

AN INTERNATIONAL ACTIVITIES PROJECT

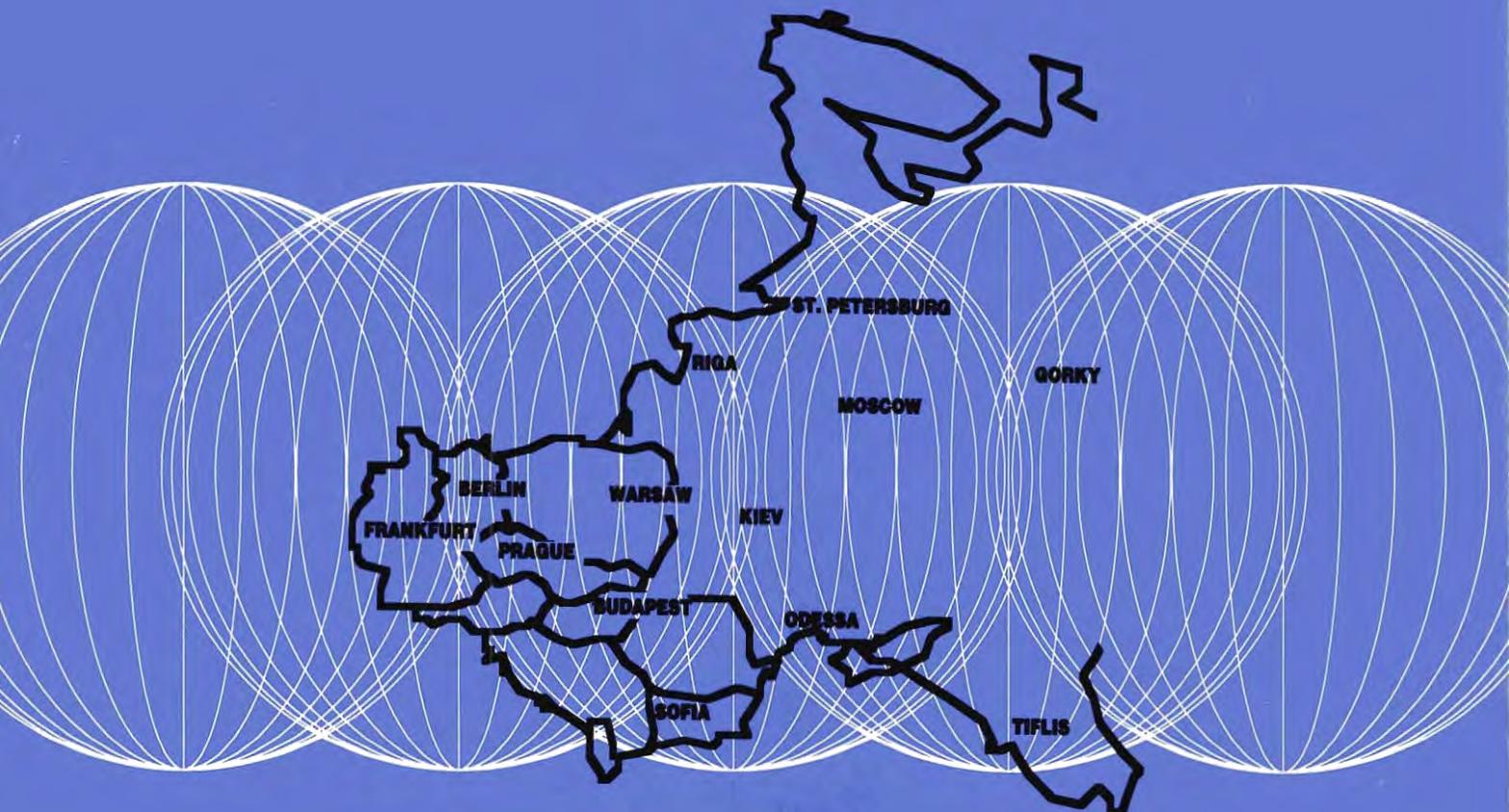
**FROM PLANNING TO MARKETS
HOUSING IN EASTERN EUROPE**

Contract No. EPE-0008-C-00-5118-00
UI Project No. 06611

**RUSSIA
HOUSING SECTOR REFORM PROJECT II**

QUARTERLY REPORT (No. 1)

October 1995 - December 1995



THE URBAN INSTITUTE

Prepared for the Office of Housing and Urban Programs (USAID)

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Section I - Contractor's Report

A. *Narrative*

1. **Background:** The Housing Sector Reform Project II continues and expands the work begun successfully under its predecessor—HSRP I. The new project concentrates its resources on several high priority demonstration activities in four locations: Moscow, Ryazan, Vladimir Oblast, and Nizhni Novgorod Oblast. In the latter two cases, some activity will be in the oblast's principal city but other cities will be involved as well.

One major direction of activity is to develop long-term sources of finance—bank loans or oblast-issued bonds—for the financing of residential infrastructure to replace the current system of on-budget financing. With municipal budgets strained to even meet operating expenses, infrastructure investment is being generally neglected. This work will include assistance to developers and municipalities to form "public-private partnerships" for infrastructure development.

Another major activity is work with municipalities to efficiently deal with the large volume of housing being divested to them from privatized enterprises. HSRP II intends to develop a program to work on a large scale in promoting unit privatization and creation of condominiums in buildings in good condition. Lower quality buildings, where privatization is less attractive and formation of condominiums in the near term unlikely, will be channeled into a program under which maintenance is provided by firms selected through open competitions. Part of this activity is in direct support of the World Bank's loan for enterprise housing divestiture.

The third principal activity is in housing finance—continued development of long-term mortgage finance, a much increased level of activity in promotion of bank lending for construction period finance, and the introduction of home improvement loans, bridge financing, and rehabilitation loans for condominium associations. The construction finance activity includes work with developers in preparing loan proposals acceptable to commercial banks. Some of the construction finance work will support the World Bank's housing sector loan.

Finally, the project will continue its work on the development of national housing policy and will expand its work on land legislation at the national level.

Institutionalization is an important element in all parts of the project. One vehicle in this area is partnering during the life of the project with existing institutions to offer training courses on a profitable, fee basis. Another vehicle is the development of indigenous advisory and teaching capability. Prominent here is the creation of the non-profit Institute for Urban Economics, formed out of the Russian team working for the past three years with the Urban Institute, which intends to specialize in the topics described above among others.

2. **Expected Results:** Objectives for the base period of the project as identified through the contract's performance indicators are as follows:

- *Institutionalization*

(1) Assessment of needs of government departments and training institutions completed;

(2) Preparation of a comprehensive plan to strengthen selected local government departments and institutions related to the activities of the contract completed; and

(3) Training courses related to activities at the initial project sites are available.

- *Mortgage and Construction Finance*

(1) A standardized set of documents for construction lending procedures and appropriate construction lending instruments should be available for dissemination;

(2) Procedures are in place and staff trained at five banks to initiated construction loans and at ten banks to initiate mortgage loans; and

(3) At least one institution offering a course in construction lending training.

- *Infrastructure Finance*

(1) Alternative local finance and revenue generation mechanisms developed and available to the project cities;

(2) Costing methodologies and infrastructure financing mechanisms developed and funding sources identified;

(3) Project cities have development strategies for financing infrastructure development; and

(4) Promotional materials are available for dissemination.

- *Enterprise Divestiture*

(1) Real estate privatization strategies for at least four selected enterprises being implemented;

(2) Dissemination of materials documenting the privatization procedures underway;

(3) Competitively let contracts will have been issued to provide privatized maintenance and management services; and

(4) Training and support to private maintenance and management firms and condominium associations as stimulated by the divested housing units is being provided by qualified local institutions.

- *Housing and Urban Land Policy*

(1) Specific legal and regulatory documents in support of market-oriented privatization of the shelter development process (land transfer and building permits), and land tenure have been adopted by local authorities at project locations;

- (2) Specific legislation and regulations conducive to public/private partnerships for infrastructure development has been drafted; and
- (3) Model documents for the regulations adopted are disseminated to other local authorities throughout Russia.

3. Current Activities:

Housing/ Construction Finance

In November, Andrei Suchkov and Lena Klepikova (CCN Consultants) traveled to Ryazan and Vladimir to identify regional banks ready to initiate a mortgage lending program for HSRP II. In Ryazan, Priovneshtorgbank and Municipal Commercial Bank were identified as likely candidates for cooperation. Priovneshtorgbank is ranked as one of the top 100 banks in Russia, has a good network of affiliates and is the second largest bank in region. Last summer the bank began to develop a housing loan program, but delayed any action until the conclusion of the banking crisis. Priovneshtorgbank is now ready to resume the development of the program and is eager to work with HSRP II to implement a pilot program in Ryazan. To date, the Municipal Commercial Bank has had some experience in housing finance and has successfully implemented a housing certificate scheme. Aleksei Kireev, Chairman of the Board of Municipal Commercial Bank stated his interest in cooperating with HSRP II to expand their housing finance program and agreed to assign an employee to work with us on the development of their mortgage lending program.

In Vladimir, Suchkov and Klepikova met with local administration officials and bankers who stated that the local banks are very weak and are on the verge of collapse. As a result of these discussions, we met with affiliates of three Moscow-based banks—Menatep Bank, Incombank, and MOST Bank—with a strong presence in the area. While the affiliates were interested in the concept of mortgage lending, because of a weak local economy, an unstable banking climate, and a limited market in the area, they all agreed that Vladimir is not yet ready to support a mortgage lending program. Consequently, we concluded that Vladimir is not the best place for us to concentrate our resources at this time.

Suchkov and Klepikova traveled to the Nizhni Novgorod Oblast in November to meet with prospective banks interested in developing mortgage lending programs under HSRP II. Economic conditions in the oblast continue to be an obstacle to mortgage lending and have limited the potential market to the upper tier of borrowers. Both Progress Bank and Nizhnegorodetsya Bank are now bankrupt and Nizhnegorodsky Kredit Bank is on the verge of bankruptcy. In addition, from discussions with Alevtina Sipkina, Deputy Chairman of a bank affiliated with Promstroibank, it became clear that future work with the bank appears to be unlikely at this time. A meeting with an affiliate of Incombank, however, was more favorable. Incombank, one of the strongest and largest banks in the oblast, has a young and progressive staff ready to start cooperation with HSRP II. Igor Sogin, Deputy Manager of the affiliate, stated that the bank has prior experience with collateralized lending to individuals (dollar-denominated with a one year term) and has lent money for housing to its employees. While the bank must go through the Moscow headquarters for final decisions, the affiliate is more or less independent. It was agreed that HSRP II will initiate a pilot mortgage lending program with the bank, beginning with bank employees.

Raymond Struyk (Chief of Party) and Donald McCarthy (UI Consultant) met with Andy Nelson and others from Vepstroi, the general contractor for the World Bank housing sector loan, to discuss working relations on construction finance with the six banks likely to participate in the construction finance line of credit under the loan. A distinction was made between two types of work with the banks: (a) technical assistance to the banks on improving their underwriting practices and procedures for controlling the disbursements of the loan; and (b) working with the banks to comply with the various special conditions for banks to be refinanced by the World Bank loan and the specific procedures for accessing the line of credit. It was agreed that, subject to USAID approval, McCarthy would work with the banks on part (a) and the general contractor would handle the other tasks which are directly associated with World Bank loan implementation. McCarthy is already working with three of the banks that are also working with HSRP I on mortgage finance (Mosbusinessbank, Promstroi-St. Petersburg, and Stolichny Bank). Under the proposed agreement, he would begin working with Tokobank (Moscow), Promstroi Bank (Ekaterinburg), and Bank St. Petersburg. Nelson will provide us with additional information on the three new banks after he meets with them. Additionally, we are providing Nelson with copies of the draft construction finance lending program prepared by McCarthy and will give them other materials as they are developed.

Infrastructure Finance

In October, Aliosha Novikov (CCN Consultant) completed a list of issues related to communal tariffs. The list is in the form of a spreadsheet and includes the following items: main price-affecting factors for each of the communal services provided; production costs structure, state and regional standards for communal services provision (including the way they have been adopted and implemented by authorities), cost structure of the communal fee; compensation sources (budget—federal, regional, municipal, including benefits for various groups of populations; cross-subsidies etc.), and the tax status of communal fees. The list is being tested by Galina Aristova in Nizhni Novgorod and Olga Kim (CCN Consultant) in Petrozavodsk (Republic of Karelia). In addition to the list, Novikov completed a study of diagnostic reviews of the gas and electric power sectors in Russia. The study showed large uncertainty in tariff decision-making policy in both sectors and large regional variations of tariff-creating approaches and prices. Both sectors are real monopolies and are aimed at communal fee increases (as a potential for the principal reserves for their investments in production facilities). This part of the market is going to be very crowded and difficult for municipal infrastructure finance projects.

Throughout the quarter, Novikov worked on creating a file of documents and analytical materials to help local authorities get started with the infrastructure finance program. The file already includes federal documentation regulating municipal finance projects and will have several types of possible investment plans. At the moment, one of the most realistic plans is to develop a public-private partnership investment program which creates a pool of investment projects with different profitability. To repay the debt, a municipality along with private partners makes a portfolio investment in a profitable project. Upon completion, the proceeds received from privatization of a municipality's part of the project is used as a source of debt payments and/or collateral. From discussions with Irina Medina (Chief of the Market Infrastructure Section, Ministry of Economy of Russian Federation) Novikov learned that this plan will be among the favored projects of the Federal Government. The Federal Government recognizes that municipal borrowing is one of the most realistic ways to stimulate the investment process in Russia and to channel them to concrete projects. Federal aid to regions will be aimed at this particular purpose and may play a role of collateral for banks loaning money for infrastructure projects.

Robert Firestine (Resident Advisor/Infrastructure Finance) met with USAID Regional Housing and Urban Development Officer Steve Giddings and USAID Housing Reform Advisor Susan Friedland in November to discuss the infrastructure finance work. Giddings and Friedland stressed the importance of infrastructure finance to housing sector reform, noting the need for coordinated efforts between potential lenders and municipal borrowers. It was agreed that initial work should focus on high-priority local activities in each of the four target cities, and that efforts on long-term finance should generally precede those on tariff reform.

Shortly after their meeting with Giddings and Friedland, Firestine and Novikov visited Ryazan to outline the infrastructure finance concept to Deputy Mayor Ampilogov and various municipal enterprise officials, and to get suggestions on high-priority municipal activities that might benefit from technical assistance in long-term financing and/or tariff reform. Collaboration appeared possible (a) with the municipal water enterprise in water distribution (upgrading of connections; restoration of pipelines), water supply (possible further development of deep wells), usage reduction (metering and public information), and perhaps water treatment (modernized purification techniques); and (b) with the municipal heating enterprise in monitoring/control of the distribution network and in related tariff reform (through on-site usage metering). For each of these municipal enterprises, organizational issues (the institutional nature of service delivery) may also affect the nature and/or quality of service provision. In early December, Firestine, Novikov, and Ilona Dmitrieva (CCN Consultant) visited Ryazan to explain the infrastructure finance program in full, to begin collecting baseline information on finance and administration of infrastructure Ryazan, and to learn more about suggestions for pilot projects.

Struyk, Firestine, and Novikov met with Ludmilla V. Kuznetsova, Deputy Head of the Engineering Department of the Moscow City Government, to explain our proposed work in infrastructure finance and to discuss its potential implementation in Moscow. Kuznetsova showed interest in the proposed long-term financing activity, but indicated some initial reluctance to any tariff reform that might involve significant increases in utility rates above inflation levels.

In November, Firestine and Novikov visited Vladimir to outline HSRP II's approach to infrastructure finance to city and municipal enterprise officials, and to seek suggestions of high-priority municipal activities for possible pilot activities in long-term financing and/or tariff reform. Officials from heating and communal services enterprises responded enthusiastically to these prospects, indicating the existence of significant problems regarding: (a) completion of construction relating to new sources of water supply; (b) renovation of the heating distribution network; and (c) renovation of the sewage network and modernization of sewage treatment facilities. Moreover, possibilities may be found for pilot activities in long-term financing and tariff reform in two planned micro-raion projects. Progress on these projects awaits, among other things, financing for the extension of water, sewer, and gas lines from the municipal network to the development, and connection of these lines to the individual units. In December, Firestine, Novikov, and Dimitrieva held a number of additional meetings in Vladimir. Each of these meetings generated good progress toward developing pilot project activity in Vladimir.

Firestine and Novikov met with Cynthia Stone, Moscow Project Director of the Fund for Democracy and Development, and William Gould, Deputy Director of the New Russia Small Business Investment Fund, to discuss the possibilities for long-term financing of municipal infrastructure in Russia under the HSRP II infrastructure finance program. Stone and Gould were very interested in this initiative. They indicated that municipal revenue bonds for infrastructure might

well find a good market in Russia, although the current rate of bank lending is very low in the wake of last summer's banking crisis amidst establishment of the ruble corridor. Stone and Gould each promised to help with future contacts in the financial sector, and they volunteered to provide future input to infrastructure finance program activities as those plans mature.

Housing Divestiture

Bill Riley (Quadel/Moscow), Sergei Sivaev, and Liza Levina (CCN Consultants) met in Ryazan with several city officials to begin mapping out a work plan on enterprise housing divestiture under HSRP II. Deputy Mayor Vladimir Ampilogov has taken the lead in this effort and arranged for HSRP II staff to meet with key administration officials concerning the program. The city is interested in obtaining our assistance in marketing the privatization efforts within enterprise housing and in designing ways to improve the maintenance bidder evaluation process. Additionally, they were informed that while 50 percent of enterprise housing in the city has been divested, only 40 percent of the municipal housing and 20 percent of enterprise housing has been privatized. Privatization has slowed in the past year because of fears that taxes will increase in the near future.

Ned Bishop (PADCO Consultant) arrived in Moscow in November to begin working on the municipal maintenance privatization campaign. His primary responsibility is to promote the privatization process in each of the seven HSRP II priority sites. In addition, Bishop will assist Katya Petrova, Rita Pinegina and Marina Shapiro (CCN Consultants) in producing a manual on monitoring private maintenance contractors. In working toward this goal, Bishop completed a draft set of instructions in December on monitoring private maintenance contractors. This draft will be used to complete the manual. In addition to Bishop's draft, Petrova is currently working on another version of "Maintenance Performance Monitoring Procedures," which will be reviewed and revised.

Riley and Levina visited Nizhni Novgorod and Bor during the quarter to finalize plans for implementing the enterprise divestiture program. Both cities are in process of selecting enterprise housing that are likely to be interested in unit privatization and condominium formation. The mass marketing campaign is scheduled to begin the second week in January and the first briefings on both unit privatization and condominium formation will be held during the week of 22 January.

In December, the City of Vladimir made the formal decision to organize a new municipal housing management agency that will manage divested enterprise housing. The agency will contract on a competitive basis for all maintenance services. For obvious reasons, this was an important decision for the enterprise housing divestiture project.

In November, consultants Mary Albon (Abt Consultant) and Yelena Shomina (CCN Consultant) completed drafts of five 15-30 second TV spots and three similarly short radio spots to promote unit privatization. In a general review meeting with about ten members staff, including Struyk, Nadezhda Kosareva, Lena Grudinina (CCN Consultants), members of the regional team and one member of the finance team, four TV spots, including one with a major change, were selected for further refinement and production. All three radio spots were cleared and are in the process of being produced. In mid-December, the four short public service announcements promoting housing privatization were filmed in Vladimir. Soon after filming, the team reviewed the "proofs" of the four videos and concluded that they were all of high quality. The team was assisted in the review by Vladislav Chadin, the director-producer of the "SNIP" program. The final decision was to accept two without change; to replace the voice of one actress whose speech was not very distinct; and to re-

shoot one, keeping the same script but changing the situation. These will be finished by early January 1996.

Sivaev and Riley completed preparing an evaluation form that will be used by the local team leaders to assess the potential for privatization and condominium registration of divesting and divested enterprise housing in the HSRP II sites. The form has been distributed to local coordinators in Prokofiev (Vladimir) and Rumyantseva (Ryazan) for immediate use. Sivaev also completed preparing a draft procedures memorandum to guide local coordinators work. Levina is translating this document for Struyk's review and approval.

4. **Performance:** The contract workplan has been reviewed in draft by USAID/Moscow. A final version is being prepared for approval in January. Technical work is being performed as planned; no significant problems have been encountered.

5. **Statement of Work:** Suggested changes to the illustrative level of effort allocation in the contract have been proposed in the 1995-1996 workplan. Also, some modifications to the contract's performance indicators have also been proposed in the workplan for USAID's consideration.

B. Administrative Data

Contract Data:	Total Level of Effort:	700.0 person-months
	Total Estimated Contract Cost:	\$11,835,976
	Total Authorized Estimated Cost (Base + Option #1):	\$8,378,851-

1. Level of Effort (last three months):

A. U.S. Technical LOE:	8.33 person-months*
B. Russian Technical LOE:	0.32 person-months*

2. Cumulative Level of Effort: 8.65 person-months

3. Unused Level of Effort: 691.35 person-months

4. Cumulative Expenditures to Date: \$299,992*

5. Remaining Unexpended Balance (from authorized ceiling): \$8,078,859

* Total LOE and cumulative expenditures stated in this report are estimates based on actual amount charged to contract through 12/19/95 + encumbrances through 12/31/95.

The Office of Housing and Urban Programs of the Agency for International Development (USAID) addresses the shelter and urbanization needs of developing and formerly planned economies. In addition to administering the USAID Housing Guaranty Program, the Office supports a broad spectrum of urban activities in program planning, management and capital investment to benefit low-income urban families.

Office of Housing and Urban Programs
U.S. Agency for International Development
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