occurs when future rights-of-way cross the land parcel. In such cases the enterprise should consider asking city authorities to adjust the location of such rights-of-way which usually may be done under local procedures. The decision to alter the location of rights-of-way is officially made by local administrations who usually require the applicant to pay for the performance of civil engineering (*designing*) work associated therewith. In this case the applicant may risk losing money spent on civil engineering works if, after the production of such works, local authorities refuse to accept right-of-way changes.

3.4 How to Determine Market Value.

The use of land parcel appraisal techniques provides an important reference point for enterprises wishing to purchase their land. Before making a final decision to purchase a land parcel, enterprises need to have a good sense of how the market values such land parcel. Land parcel appraisal techniques estimate the market value of a specific parcel of land at a specific point in time. Appraisers rely on information about actual market transactions involving comparable properties, construction costs, rents, and other factors to create their estimate of the market value of the parcel they are appraising. It is important to recognize, however, that land appraisals do not "determine" the market values of land parcels. The market determines market values, while land appraisals infer market values. Land appraisals should not be confused with normative land values announced in national laws without regard to actual market values.

Land appraisals employ a well established methodology dependent on the availability of information from the private world of real estate markets. In Russia, where the economy has yet to transform itself fully to one based on private markets, the land appraiser is forced to rely on data less precise than that expected for appraisals in established market economies. To begin with, the number of market transactions is significantly lower, and those that occur may not take place in a fully juridical and open manner. With a changing national and local juridical framework affecting land ownership and use, the appraiser must diligently examine a comparable transaction to consider whatever unique conditions may have been applicable to that property at the time of the transaction.

The key elements of effective appraisal work in Russia are the following:

- An understanding of appraisal principles, methodology, and analytical techniques.
- Knowledge about the local economy, and particularly the emerging real estate sector.
- Field research regarding the indicators of prices, supply, and demand.
- Extensive interviews with builders, developers, bankers, and real estate brokers.
- Uncovering of analogous market information within the city, and, where necessary, from other cities in Russia and even comparable markets in neighboring countries also in economic transition.

For purposes of enterprise land evaluation, the appraiser's job is to estimate the market value of parcels to be purchased. Market value is defined as the most probable price, in terms of money, that a parcel should bring in a competitive and open market, allowing a reasonable time to find a buyer, with both the buyer and seller acting prudently, in their own self-interest, and being knowledgeable about all the issues related to the parcel. In order to estimate the market value of a parcel, the appraiser must know what appraisers call a parcel's "highest and best use." The highest and best use is that use which is legally allowable, physically possible, financially feasible, demanded by the market, and which produces the highest market value for the parcel.

Land appraisers typically utilize one or more of three basic approaches to estimate the market value:

- The *Sales Comparison Approach* compares the property being appraised (the "subject property") with other similar properties that have recently sold or are currently offered for sale ("comparable properties"). Adjustments are made to account for differences between comparable properties and the subject property in order to reach an indicated market value for the subject property.
- The *Income Approach* converts expected future net income (revenue less expenses) from the property into an estimate of market value through application of market-based investment yield rates.
- The *Cost Approach* is usually used only for land parcels with improvements, and not for vacant land parcels. It estimates market value by determining the cost of replacing the improvements on the land parcel, less any depreciation or obsolescence associated with the improvements, and adding the estimated market value of the land.

These approaches are used not only to estimate the market value of a vacant land parcel, but also the market value of buildings on land parcels. If the appraiser uses more than one of these approaches, he or she may find that market values derived from the different approaches widely diverge. In such cases, the approach in which the data appears the most reliable and the analysis most thorough should receive preference.

We have included in the appendices hereto a lengthy discussion of the methodology for performing these three appraisal approaches.

3.5 Selling and Leasing Land to Others.

Due to the historical absence of a private real estate market in Russia, land uses are likely to change substantially in the near future. Urban expansion has, in many cases, caused industries in formerly outlying areas to be surrounded with residential and commercial development. Such non-conformity of land use suggests that such industrial land might be put to a higher and better use.

As the private market for land matures and developer/buyers are able to compete for parcels in private ownership, those industries occupying valuable parcels will tend to sell their land and move their operations to less expensive sites. Local architecture and planning committees have a strong motivation to encourage relocation of industrial users from urban districts to less developed areas. This trend is reinforced by committees for land resources and land management willingness to establish local tax rate modifiers designed to encourage relocation in the name of land use efficiency.

Rational enterprises recognize the need to manage land assets efficiently. In a free and competitive economic system, enterprises tend to seek the highest return from their assets, including land. For all of these reasons, enterprises may want to consider selling or leasing some or all of their privatized land.

An enterprise considering the sale or lease of land should examine closely market conditions existing in their area, their goals, their financial resources and needs, their space and location requirements, and the individual characteristics of their property:

- are surrounding land uses consistent with the enterprise's use of the property;
- is land available in other locations that would be preferable for enterprise activities;
- will the enterprise need additional land or buildings in the future;
- could the enterprise use funds generated from the sale or lease of property in a way that would provide a greater return to the enterprise than could be achieved through ownership and use of said property;
- was land allocated to, and purchased by, the enterprise that is unnecessary for enterprise activities and available for sale or lease;
- may operations be consolidated and excess parcels sold;
- do operations exist in under-utilized buildings, and, if so, may operations be consolidated and excess buildings sold or leased;
- what is the availability, quantity, and quality of public access by road;
- is there access by rail spur or navigable waterway;
- is infrastructure available of quality and quantity sufficient to support the intended use of the parcel, including consumable water, heating water, waste water collection, storm sewer, natural gas, electricity, and telephone.
- would a partial sale or lease of land assets create access or security problems;

- what type of easements or other encumbrances exist and where are they located;
- would a sale or lease require a change of functional use or zoning designation;
- characteristics of the property, including size, shape, road frontage, soil conditions, and topography;
- the historical significance of the parcel;
- the presence and extent of environmental contamination of the property.

If, after examining closely such issues, the enterprise determines that it should sell or lease a parcel, the enterprise should determine how best to accomplish such a sale or lease.

Enterprises wishing to sell their property should consider using a professional real estate broker to assist in the marketing and sales process. Brokers usually receive a percentage of the sales or lease price as a commission, however, they often have access to, and knowledge of, organizations interested in purchasing land and the parameters important to such buyers. Brokers will be able to advise enterprises about current market conditions thus enabling the maximization of revenues achieved from a sale or lease.

Enterprises that decide to forego the use of a broker should devote a substantial amount of effort to marketing. Such marketing might include on-site signage, advertisement in newspapers and trade publications, distribution of information sheets, and announcements at industry meetings and events.

3.6 Enterprises Should Purchase Land Prior to Contracting to Sell Buildings.

Enterprises considering the sale of buildings should privatize the land under said buildings before the sale is executed. Rights to the land under buildings or unfinished construction objects were granted under Article 37 of Land Code of Russian Soviet Federative Socialist Republic to the party that owns such objects. Currently, rights to land must be confirmed by an evidentiary document such as a lease agreement.

If an enterprise sells buildings, the land under said buildings will not be considered by the government to be "a land parcel under a privatized enterprise" and, consequently, cannot be privatized by the original enterprise. This is undesirable because there is then no possibility to acquire the land parcel at 10 times the tax rate formula applicable only to former state enterprises.

If an enterprise has agreed to sell a building on not yet privatized land and the sale has not been concluded, or has been concluded but not formally registered, such enterprise and its purchaser

should refrain from concluding the agreement until the land parcel has been privatized. After ownership rights to the land have been transferred, the building may be sold together with the land parcel.

It is possible, as contemplated in the Article 429 of the new Civil Code of Russian Federation, to conclude a preliminary agreement for the sale of a building and the land underneath prior to land privatization. Such preliminary agreement could state that a final agreement to purchase the building and land shall be concluded after the land is privatized and that conclusion of the final agreement shall be obligatory for both parties. A preliminary agreement requires neither registration nor presentation to the authorities responsible for implementing the process of privatization.

IV. APPENDICES

4.1. Text of Model Regulations and Forms

4.1.1. Regulations

4.1.2. Application Form

4.1.3. Land Price Certificate

4.1.4. Buy-Sell Agreement

4.1.5. Format for Committee for Land Resources and Land Management Conclusions

4.1.6. Format for Architecture and Planning Committee Conclusions

4.1.7. Certificate of Ownership

4.2. Federal Legislation

4.3. Presidential Decree 1535

4.4. Presidential Decree 478 (excerpts)

4.5. Model Land Sales Provision

4.6. Model Application Form

4.7. Model Price Calculation Form

4.8. Model Sales Agreement

4.9. Model Property Fund Procedures

4.10. Model Format for Committee for Land Resources and Land Management Conclusions

4.11. Model Format for Architecture & Planning Committee Conclusions

4.12. Model Certificate of Ownership

4.13. Legal Basis For Enterprise Land Privatization

4.14 Land Parcel Appraisal Approaches.

As discussed in Section 3.4, the use of land parcel appraisal techniques provides an important reference point for setting determining the value of enterprise land parcels. Land appraisers typically utilize one or more of three basic approaches to estimate the market value: the "sales comparison" approach, the "income" approach, and the "cost" approach. These approaches are used not only to estimate the market value of a vacant land parcel, but also the market value of buildings on land parcels.

The *Sales Comparison Approach* compares the property being appraised (the "subject property") with other similar properties that have recently sold or are currently offered for sale. Adjustments are made to account for differences between each comparable property and the subject property to reach an indicated market value for the subject property.

The *Income Approach* converts expected future net income (revenue less expenses) from the property into an estimate of market value through applications of market-based investment yield rates.

The *Cost Approach* is used only for land parcels with improvements, and not for vacant land parcels. It estimates market value by determining the cost of replacing the improvements on the land parcel, less any depreciation or obsolescence associated with the improvements, and adding the estimated market value of the land.

"Sales Comparison" Approach

Under the "sales comparison" approach, the appraiser attempts to obtain information about actual market transactions involving comparable land parcels and buildings. In Russia, accurate recent transactions data are difficult to unearth. Governments are unlikely to have an accurate registry of such transactions. Private real estate brokers may provide general information about sales, including the neighborhood location of the parcel, the sales price, the age and type of any building on the parcel, the size of the building, and the number of days it took for the parcel to sell. At the same time, brokers usually refuse to provide specific property addresses or the name of buyer or seller.

In most cities, few official sales have occurred. Instead, unrecorded "sales" or transfers of ownership, use, and lease rights have taken place, and it is not always easy to obtain accurate information on the sales price. In some cases, the buyer will exchange in-kind payments such as one or more completed dwelling units for the parcel. If the appraiser is attempting to value a vacant land parcel, he or she may be forced to use land parcels with some improvements thereon as comparables, and then allocate the overall sales price into a land and building value. The value of the improvements should be deducted from the overall value to arrive at the indicated value for the comparable transaction.

When using sales comparable properties, it is useful to state their market values in unit measures. Thus, for example, the comparable property would typically be described as follows:

- *Land:* Price per square meter of land or total allowable building area per square meter of land.
- *Apartments:* Price per square meter of building area, per unit, or per room.
- *Office:* Price per square meter of building area or per office unit if all office units are of similar size.
- *Retail (Shops):* Price per square meter of building area or price per shop unit if all shop units are of similar size.
- *Hotel:* Price per unit (guest room), occasionally price per square meter.

In measuring each comparable property, adjustments should be made to account for differences in the following areas:

- *Type of Property Right:* Consider differences in value arising from whether the parcel is under long-term lease, permanent use, or ownership, with outright ownership having the highest value.
- *Conditions of Sale:* Consider differences in value arising from whether the sale was an open market sale, forced sale, a sale between friends or family members, or a collusive sale between buyer and seller.
- *Date of Sale:* Consider differences in value arising from changes in market conditions, including inflation and supply and demand imbalances, if different than the conditions as of the date of the appraisal.
- *Market Attractiveness:* Consider differences in value arising from differences in the appeal of a property to potential purchasers. For residential properties and undeveloped residential land, these key factors typically include access to work, proximity to stores and services,

quality of neighborhood, overall safety and security, other available amenities, and prestige. For commercial use properties, these factors typically include accessibility to workers and other businesses and governmental agencies, adequacy of public transportation, parking availability, quality of neighborhood, safety and security, and prestige.

- *Physical Characteristics:* Consider differences in value arising from differences in the physical conditions of the properties. For undeveloped land, these factors typically include topography, soils, wetlands and ground water, environmental conditions, and road or water frontage. For buildings, the factors typically include the age and conditions of the building, the amenities, the functional design, and the building appearance and style.
- *Engineering Infrastructure:* Consider differences in value arising from the availability and cost of engineering infrastructure, including technical conditions, roads, water, central hot water and heat, sewer, electricity, gas and telephone.
- *Governmental Restrictions:* Consider differences in value arising from the type of restrictions affecting the property, including use restrictions, environmental regulations, historic controls, and building codes.

Price adjustments arising from the consideration of the above-listed factors are made to the per square meter value of the comparable property, with reductions where the comparable is superior to the subject property and additions where the subject property is superior to the comparable. The adjustments must be estimated from actual experiences in the marketplace. Ideally, the calculation for each adjustment would involve a direct comparison of properties similar in all respects but for the one different factor. Known as "paired sales comparisons," this is the theoretically correct technique, but it may be difficult to apply given available data.

Because there exists sufficient sales experience with privatized apartment units to estimate the relative differences in market attractiveness by area of the city, such information is relevant and may be applied to land parcels. For example, the adjustment for market attractiveness may be based on comparable sales or a comparison of rent levels for similar properties, one of which was located in the area of the subject property and the other in the area of the comparable property. The adjustment for ownership interest would reflect the comparative discount attributable to a "permanent use right" as opposed to the sale of a fully transferable ownership interest, as measured by actual transactions or reasonable proxies. Where quantitative market data are not available to estimate the relevance of the above factors, the appraiser must instead rely on interviews with buyers, sellers, and brokers.

After making adjustments, the appraiser will generate a range of indicated market values for the subject property. If an appraiser has adjusted all indicated values of the comparable properties and has arrived at the same indicated values, it is likely that the analysis is artificial and the appraisal is not to be trusted. The final estimate reflects the appraiser's best judgment based on the appraiser's knowledge of the subject property and the comparable transactions. The final estimate of market value should fall within the range of the adjusted comparable properties, and the appraiser should explain the reason for the estimated value.

"Income" Approach

The "income" approach is used to estimate the value of income-producing properties such as office buildings, apartment buildings, shops, and hotels. This approach typically measures the net operating income that the building produces (or would produce) on an annual basis under stabilized operating conditions. This amount is calculated by determining the rent paid under existing leases plus an estimate of the market rent per square meter for all rentable space currently not leased to tenants. The market rent per square meter is estimated by comparing actual rents currently being paid in similar rental properties and adjusting for differences between a comparable property and the subject property in a manner similar to estimating value per square meter under the "sales comparison" approach. The resulting amount is the *Potential Gross Revenue* of the building, expressed on an annual basis. Of course, not all space is rented all the time, and some tenants fail to pay on time or at all. After adjusting for these factors, the appraiser arrives at the *Effective Gross Income*.

The next task is to deduct the *Expenses*, the annual cost of operating the building, including the costs of heating, electricity, water, cleaning, security, maintenance and repair, trash removal, window washing, management, and taxes. Also deducted are funds set aside for the replacement of capital items such as roofing materials and heavy equipment expected to wear out over a reasonable operating period. In addition, an allowance is normally set aside to cover the cost of renovating space for new tenants who move in when an old tenant moves out. The resulting number, the *Net Operating Income*, represents the likely annual amount available from the building after collection of income and payment of expenses.

To estimate the market value of the property using the "income" approach, the net operating income is divided by the yield rate required to attract capital to the investment. This rate, the so-called *Capitalization Rate*, is based upon an analysis of investors' requirements for investments of similar risk, reward, and duration possibilities in capital markets. Of course, in Russia, it may be difficult to find such analogous investments and the issue of high inflation will complicate matters. Since most leases are indexed, however, the concern about inflation can be accounted for in the estimate of net operating income. Yield rates for other investments can be obtained from national and regional business newspapers as well as bankers and security dealers. Adjustments can be estimated through discussions with bankers and security dealers.

The following table demonstrates the income approach as applied to a 5,000 square meter office building:

Potential Gross Income		
5,000 m2 of office space @ \$150/m2	750,000	
Other income	<u>600,000</u>	
Subtotal		1,350,000
Less Vacancy and Collection Loss		
Office Space	-122,500	
Subtotal		<u>-122,500</u>
Effective Gross Income		1,227,500
Less Expenses		
Management and Administration	-61,375	
Utilities (heating, electricity, water, etc.)	-95,000	
Services (cleaning, security, trash removal, etc.)	-100,000	
Repair and Maintenance	-125,000	
Other	-15,000	
Land Taxes	-95,000	
Subtotal		<u>-491,375</u>
Net Operating Income		736,125
Value When Capitalized At 15% Capitalization Rate		\$4,907,500

In order to estimate the market value of a land parcel upon which a comparable 5,000 square meter office building could be constructed, the appraiser uses the so-called *Land Residual* method. The appraiser undertakes an analysis of the cost of developing the 5,000 square meter building and then deducts such cost from the capitalized value of the net operating income of the building. This computation yields the land residual, which is the estimate of the market value of the vacant land parcel.

Development costs for the building include amounts for design and engineering, land parcel preparation, construction, technical conditions, fees and permits, business costs, developer's overhead and profit, marketing and leasing costs, and a contingency. Although there are no generally available construction cost indices or databases, it is nonetheless possible to obtain general information from construction companies in addition to project-specific data. The best way to obtain such data is to undertake interviews with local construction and development companies. The appraiser should attempt to discover "line-item" data of construction companies and then generalize to average costs per square meter of a building of a similar construction type. By understanding line-item costs, the appraiser can better adjust for differences in average cost per square meter of a "comparable" building. Lastly, the appraiser needs to try to determine estimates of "soft" costs, such

as design and engineering, permits, marketing, finance, and technical conditions. Although difficult, each element should be separately considered and estimated from a number of independent sources.

The land residual analysis is illustrated as follows:

Value At Capitalization Rate Of 15%		4,907,500
Less Development Costs		
Design And Engineering	-90,000	
Land Parcel Preparation Work	-250,000	
Construction	-2,450,000	
Fees And Permits	-650,000	
Technical Conditions	-200,000	
Legal And Accounting	-75,000	
Finance	-175,000	
Developer's Overhead And Profit	-500,000	
Marketing And Leasing	-175,000	
Contingency	<u>-105,000</u>	
Total Development Cost		<u>-4,670,000</u>
Residual Land Value		\$237,500

The same approach may be employed when the property is a sales, rather than rental, property, such as a single-family house. The income is the expected sales price, from which the development cost is deducted to obtain the land residual reflecting the market value of the land parcel.

The above sales comparison and income approach examples illustrate various methods that may be employed in appraising vacant and improved land parcels. Where possible, more than one approach should be employed. The reliability of the market value estimate will depend upon the appraiser's ability to gather sufficient market, operating cost, construction cost, and financial data, his understanding of the factors affecting rents and prices in the local market, and his ability to make the appropriate adjustments to account for the differences between the comparable properties and the subject property being appraised. The final market value estimate will be unreliable unless the appraiser diligently follows the appropriate appraisal methodology and uses sound judgment.

4.15. Case Study: Bolshoi Plastmas Zavod

During its work with the City of St. Petersburg and Nizhny Novgorod, PADCO had the opportunity to work with more than 15 enterprises that wanted to privatize over 25 total parcels of land. In the course of that work, the firm discovered many issues and problems that enterprises are likely to encounter during the land privatization process. Whenever possible, the Model Procedures have included provisions that will simplify or solve those problems. Reviewing the experience of one hypothetical enterprise -- named Bolshoi Plastmas Zavod -- will help explain the dynamics of the land privatization process. This is not a real enterprise and is used only for illustrative purposes.

Bolshoi Plastmas Zavod (BPZ) is a large enterprise that produces injection molded household products such as bowls and pitchers. Although it formerly was involved in research and development of lightweight, high-strength plastics for the aerospace industry, there is no longer any support or demand for those goods. Because of falling household incomes and importing cheap plastics from abroad, demand for the firm's products has also been falling, and employment at BPZ has fallen from a high of 10,000 to a current low of 5,500 people.

Bolshoi Plastmas Zavod occupies two major manufacturing sites in the industrial ring of the City -- outside the 19th century core, but inside the 20th century high-rise housing ring. The main production site covers 13 hectares, and the second site covers 5 hectares. The 13 hectare site also includes a small research building, but because the future of BPZ's research activities seemed dim, the board of directors wants to focus on the main plastics business. BPZ has, therefore, formed a subsidiary company -- Aero-Plastmas -- and has transferred the research building, equipment, and employees to that company.

In an effort to remain profitable, BPZ has been searching for a foreign investor who will invest in and modernize the current production facilities, and will take advantage of the skilled work force. It has also been trying to secure loans from Russian banks to begin modernizing its facilities. It wants to purchase more advanced injection molding machines and the rights to more specialized types of plastics. It would also like to consolidate all production on the 13 hectare site if possible, and to put the second site to a different use. It would consider selling or leasing the second site in order to raise money for investment in their plastics business.

Recently, BPZ was approached by a Norwegian firm -- Ahmundsen Scientific -- that produces high-impact plastics for computer bodies and scientific instrument housings. Ahmundsen believes that the main production facility of BPZ could be updated to produce plastic computer bodies for less money than it would cost to buy and equip another plant in Norway. After considerable negotiations, Ahmundsen agreed in principle to form a partnership to invest the equivalent of \$12 million USD over the next four years in upgrades to the plant and equipment. BPZ's contribution to the partnership would be its existing plant and equipment, provided that an appraisal showed them to be roughly equivalent value to \$12 million USD. When the appraisal of BPZ's aging plant and equipment only amounted to \$3 or \$4 million USD, however, Ahmundsen insisted that BPZ also contribute its land to the partnership. Ahmundsen was disappointed to learn that BPZ did not own

its site, and was unwilling to risk the equivalent of \$12 million USD to improve facilities on land that someone else owned. It also felt that if the partnership owned the land, it could use that asset to secure new bank loans in the future and use the money to remain competitive in the rapidly-changing plastics industry. BPZ knew that a 1994 Russian Federation Presidential Decree had given them the right to purchase their site, and they agreed to do so in order to gain Ahmundsen's investment.

BPZ called the City administration and learned that the Oblast Property Fund was the official seller of its land because the BPZ enterprise was originally privatized by the Oblast Property Fund. BPZ managers visited the Property Fund and were told that they first needed to collect several application documents:

- enterprise foundation documents;
- evidence that the shareholders had approved the purchase;
- a breakdown of their stock ownership;
- a certificate that their land was not polluted;
- a certificate that their land was not a site of federal historical significance; and
- evidence that they owned all the land on their site and had not sold any of those buildings to others.

Most importantly, they needed to submit a current and accurate survey map in a scale of 1:500, showing boundaries, easements, restrictions, and topography, and evidence that the City Architecture and Planning Committee had approved that map.

When they asked what the price of the 13 hectare tract would be, they were told that a November 1994 Russian Federation regulation had set the price at 200 times their land tax rate. In addition, the City had adopted a scheme whereby land in different areas was subject to different land sales coefficients between 1 and 3. Also, the City could adjust prices based on information about market value and the City Land Committee could adjust the resulting price up or down by another 25%. The exact price would be stated on a Land Price Certificate that they needed to obtain from the local Rayon Administration of the City Land Committee.

Price. Although disappointed by the amount of work involved, BPZ had no choice but to begin collecting the documents in order to satisfy Ahmundsen's requirements. First, however, BPZ's management visited the City Land Committee to obtain a Land Price Certificate, so that the approximate amount of money required for the purchase would be known. The Land Committee, however, stated that its responsibility to produce the Certificate only began when the enterprise had submitted a completed application to the Property Fund and the exact size of the surveyed site was known. The Land Committee did confirm, however, that BPZ's land was in an area subject to a sales coefficient of 2. Because it could not obtain more accurate information, BPZ decided to estimate its purchase cost conservatively. They knew that their land tax rate was approximately 800 roubles per square meter. They therefore estimated the land cost as follows:

- land area in meters = 13 ha. X 10,000 sq.m./ha. = 130,000 sq.m.
- normative price = 130,000 sq.m. X 800 roubles/sq.m. = 104,000,000 roubles
- first adjustment = 104,000,000 roubles X 200 (federal land sales price formula) = 20,800,000,000 roubles
- second adjustment = 20,800,000,000 roubles X 2 (local sales coefficient) = 41,600,000,000 roubles
- third adjustment = 41,600,000,000 X 1.25 (Land Committee adjustment) = 52,000,000,000 roubles
- USD equivalent = 52,000,000,000 roubles ÷ 5000 roubles/dollar = \$10.4 million

This price of about \$10.4 million USD was far more money than BPZ had available. It therefore hoped to persuade the City administration to reduce the price in the interests of gaining foreign investment and preserving their employee's jobs. If it could convince the Land Committee not to adjust the price upward by 25% and convince the City administration to designate the site with a sales coefficient of 1 instead of 2, the purchase price would drop to \$ 4.2 million USD. It also thought it might be able to lease out the buildings on their second site in order to gain money and then pledge that income stream to a bank in order to get a loan to help pay for the purchase of the bigger site.

Application Documents. Meanwhile, BPZ's chief accountant began working to collect the necessary application documents. The corporate authority documents were no problem because notarized copies were kept on hand for other enterprise purposes. He was also able to get an extract of the shareholders showing that 79% of BPZ's stock had been sold by the Property Fund to other parties pursuant to Russian Federation laws on privatization. Then he began to run into troubles. BPZ had just had its annual shareholder meeting a few weeks before they began negotiations with Ahmundsen Scientific. Because there was no thought of buying its land at that time, it did not get shareholder authorization. To call another shareholder meeting so soon, with only one item of business, would be very expensive. Under the corporation documents, the board of directors had authority to conclude business transactions valued at no more than \$5 million USD, but it was unclear whether the final land price would be above or below that figure.

Because he knew it took time to get a property survey completed, the chief accountant immediately contracted with the leading design institute to get a full survey of boundaries, easements, and restrictions for the 13 hectare site. This cost substantially more than he expected. Although he knew that many other survey companies had been founded in the past five years, the chief accountant had worked with the leading institute before and he knew the City administration was familiar with its work. He did not want any questions about the accuracy of the survey once it was completed. The design institute said it would take about two months to complete the work.

In addition, the chief accountant realized that BPZ would not be able to prove ownership of all buildings on its 13 hectare site, because one building was now owned by Aero-Plastmas, its subsidiary. Either BPZ would have to ask for permission to privatize land on behalf of its subsidiary enterprise Aero-Plastmas, or it would have to carve off a piece of the 13 hectare site for

Aero-Plastmas and buy the remainder of the land for which BPZ did own the buildings. After consulting with the BPZ lawyer and the legal department of the City administration, the chief accountant learned that there was no provision in federal or local law allowing a parent enterprise to privatize land on behalf of its subsidiaries.

This created two problems. First, the chief accountant had to revise the contract with the design institute and ask them to survey a 12 hectare site excluding the Aero-Plastmas building and access. That complicated the work, because it now involved defining interior boundary lines instead of just surveying the existing fence line around the whole 13 hectare property. The design institute said the new scope of work would take at least two weeks longer to complete. Second, Aero-Plastmas would have to buy its own land someday under the rules that applied to companies other than privatized state enterprises. That probably meant that the subsidiary would pay a higher price for its land. He wished BPZ had known these facts before making the decision to transfer the research building to Aero-Plastmas.

The next step was to obtain certificates that the land was not polluted and was not part of a historical site of federal importance. Again, there were problems. The sanitary and epidemiological inspection committee stated that it did not know if the BPZ site was polluted and did not have the money to test the site. If BPZ wanted a certificate, it would first have to pay for a qualified institute to drill test holes on the site. If the tests showed that there was significant pollution, then BPZ would not get a certificate. The sanitation service warned BPZ that the official levels of allowable pollutants were fairly low compared to other industrialized countries.

Similarly, the board of state inspection of public monuments stated that it did not know whether the land was a historical cultural site of federal importance, because there was no approved list of sites and boundaries that fell into this category. Although there were no buildings of federal importance on the site, it did not know whether its counterparts in Moscow would conclude that this meant the site itself was not historic. In addition, it did not know whether there were important historic buildings on neighboring sites whose official boundaries might overlap the BPZ sites. Under these circumstances, it were not willing to issue a certificate.

Negotiations. BPZ's chief accountant felt he was running into more problems than answers. He was also worried about how long it was going to take to work through all these complications. Ahmundsen Scientific had recently mentioned that they had also located a plastics factory in the Czech Republic that could be upgraded and improved to meet their needs. It had asked BPZ how much longer it would take to get title to the 13 hectare site, and had said that if the process was going to be lengthy, it would invest in the Czech company instead. Because of these problems, the chief accountant decided to visit the Property Fund once again and to explain his position. He first presented the corporate foundation documents and an abstract from the shareholder list showing 79% privatization. He also explained the problem with the Aero-Plastmas building and submitted a certificate that BPZ owned all of the buildings on a 12 hectare site that excluded the Aero-Plastmas building. He then explained the other various problems and warned the Property Fund that future investment in the company would be lost unless the land could be acquired quickly. The Property

Fund stated that it was eager to sell land and earn money for the City, but that its ability to waive legal requirements was limited.

In response, the chief economist made the following proposals:

1. He explained that the price of the land was very high, and asked that the price be lowered. He pointed out that a recent internal memorandum by the State Property Committee in Moscow said that enterprises that had a land price calculation in their privatization plan should be able to purchase their land at that price. BPZ's privatization plan included an estimated land purchase price of only 5,000,000 roubles -- or less than 10% of the current price. They submitted a copy of the internal memorandum and asked the Property Fund to approve that price. The Property Fund said that it would not accept the validity of the internal memorandum, because it ignored the effects of inflation. A price of 5 million roubles at the time BPZ was privatized would be the equivalent of at least 20 or 30 million roubles today.

The accountant suggested that if the City insisted on using its current formulas based on land tax rates, it could waive its proposed coefficient of sale and that the Land Committee use its authority to lower -- rather than raise -- the price by 25%. The Property Fund said that it did not have authority to negotiate Land Price Certificates on behalf of the Land Committee, and urged BPZ to make a written request to the Land Committee.

2. The chief accountant explained that the local Land Committee office would not issue a Land Price Certificate until the application and official site maps had been approved. He urged the Property Fund to collect that Certificate from the Land Committee as part of the application review process. The fund agreed with this suggestion.

3. He stated that a certificate of purchase authority from the shareholders was not available, and submitted a resolution from the Board of Directors instead. Since the Board of Director's approval would be acceptable if the price were lowered to under \$5 million USD, the Property Fund would accept the certificate unless it became clear that the sale price would be above that amount.

4. He explained that a certificate of non-pollution was not available from the sanitation service, and that BPZ was unwilling to spend lots of money on tests that might prove that its land was polluted. He suggested that the Property Fund assume that land was clean unless someone submitted evidence to the contrary. The Property Fund considered its obligation to prevent the sale of land known to be polluted (and not to make the enterprise prove that it's land is pollution-free), and accepted BPZ's suggestion.

5. BPZ's chief accountant also suggested a similar approach to the problem of historical/cultural sites. He urged the Property Fund to assume that the site was not a historic site of federal importance unless the Board of State Inspection of Public Monuments provided evidence that the property was on an approved list of such sites. Again, because the fund's obligation was simply not to sell land known to be an important historic site of federal importance, it could agree with the suggestion that

the Board of State Inspection of Public Monuments had the burden of showing that the site was in that category.

6. He explained that the required survey maps were being prepared for a 12 hectare site, but would not be ready for about two months. Because BPZ was worried about losing the Ahmundsen investment, he asked to submit an old map of the site from a previous survey, with a line showing roughly where the 1 hectare site for Aero-Plastmas would be carved out. BPZ offered to pay a purchase price based on exactly 12 hectares, and to adjust the Aero-Plastmas site line on the final survey to ensure that the BPZ site was exactly 12 hectares. BPZ also offered to accept a Certificate of Ownership to the site with the preliminary boundaries shown on the old drawing, and to execute documents that those boundaries would be replaced by the official boundaries on the new survey when that was ready. The Property Fund stated that it did not have authority to accept an old unofficial map, but said that BPZ could make a written request to the City administration.

At the end of the meeting, the Property Fund agreed to create a file and begin reviewing the documents that BPZ had submitted. In particular, it would review whether any of the stockholders of BPZ were themselves enterprises that were partially owned by governmental entities. The Property Fund felt that any percentage of public ownership of a stockholder would have to be projected onto the applicant enterprise to see whether the applicant was 75% privatized. When BPZ disagreed with this interpretation, it was again instructed to put its concerns in writing to the City administration.

Follow-up. BPZ then wrote a letters to the City Property Committee and Land Committee asking that the price of the land be lowered, that an unofficial map of the site be accepted on a temporary basis, and that the percentage of privatization of stockholders not affect the percentage of privatization of an applicant enterprise. It included a copy of its latest letter from Ahmundsen Scientific showing that it was in competition with the Czech site for the investment, and that it was very important to promptly resolve these issues. It brought its letters to personal meetings with City officials and explained the reasons behind its requests.

BPZ pointed out that if it was unable to lock in the Ahmundsen investment, it had no interest in owning the property, and the City would not receive purchase money from it in the near future. In about two weeks, it were invited to a second meeting where it were presented with a letter agreeing to all of its requests except the price decrease. Instead of reducing the sales coefficient on the site from 2 to 1, the City was willing to reduce it to a point where the final sales price of the land would be \$5 million USD. That would make it easy to accept the Board of Directors' authority to approve the purchase. The Land Committee would not increase the price by 25%, but would not lower it either, because it did not want to set a precedent.

Although BPZ was pleased with the response, it still doubted whether it could raise the equivalent of \$5 million USD unless it quickly found a lessee for the 5 hectare site. Nevertheless, it began to collect the old unofficial maps and reflect the Aero-Plastmas site on these maps so that it could get the application started. At this point, the BPZ lawyer notified the chief accountant that a new

Presidential Decree dated May 6, 1995, provided that the price for land sales would be 10 times the current tax rate -- not 200 times. Under her reading, the Decree also removed the Land Committee's power to adjust prices up or down by 25%. It appeared the City still had the power to apply sales coefficients of 1 to 3.

BPZ brought its old map documents, its written response letter from the City officials, and a copy of the new Decree to the Property Fund, and asked it to start processing the application. The Property Fund refused to be responsible for interpreting the Decree, but indicated that the official interpretation would presumably be reflected in the Land Price Certificate produced by the Land Committee. It informed BPZ that it would take about 5 weeks to circulate the application to the Land Committee and the Architecture and Planning Committee for conclusions, and draft a buy-sell agreement for the land. BPZ urged the Property Fund to rush the application as much as possible and asked its own contacts in the two Committees to speed up the application. The Director of BPZ notified Ahmundsen that the application had been accepted and that the land might be owned in a little more than a month.

Closing. Four weeks later, BPZ's chief accountant was invited to the Property Fund to review the Land Price Certificate and the draft buy-sell contract. As usual, there were some surprises. The Land Price Certificate showed that the City was applying the federal Decree land tax multiplier of 10, rather than 200. However, the City had also reviewed the local sale coefficient and had increased it from 2 to 3. The Property Fund explained that all industrial land was now categorized with a coefficient of 3. In addition, the City had adopted new land tax rates, and BPZ's new rate was now 2,000 roubles per acre rather than 800. The Property Fund explained that this was simply an adjustment of previous tax rates that corrected for inflation and incorporated a more sophisticated model of City land values. The sale price for the land was therefore:

- land area in meters = 12 ha. X 10,000 sq.m./ha. = 120,000 sq.m.
- normative price = 120,000 sq.m. X 2,000 roubles/sq.m. = 240,000,000 roubles
- first adjustment = 240,000,000 roubles X 10 (federal land sales price formula) = 2,400,000,000 roubles
- second adjustment = 2,400,000,000 roubles X 3 (local sales coefficient) = 7,200,000,000 roubles
- USD equivalent = 7,200,000,000 roubles ÷ 5000 roubles/dollar = \$1.44 million

The draft Buy-Sell Agreement included some restrictions imposed by the Land Committee and the Architecture and Planning Committee that BPZ had not expected. The Land Committee stated that the western two hectares of the site were burdened by an easement providing a second truck access to a neighboring factory. The Architecture Committee stated that both of the major streets on the north and east sides of the site would be widened in the future, and "redline" restrictions meant that no buildings could be built within 10 meters of those streets. One "redline" passed through a BPZ storage building, and that building would have to be torn down. Both conditions had been made part of the contract. BPZ did not like the restrictions, but since neither of them would affect the ability to use the main production facility for Ahmundsen's products, it decided to consider challenging

them in court later rather than hold up the sale.

Because the price of the land was now well below \$5 million USD, there was now no need for BPZ to obtain approval from the shareholders for the purchase of the land. Within two weeks of its meeting with the Property Fund, it was able to raise the sale price through the sale of equipment and the lease of the 5 hectare site. It signed the Buy-Sell Agreement, and paid the money by wire transfer to the account designated by the City. The Property Fund registered the signed Buy-Sell Agreement and the payment of the land price in its records, and forwarded a copy of the signed Agreement to the Land Committee. Within two weeks, the Land Committee created a file for the property, assigned it a number, registered the sale, and issued a Certificate of Ownership. This Certificate allowed BPZ to conclude its agreement with Ahmundsen Scientific. About one month later, the final survey of the site was completed and approved by the City. The revised information was recorded in the records of the Property Fund and the Land Committee, and a replacement Certificate of Ownership was issued. Bolshoi Plastmas Zavod had now completed purchase of the 12 hectare parcel.

Conclusions. The example described here addresses some of the typical problems experienced by an enterprise in a land purchase transaction. There are many other problems which can occur. The point of this example is to show how some of these problems can be resolved. There are three major lessons to be learned from this example.

First enterprises should not be discouraged by any apparent obstacles to the purchase of their land. Almost all problems can be resolved with some imagination, negotiation and persistence. Second, the position taken by a local governmental may not always be correct or legal. For this reason, the third lesson is very important: it is important for enterprises to become completely informed about the current legal basis for the purchase of their land, both at the federal level and the local levels. The emphasis is on "current" as this area is one of rapid change and evolution as the process of land privatization develops in Russia. The person with a good command of the legal rights and obligations for enterprises and the local government will have an advantage.

Finally, as the owner of land, the enterprise will want to begin to manage this asset to provide the maximum return on investment. this includes the possibility of reselling all or a part of the land, either immediately or in the longer term. The following section considers this possibility.