

AN INTERNATIONAL ACTIVITIES PROJECT

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

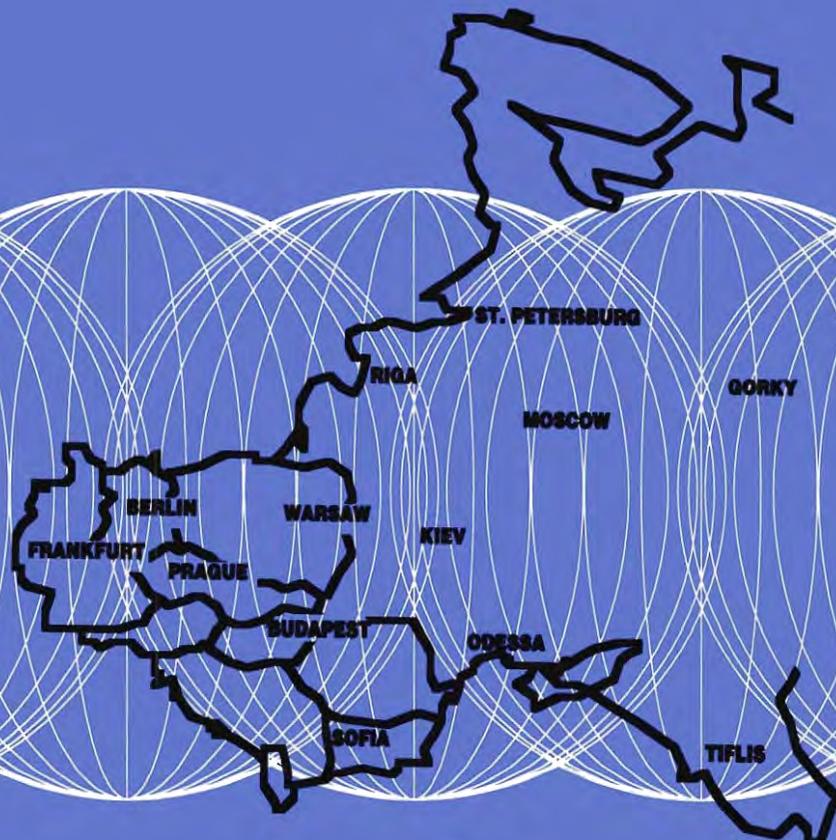
THE URBAN INSTITUTE

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

**RUSSIA
HOUSING SECTOR REFORM PROJECT II**

QUARTERLY REPORT (No. 2)

January 1996 - March 1996



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 Finance*

Ray Miller (UI Consultant), Andrei Suchkov (IUE), and Anton Nioradze (CCN Consultant) met with Yanis Kanestry, Head of the Credit Department at Stolichny Bank, to introduce Miller to the bank and begin work on pricing issues. Kanestry stated that the bank has originated \$17 million in mortgage loans (over 1,000 loans to date) with a maximum loan term of 10 years and average balance of \$50,000 each. The bank recently completed its first foreclosure and has put the property up for sale. In this case, the bank used a traditional mortgage agreement and the borrower left the property on his own will. The bank is considering implementing a dual rate mortgage instrument, similar to DAIR, using the GKO rate rather than the interbank lending rate.

James Cook (UI Housing Finance Advisor) and Suchkov met with Ole Tchourbanov, Vice Chairman, and Alexander Shabardin, General Manager of Loans and Advances of Prioveshtorgbank in Ryazan. In light of the banking crisis, the bank is currently looking at mortgage finance as a way to diversify its credit portfolio. We discussed the options available to the bank on developing a program and provided them with the mortgage loan application, underwriting guidelines, and forms for their review. The bank agreed to a timetable of intense work over the next four weeks in developing the mortgage lending program. The bank has set a tentative schedule of originating its first loan in June or July. Prioveshtorgbank will assign an employee to work directly with HSRP during the development stage.

Miller, Lena Klepikova (IUE), and Nioradze met with Galina Sokolovskaya, Director of Mortgage Lending, and Oleg Klementiev, Chief Economist, of Mosbusinessbank. Initially, we discussed the bank's current problems with screening applicants during the pre-qualification stage. The bank is being deluged by telephone calls inquiring about mortgage loans, which is causing a drain on staff resources. The new originations software developed by HSRP can be used effectively to pre-qualify applicants, run the calculations, and assist the loan officer with rendering a recommendation based on raw data. We will go over the program with the bank to see if this can be used to streamline the process. Plans are underway to begin a savings program, to begin targeting the demand deposit market, and to possibly implement a fee schedule for services. The bank has originated approximately \$7 million in mortgage loans to their staff and approximately 150 loans since the introduction of the program in 1994.

Miller and Nioradze met with Valerie Mikheev, Director of Mortgage Lending for Baltchug Bank. The bank is currently considering the introduction of a mortgage instrument based on DAIR, but indexed to the government bond (GKO) rate rather than the interbank lending rate. The bank is seeking ways to diversify its credit portfolio and address the problem of affordability for its clients. We discussed the problem of negative amortization and was provided with a draft of their plan for expansion of the program. We agreed to review the plan, provide them with our comments, and begin work on pricing issues. Mikheev stated that the bank has originated approximately 230 mortgage loans to date.

Suchkov and Ivan Labutin-Rymsko (CCN Consultant) met with Tatiana Lurmina, Deputy Director of Sergei Zhivagao Municipal Bank in Ryazan to discuss the Bridge Loan and working with enterprises. The bank has pledged to give 2 billion roubles for a pilot program for mortgage lending and is hoping to combine the program with a 20 million rouble municipal subsidy program. The bank has set a target date of the third quarter of 1996 to officially start their program. We installed the originations and servicing software and began work on a draft business plan.

Suchkov and Labutin-Rymsko met with Alexander Sherbardin, Head of the Credit Department, and Alexander Polteltavsev, Expert on Construction and Mortgage Lending, at Priovneshtorgbank in Ryazan. They are still considering the mortgage lending program, but have not received final approval from the Board of Directors. We discussed the Bridge Loan, working with enterprises, and installed both the originations and servicing software. The bank is tentatively planning to start a pilot program after June and has asked for our assistance in developing a draft business plan. The bank was very interested in the Bridge Loan and may use the loan program as the basis for their mortgage lending project.

Cook, Nioradze, and Sasha Ozerov (CCN Consultant) met with Andrei Morov, Deputy Chairman of Finance, and Dimitri Fedjunin, Department Head of Risk Evaluation, at Nizhnegorsky Bankers House in Nizhni Novgorod to discuss the Bridge Loan, self-amortization, and underwriting guidelines. The bank was particularly interested in the Bridge Loan and changing its entire loan program to self-amortization. We discussed both programs in detail and compared the advantages of self-amortization compared to their current system. We agreed to meet with them in April to install the software and run the applications. The bank also announced that it has already closed four mortgage loans and may use the Bridge Loan to expand its program.

Cook, Nioradze, and Ozerov met with Valerie Bobylev, Manager of Mortgage Lending at Nizhnegorsky Land Bank in Nizhni Novgorod. We discussed the Bridge Loan and installed the self-amortization software. Up to this point, the bank has been giving its customers a choice between self-amortization and constant-amortization loans. We discussed the effect on bank profitability and borrower affordability and ran a comparison between the two types of amortization. Bobylev stated that the bank would test the software and will consider switching its overall loan program to self-amortization.

Suchkov, Klepikova, V. Porizhenko (CCN Consultant), and Ozerov met with Lena Tarasova, Chief Lawyer, and Pavel Koshin, Head of the Credit Department, of Diamont Bank and Anatoli Pechatnikov, Director of Inter-Real Realty Firm in Moscow. Diamont Bank has hired former staff members from Krasnye Vorota and Nefthanoi Bank and has already created a mortgage lending department within the bank. The bank will originate mortgage loans with a term of three years on the basis of the lease/purchase agreement. They are now considering the possibility of working as a correspondent bank with Stolichny Bank. The Chairman of the Board, formerly from Nefthanoi Bank, was the main advocate for the bank's development of mortgage lending and has given approval for the bank to begin its program.

- *Construction Finance*

Donald McCarthy (UI Consultant) and Ozerov visited at length with Lubov Zaharova (Chief Expert) and Valeri Novocrestchenov (Deputy Director) of the Construction Department of Nizhni Novgorod Oblast. During their visit, McCarthy and Ozerov discussed the residential construction lending program for banks. In addition, they advised them of the upcoming HSRP/World Bank seminar. McCarthy suggested a program for using uncompleted housing structures owned by enterprises: donation of a major portion of the equity they have in those structures, a take-back of small 20 year loans by the enterprises, construction loans to finish the units, and a small down-payment from purchasers (or a subsidy from the budget for those without funds) who are awaiting housing. He explained that the cost of construction funds could be reduced by use of the World Bank program. We asked for a listing of strong developers in the area in order to forward it to PADCO.

McCarthy and Ozerov met with Andrei K. Morov (Deputy Chairman For Finance), Dmitri Fedjunin (Department Head, Risk Evaluation) and Natalia Sedelnikova, (Economist) of Nizhegorodsky Bankirsky Dom. The bank is the second largest bank in Nizhni Novgorod and is working closely with the European Bank for Reconstruction and Development. They were presented with their copy of the program for financing the construction of residential housing and were advised of the total program of support offered. They are currently in a number of small construction loans and pleased with what was offered. A request was made for a list of local developers for PADCO.

The following banks have requested a list of developers from PADCO: Menatep, Stolichny Bank, Sergei Zhivago Municipal Commercial Bank, Priovneshtorgbank, and Nizhnegorodsky Bankirskiy Dom.

McCarthy and Andrei Tkachenko (CCN Consultant) met with Sasha Visokovsky from PADCO's group advising developers concerning the preparation of loan applications for construction lenders. They discussed their progress with the lenders to date and presented him with both a Russian and an English version of the program. McCarthy spoke with David Dunbar and Ernest Slingsby of the PADCO advisory group and invited them to the construction lending seminar. In addition, McCarthy asked Slingsby to have one of his group prepared to make a short presentation concerning their program at the seminar.

Stolichny Bank has started underwriting construction finance projects under the World Bank program in the cities of Tver and Moscow. They will begin work with McCarthy on the market analysis phase of the Moscow project in early April.

David Dunbar (CHF) and Alexander Vysokovsky (Polis-3) traveled to Ryazan to meet with developers, city officials, bankers, and administrators of training institutions. In keeping with the strategy laid out in the work plan, the trip had two objectives: to identify developers with projects underway which could serve as pilot projects; and, to identify an institution suitable for sponsoring and administering a developer training course. The team met with Yuri Ivanovich Andrianov, Deputy Mayor on Urban Development, Director of Construction Dept who organized a follow-up meeting with the ten largest developers/builders in Ryazan. In addition the team met with Alexi V. Kireev, Chairman of the Board of the Municipal Commercial Sergei Zhivago Bank, one of the banks participating in the HSRP banking team activities.

James Hemphill (PADCO) arrived in Moscow in February to begin work with developers. He met with Ernie Slingsby (PADCO/Moscow) and received a general briefing on current conditions. He traveled to Nizhni Novgorod to meet with the oblast administration, the Nizhni Novgorod Real Estate Fund, and Nizhni Novgorod Interregional Land Bank. The city is interested in developing a pilot program and is currently identifying potential developers for the project.

In March, Vysokovsky visited Ryazan and met with five developers, two of whom may be chosen for future work (Bystrets and Mayak Companies). The next visit to Ryazan will include the preparation of the business plan and application.

- *Infrastructure Finance*

Bob Firestine (Infrastructure Finance, Resident Advisor), Iona Dmitrieva (CCN Consultant), and short-term consultant John Lisekno (RTI) visited Nizhni Novgorod and Vladimir, and Dmitrieva and Lisekno visited Ryazan. The major purpose of these visits was for Lisenko, an American Russian-speaking municipal engineer, to review technical aspects of a few projects in each city that were selected from a longer list that the respective municipal enterprises had proposed for financing under the assistance of the infrastructure finance program. Lisenko examined several projects in water-sewer and heating enterprises in each of these cities. He judged them generally to be acceptable candidates for long-term financing, finding them satisfactorily grounded in the extant technology and conforming to broader capital development needs of their respective communities. As a result of these visits, the infrastructure finance team decided to broaden its search for capital financing to include each of these selected projects from each city. This should enhance the likelihood of achieving a successful project financing arrangement in each city, as it will offer several projects for possible financing, rather than just one project per city, as had been envisioned earlier.

Firestine, Kopekin (CCN Consultant), Aliosha Novikov (CCN Consultant), and Dmitrieva met with Sergei Karpukhovich, Director of Renova-Invest, and Daniel Wolfe, a principal of Park Avenue Capital, to discuss Renova-Invest's approach to preparing and managing a municipal bond issue. Renova-Invest has participated in four oblast-level municipal bond issues: Yaroslavl social-economic bond issue, Yaroslavl ecological bond issue, Vladimir tractor bond issue, and Pablodar (Kazakstan) medical equipment bond issue. Karpukhovich said that a bond issue in excess of two years would be very difficult to market and even a two-year issue was considered very high risk. He also indicated that, in Yaroslavl, 50 percent of the issue was placed in a reserve fund (invested mostly in Russian treasury bills) that was used to partially ensure repayments. The interest rate on Renova-Invest bonds was keyed to different percentages of the Central Bank refinancing rate, which were announced before each tranche is offered for sale. On the basis of our explanation of our project, we agreed to conduct further talks to explore the possibility of Renova-Invest working with us on a bond issue for a single municipal enterprise project.

Kopeikin and Novikov met with Tokobank officials Elena Dobrovo, Head of the Division of Investment Projects, Department of Credit, and Yuri E. Antropov, senior expert, to discuss the possibility of commercial bank loans for infrastructure financing. Dobrovo indicated that there is a possibility of making a 2- to 3-year bank loan to municipalities with a 23 percent interest rate for dollar loans and perhaps a 90 percent interest rate for ruble loans (the latter of which the bank is willing to consider). Collateral would consist of a portion of revenue collections of the municipal enterprise. Institutional and legal arrangements were discussed in detail.

Firestine and Novikov participated in RTI's Capital Finance Seminar in Golitsino in March. The seminar offered comprehensive explanations of all aspects of municipal bonds, including concepts of long-term municipal financing, kinds of municipal borrowing, participants in the municipal bond process, and technical aspects of municipal bond design. This seminar could be of significant assistance to our infrastructure finance program in helping to prepare local officials to consider and then to carry out the issuance of municipal bonds. In addition to participating in all substantive aspects of the seminar, Firestine and Novikov made or renewed important contacts with local officials in several cities in which the infrastructure finance program may find promising opportunities to work in the future.

In March, Firestine, Novikov, Dmitrieva, RTI financial analyst Valeri Marfitsin, and RTI municipal bond consultant Tom Cochran visited Vladimir for detailed explorations of possible financing alternatives for infrastructure municipal enterprise loans. The infrastructure finance team made technical presentations to Director Philipov and Chief Engineer Gousov of the water-sewer company and to a large meeting chaired by Vladimir Deputy Mayor Siderov on alternative forms and parameters of potential infrastructure financing. Marfitsin's financing model provides relevant information on a variety of financing types and lending terms. The team will continue to refine the model over the next week or so, thereafter to pose more user-specific information to the participating cities of Ryazan, Vladimir, and Nizhni Novgorod. This analytic approach seems promising, although the numbers to date begin to raise questions about the viability of the 3-year loans (either bank lending or municipal bonds) that financial representatives have indicated to be the longest potential financing period.

Kopeikin, Novikov, and Dmitrieva met with Vladimir Kravchenko and Maria Naturina of the Capital Market Surveillance Unit of the Federal Commission on Securities and Capital Markets, Moscow, to discuss preparation, issuance, and circulation of sub-Federal bond issues (securities of Subjects of Federation and municipalities). We discussed the definition of "state securities" and its relation to securities of Subjects of Federation and municipalities. Kravchenko confirmed the profit tax exemption for municipal bonds, according to State Duma decree "On amendments and changes in the law on profit ..." signed by the President on December 31, 1995. Kravchenko explained the option of paying for the registration of the bond issue (0.8 percent of issue) in installments. He provided a list of the most active general managers in sub-Federal securities market, plus the report, "Analysis and Monitoring of the Municipal Bond Market," by the Capital Markets Surveillance Unit of the Federal Commission on Securities and Capital Markets. Although Kravchenko supported the establishment of a municipal bond rating agency, he indicated that such a move would be premature, because of the absence of regular information on municipal bond issues and their results.

Kopeikin, Novikov, and Dmitrieva met with Moscow City Duma Deputies Alexander N. Krutov and Ludmila V. Stebenkova, to discuss the possibilities of the Infrastructure Finance Program working with the Moscow Municipality. The team members first outlined the nature and objectives of the Infrastructure Finance Program. Then, several infrastructure projects were discussed -- including garages, parking places, cargo terminal in Sheremetevo Airport -- although their relation to housing seems to be problematic. Deputies promised to help arrange a subsequent meeting with Moscow water-sewer company staff and to discuss a possible project with them.

- *Housing Divestiture*

Marina Shapiro (IUE) met with V. Tabolin, Subprefect of the "Aeroport" Municipal District, and N. Bulanova, Chief of the "Aeroport" DEZ, to discuss the participation of this district in the Housing Divestiture Program. They have reached a preliminary agreement that 18,000 units will be maintained by private firms.

During discussions with representatives of the Nizhni Novgorod Oblast Administration, it was agreed that we will work not only in Nizhni Novgorod and Bor, but in Arzamas Region. Sergei Sivaev (CCN Consultant) is planning to visit the area before the middle of February. Nizhni Novgorod has selected to have competitive maintenance in two regions of Nizhni Novgorod City: Leninsky and Kanavinsky. (They have the largest percentage of enterprise housing).

Petrova, Nozdrina and Khomchenko had a meeting with the residents and activists of the Building Committee Association "Velozavodsky." The Building Committee Association consists of 17 former ZiL enterprise houses located on Velozavodskaya Street of the South-East administrative district. These brick, "Stalin-style" buildings are presentable, but in a rather poor condition; in four houses the rate of privatized units is rather high (more than 47 percent). There is no information like that on the other 13 buildings, but we have been told that the rate is much lower. Katya Petrova, N. Nozdrina, and Dima Khomchenko (CCN Consultants) introduced the Program of Privatization and Organizing Condominiums and answered questions about different economic and law aspects of the program.

This quarter preparatory work was completed and the advertising campaign to promote unit privatization got underway. In early February the videos and radio spots were distributed to all team leaders, as were the final fliers. In Ryazan, 1,200 fliers were distributed to 9 of the 13 buildings selected for the privatization/condominium program. In Vladimir, where 87 enterprise apartment buildings have been selected for the program, a total of 1,620 fliers were distributed and video clips on the privatization of units were on local television.

In January, Sivaev was informed that the Vladimir City Administration approved the new structure of management of the city housing stock. Under the new structure, new Municipal Management Enterprise for divested housing stock will be organized in the city. They are planning to have the first bidding to select a contractor for diversified housing stock in April.

Sivaev had a meeting with The Head of Department of Local Public Self Management Committee, Mr. Andrianov, to ask for their assistance in organizing a seminar on "Privatization in Vladimir." Vladen Prokofiev (CCN Consultant) had a meeting with the Director of the Agency of Maintenance of Housing Stock, Mr. Grachev, and discussed the preparation of a model contract between the City Administration and maintenance organizations on the maintenance of housing stock. Currently, there are 5 condominiums registered in Vladimir City and 2 in Vladimir Oblast.

Sivaev had a meeting with Samoilenko to discuss issues concerning future bidding for the Nizhni Novgorod City and Oblast. The time-table of bidding was prepared and the first one is scheduled for the beginning of April. The issues of forming a DEZ were discussed and Samoilenko agreed that city should have a person responsible for condominium formation.

Three more condominiums have been registered in Ryazan on the basis of new construction (total number 34). Rumanseva (CCN consultant) had a meeting with the Editor of the newspaper "Vecherniya Ryazan" and agreed on the free publication of marketing materials.

Alexander Vihrev from the Information Center "Land and Real Estate," called Lena Grudinina (CCN Consultant) and informed her that one of three radio clips on privatization of housing, provided by the Institute for Urban Economics, will be included in an April radio presentation. The presentation will be distributed to 140 radio stations throughout Russia.

Nozdrina met with G. Teryokhina, Head of Home Owners Associations Activity Coordination Board of the Department of Municipal Housing, to discuss a) the signing of the Agreement between the USAID and the City of Moscow for Technical Assistance in the Housing Sector; b) the problem of delivering information about HSRP activity on the Promotion of Unit Privatization and Condominium Formation Program to the Department staff; c) the possibility of using the Department media for the HSRP advertising campaign; d) the Department propositions on collaboration; e) the Department assistance in holding a meeting with tenants in the North Administrative District; f) different problems that arise when organizing condominiums.

4. Performance: Following receipt of USAID's comments, a final version of the first year workplan was submitted to USAID and approved on January 26, 1996. 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 work plan. Also, some modifications to the contract's performance indicators have also been proposed in the work plan for USAID's consideration. These items are being considered by the USAID Project Office.

B. Administrative Data*

Contract Data:	Total Level of Effort:	700.0 person-months
	Total Estimated Contract Cost:	\$11,835,976
	Total Obligated Funds:	\$8,378,851
1.	Level of Effort (last three months):	21.63 person-months **
2.	Cumulative Level of Effort:	
	A. U.S. Level of Effort:	15.54 person-months
	B. Russian Level of Effort:	11.89 person-months

		27.43 person-months
3.	Unused Level of Effort:	672.57 person-months
4.	Expenditures (last three months):	\$466,749*
5.	Cumulative Expenditures to Date:	\$634,342
6.	Remaining Unexpended Balance:	\$11,201,634
7.	Remaining Obligated Funds:	\$7,744,509

*Data reported here reflects cost and LOE recorded by the Urban Institute's cost reporting system. Accrued expenditures (such as subcontractor and consultant invoices, travel expenses, and charges for other direct costs not yet received by UI) are not included in these figures.

**Estimated LOE and expenditures reported in last quarterly performance report (QPR) were higher than actuals reflected in end of year voucher, thus the discrepancy between this QPR and last QPR.

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
Washington, D.C. 20523**

The Urban Institute's International Activities Center extends the Institute's expertise on the domestic policy front to help solve similar problems in other countries. Institute staff have now provided policy analysis and policy implementation assistance to 23 nations. International activities focus on three main issues: housing and housing finance; urban development and management, including infrastructure and municipal finance; and human resources, including health care financing and family planning. International Activities project papers can be obtained from:

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