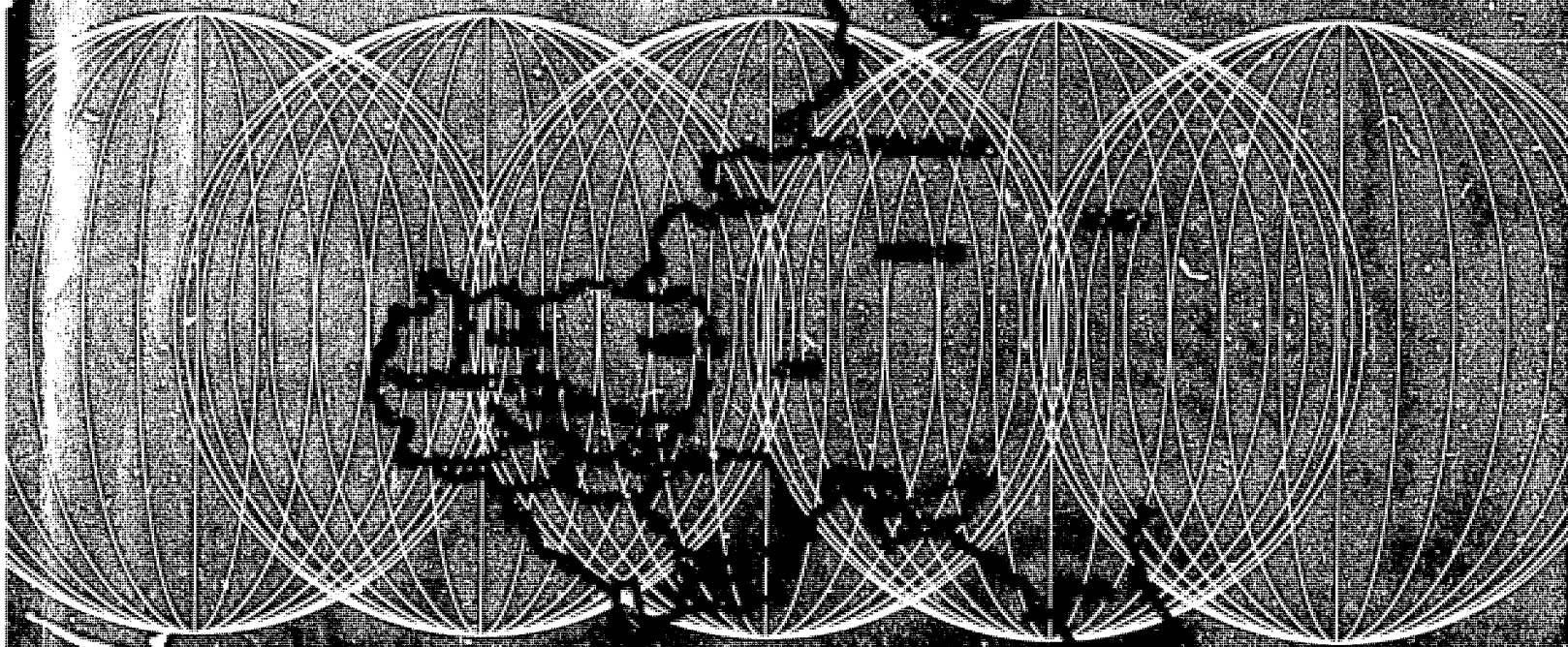
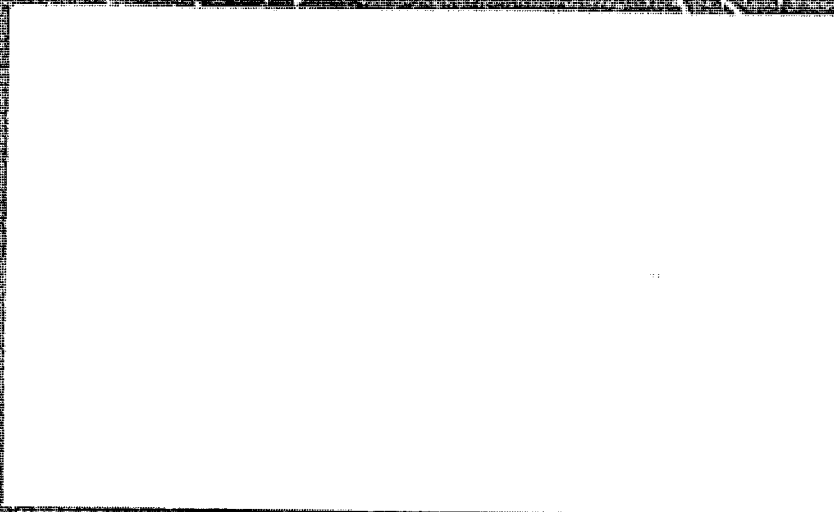


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FROM PLANNING TO MARKETS
HOUSING IN EASTERN EUROPE



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Real Estate Tenure and Taxation in the Russian Federation

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EXECUTIVE SUMMARY

Under the government of the Soviet Union, the expenses of city infrastructure and operations were met mostly by funds allocated to the city from higher levels of government. That is no longer the case. The City of Moscow must generate its own revenues to support its operations. Revenues from real estate are destined to be a mainstay of city budgets, just as they are in many countries.

But Russia has little experience with the private ownership of real estate and no experience with real estate taxation. Privatization creates potential taxpayers; title registration, value assessment, and tax laws are needed to collect the potential revenue. For either to succeed, the two programs--privatization and real estate taxation--must develop simultaneously. And if the city is to avoid a fiscal crisis, both programs must develop rapidly.

EMERGING PROBLEMS WITH REAL ESTATE PRIVATIZATION AND TAXATION

I observe substantial progress in federal legislation to create a private market in real estate and a tax system to provide cities with the revenue they need. I also observe great initiative in Moscow's government to exploit the new opportunities provided by federal law, and even to anticipate federal law by designing local programs and procedures where federal guidance is lacking or ambiguous.

However, I also observe actual or potential problems with both federal and local laws and programs, which I will now summarize.

- **Different Systems of Tenure and Taxation for Land and Property.** The laws of the Russian Federation concerning land tenure and taxation have developed quite separately from the laws concerning immovable property such as buildings. Land and property laws have been written by different committees and reflect different legal principles. But in urban life, land and buildings are used jointly. If the user has one set of rights pertaining to the land and another set pertaining to the building, his ability to use them jointly becomes the lowest common denominator of title.

For example, if a natural person or a corporate organization holds ownership title to a building but has only a leasehold on the land, problems arise at the expiration of the lease. When the land reverts to the municipality, to whom does the building now belong? Will a person or organization be willing to invest in long-lived structures, knowing that his land tenure is finite?

Consider also the case of a privatized municipal flat. Under the privatization law, the owner of the flat has the right to sell, lease, mortgage or bequeath his apartment. The owners of privatized apartments also "become the owners of mechanical equipment and places of communal use in such buildings." The law is silent concerning title to the land on which the building is located. If the owner of such a flat subsequently sells it, the buyer will pay not only for the housing space and the use of the communal areas but also for the location of the building; so the owner seems to have the right to sell an undivided share of the location if not the land itself.

- **Uncertainty about Who Holds Title, Form of Tenure, and Boundaries of Land Parcels.** To create a private market in urban real estate and to assess and collect taxes, it is necessary to have clear titles to well-defined parcels of land and to the buildings on the land, and to know who holds each title.

The land and property codes of the Russian Federation describe permissible forms of tenure but are generally obscure about how tenure is achieved. Presently, most urban land is held by state or municipal enterprises, public agencies, institutions, and chartered organizations under "right of use" tenure that may even predate the 1917 Revolution. About half of all users lack adequate documentation of their claims to title. Even recent land allocations seldom include a careful description of the parcel conveyed, so parcel boundaries are uncertain.

The situation is better with respect to property. Moscow's Bureau of Technical Inventory (BTI) has a nearly complete register of buildings in the city. Each building is shown on a carefully drawn site map, including measurements of building

perimeters. The building's dossier or "passport" includes a register of the owners and leaseholders that occupy the building, and a reference to the contract or document that granted their title to the building. However, this register is infrequently updated, so the information may be incorrect.

- **Normative Land and Property Assessment.** Both for purposes of privatization and taxation, federal law has established norms for the assessment of all land and for assessment of residential property. As yet, no federal law provides rules for the assessment of nonresidential property.

Clearly, some simple temporary method of assessment is needed to enable privatization and taxation to proceed. However, the methods that have been chosen result in assessments that are much too low and radically different for different land uses. Even worse, no procedure has been indicated for shifting later to market value assessment.

In my judgment, the normative values prescribed by federal law are likely to become permanent standards. But even if they are eventually replaced by market value assessments, in the meantime the low normative assessments will create very small real estate tax liabilities for most users and very small revenue from real estate taxes.

- **Low Effective Tax Rates.** Under federal law, both normative assessments and specified tax rates are low, so that the effective real estate tax is trivial for most users. Under present conditions, real estate taxes will cost more to collect than they will yield in revenue. Moreover, a potentially productive revenue source, the transactions tax, has been ignored by Moscow's government.

Consider first the land tax. For nonresidential uses in Moscow, this tax ranges from 13.5 rubles to 82.6 rubles per square meter. For a parcel of 600 square meters, the tax yield will therefore range from 8,100 rubles to about 50,000 rubles annually, and those ruble amounts are fixed without regard for inflation. By the time these taxes

are actually collected, the expense of collecting them will exceed the revenue for all but the upper range of tax rates.

For residential land use, which occupies a fourth of Moscow's area, the tax ranges from 40 kopeks to 2.5 rubles per square meter. Even today, such a tax is not worth collecting.

The property tax is set for all Russia at 0.1 percent of assessed value for property owned by natural persons; no rule has yet been adopted for juridical persons, though a figure of 0.5 percent appears in draft legislation. For residential property in Moscow, we can consider the case of a typical privatized flat. It contains 50 square meters of total space and has an assessed value (from BTI) of about 10,000 rubles. The annual property tax is 10 rubles.

Changing the land or property tax rules will require federal legislation. However there is another source of real estate revenue for which the law is clear but not enforced. This is the transactions tax on private sales of property. For residential property such as a privatized flat, the tax rate is 10 percent of the purchase price.

Brokers in Moscow tell us that sellers of these flats are required to obtain from BTI the current depreciated replacement value of the flat, and that they usually enter this value in the contract as though it was the actual purchase price. Neither the tax collector nor the notary question this entry, although it must be obvious that it is incorrect. Under these circumstances, the tax yield from the sale of a typical (50 m²) flat is about 1,000 rubles.

We have compiled brokers' records of private sales of apartments in Moscow during the past year. These records indicate that the typical hard-currency purchase price for such a flat is about \$26,000, which converts to about 2.6 million rubles. We are also informed that at least 2,000 private sales have occurred in the past year. A few simple calculations tell us that if each buyer had paid the full tax on sale price, the

revenue to the City of Moscow would have amounted to 522 million rubles, about 4 percent of the city's budget in 1991.

RECOMMENDATIONS

Some of my proposals seem to be within the authority of the municipal executive departments to implement without new legislation. Some would require new laws or amendments to existing laws enacted by the city council. Others require federal enabling legislation or executive decrees. Because the lines of authority have not yet crystallized in either the federal or city governments, it is not always clear to me whose consent is needed to change the form of emerging institutions or the direction of emerging policies.

I do not pretend to understand which apparently reasonable actions are politically impossible or administratively infeasible. I can only suggest alternatives to present policies and institutions, alternatives that have been successful in countries with market economies.

- **Clarify and Integrate Legal Forms of Tenure.** I think that federal legislation is needed to clarify obscure passages in the land code and the property law and to create stronger links between land tenure and property tenure. I will not treat this issue at length here, but will suggest one useful change that may be within the authority of the city council.

Joint stock companies formed to develop residential estates find the tenure laws especially cumbersome. Although the city can allocate small plots **in ownership** to individual families who plan to build a house, the city can only **lease** a large estate to a development company. If the company builds houses on the leased land, it cannot convey land ownership title to individual families that buy the houses.

I think it would be possible for the city council to prepare a standard leasehold contract for residential developers, a contract which guarantees that as houses are built and sold their sites can be removed from the leasehold and conveyed to the buyer in full ownership. I urge you to study this possibility because of the potentially important role of development companies in expanding the housing supply. Without

going into detail, I also urge you to study the possibility of reorganizing municipal apartment buildings as condominiums with share held by the individual owners of privatized flats and by the city on behalf of the remaining rental flats.

- **Clarify and Integrate Public Records of Real Estate Title.** At present, BTI has good technical descriptions of individual buildings and a register of their owners or leaseholders. The Land Reform Committee has a detailed plan for a cadastral survey and registration procedure that will clarify the boundaries of land parcels, identify the owners, and document their tenure. However, plans for integrating these two record systems seem to be at the stage of pious hopes rather than realizable procedures.

I do not think it is appropriate for me to suggest who should be in charge of an integrated record system. However, I will note that different skills are needed for designing such a system and for operating it. System design requires disciplined imagination; system maintenance requires rigorous adherence to carefully specified procedures.

I also recommend that both the title and transactions registers should be **public** records available to all--though a cost-recovery fee may be charged for record searches. The public availability of this information will help keep both public officials and private parties honest and scrupulous in meeting their obligations.

- **Increase the Normative Values of Land and Property.** Real estate taxes will generate significant revenue for Moscow only if the federal norms for land and property assessment are changed. The land assessment (and tax amount) is fixed in rubles whose value is rapidly being eroded by inflation. The property assessment is based on BTI depreciated replacement cost, which would work if properly indexed to reflect current construction costs; the indexed values would be about 35 times the currently reported values.

I recommend vigorously lobbying the federal legislature and executive to increase assessment norms for both land and buildings and to equalize the norms for residential and nonresidential uses.

The amended provisional norms will have to serve for a least a decade, while a private market in real estate develops and the city accrues information about actual market transactions, information that is needed to shift to market value assessment of real estate.

- **Increase Real Estate Tax Rates.** Federal law fixes land taxes and land rents for all of Russia in rubles per square meter, but allows cities to vary the rate in small zones so long as the federal average value is respected. The federal law on property tax payments by natural persons sets the rate on residential property at 0.1 percent of BTI value. As yet, no rate has been set for corporate landholders, though a figure of 0.5 percent has been mentioned in draft laws. The tax yield from these rates will be trivial.

I recommend that the city persuade the federal legislature to delegate rate-setting power to city councils. I further recommend that the city councils be empowered to review and revise these rates annually, considering the city's need for revenue and the taxpayers' ability to pay.

I further recommend that all real estate taxes be expressed in law as percentages of assessed value rather than as absolute amounts. When market value assessment is adopted, an increase in real estate values will automatically generate an increase in tax revenue, but the real cost to the taxpayer will not change.

I. INTRODUCTION

This report describes the system of real estate tenure that is emerging from the privatization reforms of the Russian Federation and the fiscal relationships between municipal governments and the users of real property, including both residential and nonresidential users. It discusses the major problems with this system from the perspective of U.S. experience with real estate tenure and taxation in a market economy. Finally, it recommends specific changes in real estate and tax laws and proposes programs to implement the amended laws.

The report builds on work commenced by Charles Hanson, Nadezhda Kosareva, and Raymond Struyk on general problems of housing reform in the Russian Federation (see Appendix B), but is based primarily on a review of existing and draft legislation and interviews with government officials (both executive and legislative branches) in Moscow and St. Petersburg during the period 20 May - 10 June 1992. The major findings were briefed to officials of the Moscow government on 9 June.

Under its contract with the U.S. Agency for International Development, the Urban Institute's mission in Russia focuses on housing problems. Although our task was initially conceived as providing technical assistance in methods of valuing residential real estate, it quickly became apparent that this narrow focus was unproductive. Valuation issues were embedded in programs of tenure reform and real estate taxation whose principles and purposes required analysis to justify choosing a specific method of valuation. Moreover, valuation and taxation issues are not distinctive for residential and nonresidential real estate; all uses should be considered together.

Consequently, this report begins by summarizing the real estate privatization program of the Russian Federation and the emerging systems of land and property tenure (Section II). Then it reviews recent legislation concerning payments to municipalities for the use of land and property, including both taxes and rents (Section III). With this background, we are able to explain actual and potential problems created by the reform programs (Section IV), and to recommend legislative and programmatic remedies for these problems (Section V).

One of the problems in drafting this report is communication with two audiences--one Russian-speaking and one English-speaking. Because our political and economic institutions differ, some common terms in one language have no equivalent in the other and some words and phrases are prone to mistranslation. Appendix A is a glossary of terms that are likely to be mistranslated or misunderstood.

Another problem is documentation. Although the published articles listed in Appendix B provided helpful background information for our study, most of our information comes from close reading of laws, decrees, and regulations and from discussions with the officials responsible for implementing these directives. Appendix B identifies the pertinent legal documents, consulted both in Russian and English translation. The appendix also lists the persons interviewed specifically for this study. Because they had no opportunity to review or correct our notes, we do not cite them as sources for specific statements. We must take full responsibility for errors in recording or interpreting what they told us.

II. LAND AND PROPERTY TENURE IN THE RUSSIAN FEDERATION

In the legal system of the Soviet Union, all land and natural resources were considered to be the property of the state. The management of most land in urban areas was delegated to the municipal government, although areas reserved for military and industrial use were usually controlled by ministries of the Soviet Union.

Within urban areas, land was allocated to specific uses by the municipal government. The users might be public agencies and institutions, state or municipal enterprises, chartered organizations, or individual families. The occupant of a parcel of land, whether a household composed of "natural persons" or a corporation ("juridical person"), had the right to use it for a specified purpose and for an indefinite period; however, the user could not sell or lease the land to others and his "right of use" could be revoked by the municipal government that granted it. Residential parcels and garden plots were inheritable by family members but not alienable. Occupants of the land paid no rent or taxes for its use.

Structural improvements such as buildings were called "immovable property" in the Soviet lexicon. Existing property (for example, pre-1917 buildings) was allocated to public agencies, institutions, enterprises, and chartered organizations either for use without payment or leased for a specified term in return for payment of rent. New buildings were built for state enterprises and for the municipality itself on sites provided by the municipality. In either case, construction was financed by an allocation of funds from the central government and the work was done by a state-owned construction enterprise. In the case of housing construction, the construction firm was paid partly in cash and partly in dwellings reserved for the industry's employees.

Most buildings specifically built for the use of an agency or enterprise were "owned" by that entity, in the sense that the building was carried on the entity's books as a depreciable asset, and the entity could lease out surplus space.¹ Thus, apartment houses built by the municipal Department of Housing (financed by grants from the central government) were owned by the

1. However, this limited form of ownership did not include the right to sell a building, and the supervising ministry could transfer custody of such a building to another enterprise.

Department, which often leased ground-floor space to municipal enterprises such as retail stores. Individual apartments were rented to individual households for a nominal rent and what amounted to life tenure.²

With the dissolution of the Soviet Union, the Russian Federation inherited the Union's political and economic functions and its governmental apparatus, but has undertaken a vast program of privatization, leading toward a full market economy. Most state and municipal enterprises are to be reconstituted as joint stock companies owned by their employees and public. In the residential sector, dwellings owned by both state enterprises and municipalities can be claimed as private property by their occupants, but those who prefer to continue as renters may do so. New forms of tenure for both land and property have been enacted or decreed. The functions of municipal government will no longer be supported by budget allocations from the central government. Instead, municipalities must find revenues from local sources, including income taxes, real estate taxes, and the sale of municipal assets.

The rapid restructuring of political institutions has created much legal and administrative confusion. At both the federal and the municipal level, the legislative and executive branches of government are competing for authority over policy, promulgating conflicting laws and decrees. Failure of the federal government to provide clear guidance on various issues has prompted local solutions in the form of laws, decrees, and administrative regulations of doubtful constitutionality.

Nevertheless, from this confusion a coherent system of legal rights and fiscal responsibilities is beginning to emerge. The remainder of this section describes its features.

LAND TENURE IN THE RUSSIAN FEDERATION

As noted, the only form of land tenure recognized under the laws of the Soviet Union was a **revocable right of use**, which could be held by either a corporate body or a natural person or group of persons. It was not transferable and could be terminated by the municipality with jurisdiction over the land. According to our informants in Moscow and St. Petersburg, less than half of all land users in those cities have documentary evidence of title.

2. See below, "Indefinite right of occupancy."

Since the collapse of the Soviet Union, the legislature of the Russian Federation has created three new forms of urban land tenure, each limited to certain kinds of owners or certain kinds of land uses. Russian citizens may be granted **hereditary life tenure** of a garden plot or single-family residential site, without the right to sell or lease it to others; alternatively, they can choose **full ownership tenure**, subject to certain restrictions: Owners cannot sell their property during the first ten years of ownership and cannot lease it for more than five years. All natural and juridical persons can be granted **leasehold tenure** for any land use for up to 50 years, without the right to sublet; such a lease entails annual rent payments to the municipality that granted the lease.³

The objective of land privatization is to convert the traditional "right of use" tenure to one of these three forms as rapidly as is feasible. In March 1992, President Yeltsin further liberalized tenure options by a decree that granted "citizens and juridical persons a right not only to rent but also to buy the land lots when state and municipal enterprises are privatized" or expanded. Under this decree, citizens can buy land for business enterprises as well as for houses and garden plots; and corporations--"juridical persons"--can acquire ownership as well as leasehold tenure.⁴

PROPERTY TENURE IN THE RUSSIAN FEDERATION

Under the laws of the Soviet Union, both juridical and natural persons were granted the right to use state-owned property. Enterprises often had **limited ownership tenure** in buildings that had been built especially for their activities and which were carried on their books as depreciable assets; they could lease out surplus space, but could not sell the buildings. **Leasehold tenure** was also common: Institutions and enterprises leased space in buildings that

3. **Land Code of the Russian Federation**, adopted 25 April 1991.

4. Decree Number 301 of the President of the Russian Federation, dated 25 March 1992. It remains to be seen whether the federal legislature will incorporate these principles into law or will attempt to nullify the decree by contrary legislation. In the meantime, cities such as Moscow and St. Petersburg must decide whether to use the more liberal provisions of the decree in their privatization programs.

were owned by the state but administered by the municipality in which they were located; the lease revenues accrued to the municipality.⁵

In the case of residential buildings owned by a municipal housing department, a state enterprise, or a chartered organization such as a trade union, individual apartments were occupied by individuals and families who paid nominal rents and were practically not evictable; their tenure can best be described as **indefinite right of occupancy**.⁶

Members of a housing cooperative, who supplied equity capital for constructing their building, held joint ownership title to the building, but could transfer their rights to individual apartments only through the mediation of the cooperative association (**cooperative tenure**). With the association's consent, they could lease their apartments to other parties without losing title. Of course, they then faced the problem of finding some other place to live.

A small number of single-family houses in urban areas (but many in rural areas) were held in **full ownership tenure**--although the sites of these houses were held only in revocable right of use.

Federal legislation now provides for the privatization of state enterprises by transforming them into joint stock companies, the stock being sold or distributed to employees and the public.⁷ The movable property of the state enterprise is usually transferred to the stock company upon payment of a negotiated sum to the municipality that conducts the privatization. Existing leaseholds on immovable property are apparently renegotiated or else the municipality offers to

5. Municipal rights to this property were and are tantamount to ownership; the municipality could assign the property to the use and user of its choice and received the revenues from leaseholds. For simplicity, I will henceforth speak of "municipally owned property."

6. Rents were set in 1928 rubles and have not since been adjusted. Although an occupant could be evicted for nonpayment of rent, the government had a responsibility to find the evictee another place to live. If children or other relatives were registered as residents of an apartment, they could continue their residency when the original occupants died or departed. Otherwise the apartment reverted to the building owner or lessor for reassignment to another family. Apartments could be exchanged between households by mutual agreement, and illegal subleases were common.

7. As we understand the privatization plan, retail trade and services are to be privatized by municipal authorities, whereas the federal government will handle the privatization of industrial organizations whose economic functions transcend the jurisdiction in which they are located. Our discussion with officials of Moscow and St. Petersburg dealt only with municipal privatization programs.

sell the property to the joint stock company. Immovable property "owned" by the state enterprise is apparently sold to the joint stock company at a negotiated price.⁸

In the case of apartment buildings owned by municipalities or state enterprises, occupants may voluntarily privatize their flats, acquiring full ownership title either free or at modest expense, depending on municipal policy. When members of cooperative associations have fully paid in their shares, they can also acquire full ownership title, enabling them to sell their apartments without the consent of the cooperative association.

The Property Law of the Russian Federation specifies the legal forms of tenure for both moveable and immovable property. For immovable property--buildings and other structures attached to the land--tenure possibilities vary with both type of use and type of user.

For nonresidential property, both **full ownership** and **leasehold tenure** are allowed to natural persons (regardless of citizenship) and to private firms (regardless of nationality). State-owned enterprises and chartered organizations may continue as **leasehold** or **revocable right-of-use tenants** (as arranged before reform), though the latter form of tenure will eventually be replaced by leaseholds or ownership.

For residential property, both single and multiple dwellings can be fully owned or leased by either natural persons or corporations (juridical persons). The rights of rental tenants in buildings owned by municipalities, state enterprises, and chartered organizations continue as they were under Soviet Law; we will call this tenure **indefinite right of occupancy**--because if occupants change their address of record, they forfeit rights to the apartment. Inheritable life tenure, allowed for land, does not seem to be an option for property.

COORDINATION OF LAND AND PROPERTY TENURE

The Land Code of the Russian Federation includes provisions (Article 37) for reconciling land and property tenure when ownership of a building is transferred. When ownership title to a nonresidential building is transferred to an enterprise, institution, organization, or citizen, title to the land on which the building is located is also to be explicitly transferred; the new owners

8. Procedures for privatizing municipal property are not standardized throughout the Russian Federation. Both Moscow and St. Petersburg have experimented with different methods for transferring existing rights to new private entities.

of the building may obtain either inheritable life tenure (citizens only) or traditional right-of-use tenure of the land. In the case of a single-family dwelling, where both land and building were held in full ownership, ownership title to both land and buildings are transferred to the new owner, although by different procedures. Apparently to satisfy some technicality of the law, the land title of the previous owner passes first to the local soviet and thence to the new owner of the building.

Also, as explained earlier, the President's Decree No. 301 enables municipalities to sell the land occupied by privatized enterprises to the citizen or corporate body that acquired the buildings.

III. PAYMENTS TO THE STATE AFTER PRIVATIZATION

As explained in Section II, Russia's privatization program is designed to transfer tenure rights to land and property from the state (municipality) to private (natural or juridical) persons. Under some circumstances, such rights are transferred free of charge to the recipient; in other cases, the recipient pays only registration fees; and in others, he pays a lump sum that is at least nominally the value of the rights transferred.

Depending on the form of their tenure, private parties with rights to land or property must also pay real estate taxes (hitherto unknown in Russia) or rents, but not both. Ten percent of the land tax goes to the federal government; the remainder of the land tax, all of the property tax, and all rents are paid into the municipal treasury for local use. Finally, transactions between private parties are subject to a transaction tax paid into the municipal treasury.

This section explains the circumstances under which each type of payment is mandated and how the amount is calculated. We deal first with payments at the time of transfer, distinguishing transfers of developed land and property from transfers of raw land, and distinguishing transfers for nonresidential use from transfers for residential use. Then we consider recurring payments--real estate taxes and rents.

PAYMENTS UPON TRANSFER OF TENURE RIGHTS: NONRESIDENTIAL PROPERTY

The question of payments for the transfer of tenure rights to nonresidential land and property arises in the course of privatization plans supervised by each city's Department of Property. At the time of our fieldwork, experience with such transfers was quite limited, and both Moscow and St. Petersburg were inventing methods and standards in the absence of clear federal guidance.

To the best of our knowledge, transfers to privatized firms have granted only leasehold tenure for both land and immovable property. The transfers have been accomplished by noncompetitive negotiations between a city agency and the founders of a joint stock company. For these transactions, we heard little about lump-sum payments as distinguished from annual rents.

Under the federal property law, cities have the right to either sell or lease municipal property to private firms, and we observed strong differences of opinion as to the better course. Much municipal property is already leased to state enterprises, institutions, and chartered organizations; lease administration is scattered among functional departments of the executive branch, which prefer the status quo.

In Moscow, the Director of Privatization in the Department of Property wants to centralize administration of city-owned property under his agency, which also supervises privatization deals. He favors selling both land and property to the joint stock company that is formed to take over the functions of a state-owned firm, using Decree No. 301 as his legal authority for land sales. The administration's Land Reform Committee would like the city to retain ownership of the land, offering it only on longterm lease.

At the time of our fieldwork, St. Petersburg's Fund for Property --an independent executive agency--had managed about 100 compulsory privatizations of retail and service enterprises. Movable equipment was auctioned, but the premises--land and buildings--were transferred to the new private firms on 15-year leases, with an option to buy if subsequent federal legislation makes that possible. Except for the purchase of movable equipment, no lump-sum payment was required when title was transferred. The annual lease rental was calculated by formula, not negotiated.

President Yeltsin's Decree No. 301 allows municipalities to sell as well as to lease land when privatizing a state enterprise, but says only that the selling price must be no less than the "normative value" of the land, discussed later in this section. We did not hear of any actual land sales for nonresidential use.

PAYMENTS UPON TRANSFER OF TENURE RIGHTS: RESIDENTIAL PROPERTY

The federal law on housing reform specifies that a renter in municipal or state-owned housing has the right to privatize the apartment he occupies, and guarantees free transfer of a

minimum quantity of space per household member. The law is silent about payments for extra space or extra amenities, leaving this issue to be resolved by local governments.⁹

In Moscow, the Committee on Housing Privatization decided to transfer ownership to sitting tenants without charge, regardless of the characteristics of the dwelling and of the occupying household. In May 1992, about 100,000 apartments had been privatized under this rule.

In St. Petersburg, the Housing Committee elected to convert each apartment's attributes (space and amenities) to a ruble equivalent and express the normative entitlement in rubles; the privatizers would pay extra for value received above the normative amount. In May 1992, about 3,000 apartments had been privatized under this rule, yielding payments that averaged 2,500 rubles per apartment.

The valuation of apartments was based on depreciated replacement values reported by the city's Bureau of Technical Inventory (BTI), of which more anon. Recognizing that these values are far below actual replacement cost, the Committee decided to increase them by a factor of 10 beginning 1 July; so the average payment for extra space and quality will thereafter be on the order of 25,000 rubles per apartment. Since this plan was announced, over 100,000 applications for privatization have been filed by tenants who naturally prefer the old standard.

Article 17 of the Land Code assigns to municipal governments the responsibility to allocate land to its citizens for single-family houses and garden plots. It allows the applicant for such an allotment to choose between full ownership, inheritable life tenure, and leasehold tenure, and allows the municipality to auction the plots; it doesn't explain how these two concepts fit together.¹⁰

Neither Moscow nor St. Petersburg have made much progress with this program. City planners in both jurisdictions resist the idea of encouraging single-family housing development in place of highrise multiple dwellings, arguing that infrastructure and municipal service costs

9. However, in October 1991, the federal Committee for Housing and Public Services approved model regulations for privatizing housing that included rules for computing payments for extra space or amenities. These rules are not binding on local authorities.

10. Does the municipality set aside land for and conduct separate auctions of each kind of tenure right? Or does the applicant choose the plot he wants and force an auction of the tenure rights he prefers?

will be much higher for low-density housing. However, the Land Reform Committee of St. Petersburg experimentally auctioned 50-year residential leasehold rights on an undeveloped parcel of 1,200 square meters. The winning bid, which included prepaid rent for the life of the lease, was 700 rubles per square meter.

PAYMENTS TO GOVERNMENT FOR TRANSFERS BETWEEN PRIVATE PARTIES

Under federal law, private sales of residential property are subject to a transfer tax of 10 percent of the purchase price. However, in both Moscow and St. Petersburg, we are told that the purchase price is usually underreported. In fact, brokers in Moscow tell us that BTI's depreciated replacement cost is usually entered as the purchase price and that this figure is routinely accepted by both the tax collector and the notary who registers the contract.

RECURRING PAYMENTS: REAL ESTATE TAXES AND RENTS

Prior to the reforms of 1991, neither land nor property was taxed in Russia. A federal law "On Revenue from Land" (October 1991) establishes the principles for recurring payments to the state for the use of land. In December 1991, the federal legislature adopted a law "On Taxes Levied on the Property of Natural Persons." As yet, no federal law establishes standards for taxes on the property of corporations ("juridical persons").

Revenue from Land

The federal law cited above provides that the owners, proprietors, and users of land, whether private parties, public enterprises, or agencies of government, are subject to a land tax. Furthermore, those who lease municipal land must pay annual rents.¹¹ Within municipal jurisdictions, land taxes and rents are collected by the city government. Ninety percent of the tax revenue is credited to the municipal treasury; the remaining 10 percent goes to the federal

11. The Land Code of the RSFSR envisions land lease rents as the functional equivalent of land taxes, specifying that no tenant should pay both, and that the lease rent cannot be higher than the tax rate for all types of land. However, the October 1991 law "On Revenue from Land" retains these principles only for rural land; it allows urban land rents to be negotiated between the tenant and the municipality. Moscow has followed the Land Code, with lease rents equal to the tax liability that would apply if the land were owned by the tenant. In St. Petersburg, the Committee on Land Reform has promulgated lease rentals that average about twice the equivalent land tax.

government to be used for public works that benefit the cities. All rental revenue goes to the municipal treasury.

The statute actually sets the land tax per unit area (e.g., rubles per hectare) for all land in Russia, specifying different amounts for each of 12 "economic regions," for agricultural land by quality, and for urban land by size of city. For urban land, multiples of the basic rate are scheduled for resort areas and for cities with "developed socio-cultural potential." The accompanying executive decree (25 February 1992) allows cities to vary the land tax by district, so long as the citywide average tax is unchanged. The tax for Moscow is 13.5 rubles per square meter; for St. Petersburg, 10.5 rubles per square meter.

Having specified land taxes throughout Russia, the law also introduces the concept of a standard or "normative" land price to govern the terms of transfers of land to private ownership, the establishment of collective land ownership shares, transfer by inheritance or donation, and obtaining mortgage credit. The procedure for fixing normative land prices is left to the federal Council of Ministers. Their decree (25 February 1992) sets the normative price of land at 50 times the promulgated land tax.

An extremely important provision of the federal law deals with residential land in urban areas. As translated, it states that "The tax for lands occupied by the housing stock (state, public, cooperative, individual), agricultural lands and private [garden] plots within city or settlement limits will be calculated in the amount of three percent of the land tax rates established in the cities and urban types of settlement." By this rule, the average tax on residential land and garden plots amounts to 40 kopeks per square meter in Moscow and 32 kopeks per square meter in St. Petersburg.

Both Moscow and St. Petersburg have responded to the federal law by devising schedules of land taxes and land values by small zone within their respective jurisdictions. Moscow distinguishes 69 zones, with tax amounts varying from 13.5 to 82.6 rubles per square meter, obviously ignoring the requirement to respect the specified citywide average of 13.5 rubles. St. Petersburg has respected its assigned average.

Revenue from Property

In December 1991, the federal legislature adopted a law "On Taxes Levied on the Property of Natural Persons"; the law was further implemented by an executive order of the federal Ministry of Architecture, Construction, and Housing (No. 87, 4 April 1992). To date, there is no law on the revenue from property belonging to juridical persons, including public agencies and institutions, state or private enterprises, chartered organizations, and housing cooperatives.

Under this law, the only kinds of property that are taxed are "residential houses, flats, country cottages, garages, and other premises, buildings, and structures" owned by natural persons; and certain vehicles such as helicopters, airplanes, yachts, motor launches, and motor sledges. The latter--"movable property"--do not concern us.

The tax on residential premises is set at 0.1 percent of "assessed value," an undefined term in the statute. The implementation order specifies that the assessed value is equal to BTI's depreciated replacement cost, indexed to current construction costs. As of 1990, BTI's estimate of the average indexed replacement cost for residential buildings in Moscow was 203 rubles per square meter of total space. For St. Petersburg, the corresponding figure is 112 rubles.

IV. EMERGING PROBLEMS WITH TENURE AND TAX REFORM

Our survey of real estate tenure and taxation under the reforms instituted in the Russian Federation indicate to us that four serious problems are emerging. Unless these problems are remedied by legislation and implementation programs, it is likely that privatization will stall, municipalities will be unable to finance necessary public services, housing space will continue in short supply, and land use in urban areas will continue to be extraordinarily inefficient.

DIFFERENT SYSTEMS OF TENURE AND TAXATION FOR LAND AND PROPERTY

The laws of the Russian Federation concerning land tenure and taxation have developed quite separately from the laws concerning immovable property; they have been written by different legislative committees and reflect different legal principles. In urban life, land and buildings are used jointly. When the user has one set of rights pertaining to the land and another set of rights pertaining to the buildings on the land, his ability to use them jointly becomes the lowest common denominator of title.

For example, if property can be held in full ownership but land can only be held in 50-year leaseholds, the builder of a factory must assume that his title to the improvements he has made will expire at the end of his land leasehold. If full ownership of property is permitted for both natural and juridical persons, but full ownership of land is permitted only for natural persons, juridical persons do not genuinely have full ownership of property because they cannot convey the property apart from the land.

A second aspect of this problem is permanent confusion in real estate valuation and taxation, leading in some cases to double-counting, in others to undercounting. For example, when a municipal flat is privatized, the rules assume that the "real value" of the rights transferred is adequately measured by the depreciated replacement cost of the flat. In fact, the transfer also includes an implicit right to live in a particular location, a right whose market value may exceed the replacement cost of the apartment.

A third aspect of this problem is administrative duplication. The cities of Moscow and St. Petersburg are well on their way to creating parallel systems of title registration, value

assessment, and tax collection for land and for buildings. One administration could manage these functions for both land and buildings more efficiently and with many fewer inconsistencies in the records.

UNCERTAINTY ABOUT WHO HOLDS TITLE, THE FORM OF TENURE, AND THE BOUNDARIES OF LAND PARCELS

To create a private market in urban real estate and to assess and collect taxes, it is necessary to have clear titles to well-defined parcels of land and to the buildings on the land, and to know who holds each title.

The land and property codes of the Russian Federation describe permissible forms of tenure but are generally obscure about how tenure is achieved. Presently, most urban land is held by state or municipal enterprises, public agencies, institutions, and chartered organizations under "right of use" tenure that may even predate the 1917 Revolution. More than half of all users lack adequate documentation of their claims to title. Even recent land allocations seldom include a careful description of the parcel conveyed, so parcel boundaries are uncertain.

The situation is better with respect to property. Moscow's Bureau of Technical Inventory (BTI) has a nearly complete register of buildings in the city. Each building is shown on a carefully drawn site map, including measurements of building perimeters. The building's dossier or "passport" includes a register of the owners and leaseholders that occupy the building, and a reference to the contract or document that granted their title to the building. However, this register is infrequently updated, so the information may be incorrect.

In both Moscow and St. Petersburg, the Committee on Land Reform has undertaken a cadastral survey to fix the boundaries of land parcels and to register the titles of their owners or occupants. It is generally agreed that many boundary disputes will have to be arbitrated or adjudicated. The initial registration in both cities is aimed at documenting existing tenure rights, not altering them. Conversion of existing rights to the new forms of tenure envisaged by the federal land and property laws seems to require case-by-case privatization and reregistration of title.

Privatization will also change the tenure and title holder for property--the buildings on the land and privatized apartments within buildings owned by the municipality or by a state

enterprise. Responsibility for registering such changes has been in flux, and procedures are not yet well-defined.

In Moscow, privatization of nonresidential property is registered by the Department of Property; In St. Petersburg, it is registered by an independent executive agency, the Fund for Property. Privatization of residential property is registered by the Department of Housing in Moscow and by District Privatization Agencies in St. Petersburg. Only in the last case is there a clear link between registration and existing records.¹²

INADEQUATE PROVISIONAL LAND AND PROPERTY ASSESSMENTS

Both for purposes of privatization and taxation, federal law has established norms for the assessment of all land and for assessment of residential property. As yet, no federal law provides rules for the assessment of nonresidential property.

Clearly, some simple temporary method of assessment is needed to enable privatization and taxation to proceed. However, the methods that have been chosen result in assessments that are much too low and radically different for different land uses. Even worse, no procedure has been indicated for shifting later to market value assessment.

In our judgment, the normative values prescribed by federal law are likely to become permanent standards. But even if they are eventually replaced by market value assessments, in the meantime the low normative assessments will create very small real estate tax liabilities for most users and very small revenue from real estate taxes.

For example, the federal standard assessment for nonresidential land in Moscow is 675 rubles per square meter; in St. Petersburg, 525 rubles per square meter. Variations within each city, ordained by their city councils, range as high as 4,130 rubles per square meter for the central commercial district of Moscow. There, a parcel of 600 square meters, large enough to a multistory office building, would be assessed at nearly 2.5 million rubles. In Los Angeles or New York, the assessment, based on market value, would be at least 50 times as large (using \$1 = R100).

12. Registration data is forwarded from the District Privatization Agency to the Bureau of Technical Inventory, which maintains an ownership register for each building. However, we are informed that this link is not well organized in some districts of St. Petersburg.

A suburban plot in Moscow suitable for a single-family house or garden, has a normative value of 20.25 rubles per square meter, or 12,150 rubles for 600 square meters. If this value is used for tax purposes, the tax yield will be trivial (see below).

The situation with property taxes is now defined only for residential buildings and flats owned by natural persons. These are assessed at their "depreciated replacement cost," a book value maintained by BTI on all buildings. In principle, it is the depreciated original cost of the property, indexed for changes in construction cost. For properties built since 1960, the original cost was taken from actual construction contracts; values for older buildings were estimated. Depreciation is assessed by field inspection on a nominal five-year cycle; between inspections, rate schedules are used. Replacement cost has been indexed twice for changes in construction costs--in 1984 and 1990.

In principal, depreciated replacement cost is a good proxy for the market value of a reproducible asset, and BTI has 65 years of experience in collecting base data, surveying building condition, and applying depreciation schedules. However, the federal BTI, responsible for promulgating technical standards, has not been willing to recognize the facts of construction cost escalation. In the entire history of BTI, only two index adjustments have been made, increasing replacement costs by a factor of 1.25 in 1984 and again by 1.67 in 1990. These adjustments (increases of one-fourth and two-thirds) are manifestly arbitrary.

Following the 1990 index adjustment, Moscow's BTI estimated that the average depreciated replacement cost of residential property in the city was 203 rubles per square meter of total space. According to BTI's director, construction firms say that residential construction costs now run in the range of 7,000 to 10,000 rubles per square meter. Taking the median value of 8,500 rubles/m² and depreciating by the stockwide average of 16 percent, we obtain a current replacement cost of 7,140 rubles/m², or 35 times the official value.

In St. Petersburg, the official 1991 average was 112 rubles per square meter of total space. Absent a federally promulgated index for 1992, the St. Petersburg Housing Committee began privatization of apartments using a norm of 200 rubles per square meter, and now proposes to raise the norm to 2,000 rubles/m². Although this decision will govern the amounts paid for

excess space in privatized flats, it does not automatically apply to property tax assessment. Even if it did, 2,000 rubles/m² is less than a sixth of current construction cost in St. Petersburg.¹³

In order to move to a system of market-value assessment for either land or property or both, it is absolutely essential to build a systematic data base of actual prices paid for real property in transactions conducted under competitive conditions. It is possible and desirable to estimate the market value of **property** from its replacement cost, but it is not possible to estimate the market value of **land** from its infrastructure costs, as was done in Moscow; or from accessibility and amenity indexes as was done in St. Petersburg. If a lump sum is paid for both land and property rights, the land value can be derived as a residual, as described in Section V, below.

However, the municipal agencies we visited in both Moscow and St. Petersburg have no plans to require the buyer or seller of residential property to register actual sales prices. For nonresidential property, private market transactions are unlikely because municipalities are unwilling to relinquish control. They prefer to grant leasehold rights to privatized enterprises and new firms, setting rent payments by noncompetitive negotiation.

LOW EFFECTIVE REAL ESTATE TAX RATES

Under federal law, both normative assessments and specified tax rates are low, so that the effective real estate tax is trivial for most users. Under present conditions, real estate taxes will cost more to collect than they will yield in revenue. Moreover, a potentially productive revenue source, the transactions tax, has been ignored by Moscow's government.

Consider first the land tax. For nonresidential uses in Moscow, this tax ranges from 13.5 rubles to 82.6 rubles per square meter. For a parcel of 600 square meters, the tax yield will therefore range from 8,100 rubles to about 50,000 rubles annually, and those ruble amounts are

13. According to Mr. Valery Antonov, principal engineer of the Institute of Architecture and Urbanistic Theory, residential construction costs were about 800-1,200 rubles per square meter at the end of 1991. In early 1992, they had risen by 700 to 800 percent, and now have risen by 1,200 percent. It should be noted that the residential construction industry in each city is dominated by a single state-owned construction firm. Although private construction firms exist, we are told that they find it difficult to obtain supplies.

fixed without regard for inflation. By the time these taxes are actually collected, the expense of collecting them will exceed the revenue for all but the upper range of tax rates.

For residential land use, which occupies a fourth of Moscow's area, the tax ranges from 40 kopeks to 2.5 rubles per square meter. Even today, such a tax is not worth collecting.

The property tax is set for all Russia at 0.1 percent of assessed value for property owned by natural persons; no rule has yet been adopted for juridical persons, though a figure of 0.5 percent appears in draft legislation. For residential property in Moscow, we can consider the case of a typical privatized flat. It contains 50 square meters of total space and has an assessed value (from BTI) of about 10,000 rubles. The annual property tax is 10 rubles.

Changing the land or property tax rules will require federal legislation. However there is another source of real estate revenue for which the law is clear but not enforced. This is the transactions tax on private sales of property. For residential property such as a privatized flat, the tax rate is 10 percent of the purchase price.

Brokers in Moscow tell us that sellers of these flats are required to obtain from BTI the current depreciated replacement value of the flat, and that they usually enter this value in the contract as though it was the actual purchase price. Neither the tax collector nor the notary question this entry, although it is obviously incorrect. Under these circumstances, the tax yield from the sale of a typical (50 m²) flat is about 1,000 rubles.

We have compiled brokers' records of private sales of apartments in Moscow during the past year. These records indicate that the typical hard-currency purchase price for such a flat is about \$26,000, which converts to about 2.6 million rubles. We are also informed that at least 2,000 private sales have occurred in the past year. A few simple calculations tell us that if each buyer had paid the full tax on sale price, the revenue to the City of Moscow would have amounted to 522 million rubles, about 4 percent of the city's budget in 1991.

V. RECOMMENDATIONS

In the preceding section, we described actual or potential problems arising from Russia's rapidly evolving laws governing real estate tenure and taxation--problems that may escape the notice of Russians because their daily experience does not include the institutions of a market economy or of real estate taxation. Having summarized those problems, we now propose some remedies for them.

Some of our proposals seem to be within the authority of the municipal executive departments to implement without new legislation. Some would require new laws or amendments to existing laws enacted by the city council. Others require federal enabling legislation or executive decrees. Because the lines of authority have not yet crystallized in either the federal or city governments, it is not always clear whose consent is needed to change the form of emerging institutions or the direction of emerging policies.

Policies and programs that are abstractly desirable may nonetheless appear to be politically impossible given current constellations of interest groups, or administratively infeasible given the current capabilities of government agencies. We do not think we can accurately judge the strength of such impediments. Our role is to suggest alternatives to present policies and institutions, alternatives that have been successful in countries with market economies. We hope that the Russian readers of this report will find at least some of those ideas worth investigating further.

CLARIFY AND INTEGRATE LEGAL FORMS OF TENURE

Federal legislation is needed to clarify obscure passages in the land code and the property law and to create stronger links between land tenure and property tenure.

Presently, permissible forms of land tenure depend on both the type of use and type of user. Under the federal Land Code, full ownership of land is permitted only to Russian citizens and only for agricultural or residential use. Industrial and commercial enterprises, chartered organizations, and agencies of government retain their traditional "right of use" until they negotiate a land lease with municipal authorities. However, Presidential Decree No. 301 allows

both citizens and corporations to acquire the land of privatized enterprises in full ownership as well as in leasehold. When laws and decrees conflict, the prudent investor waits for resolution.¹⁴

Shifting from Right of Use to Leasehold Tenure of Land

At present, it seems that most municipally owned nonresidential buildings are leased to the occupying state or municipal enterprise, institution, or chartered organization--though we haven't seen actual statistics. The sites occupied by these building are not explicitly included in the leases, although the lease rents implicitly pay for both building space and site.

The federal Land Code now allows land leaseholds as well as property leaseholds. It has been suggested to us that municipalities may unilaterally reopen their relationships with property leaseholders, demanding a land leasehold and land rents as well. With locked-in tenants, we can imagine that such demands might be effective. However, they would amount to charging the leaseholder twice for the site.¹⁵

Corporate Ownership of Land

Although a strong argument can be made in favor of permitting corporate as well as personal ownership of land, as in the United States, municipal land ownership is common in European countries. They allow private persons and corporations to use the land under long-term leaseholds (99 years is a common duration), and specify the disposition of structural improvements at the end of the lease. Whether or not Russia accepts the principle of corporate ownership for land, municipal leaseholds must spell out the rights and obligations of both parties at the termination of a land lease so that investment in fixed structures can be appropriately amortized by the investor.

14. Especially because Decree No. 301 is clumsily worded, its scope is arguable.

15. There seem to be no federal standards for nonagricultural land rents. The federal Law on Payment for Land says that agricultural land rent cannot exceed the applicable land tax, but for nonagricultural land says only that "The amount, terms, and date of payment of rent for land will be fixed by an agreement" between the lessor and lessee. (Article 21)

Joint stock companies formed to develop residential estates find the tenure laws especially cumbersome. Although a city can allocate small plots **in ownership** to individual families who plan to build a house, the city can only **lease** a large estate to a development company. If the company builds houses on the leased land, it cannot convey land ownership title to individual families that buy the houses.¹⁶

We think it would be possible for the city council to prepare a standard leasehold contract for residential developers, a contract which guarantees that as houses are built and sold their sites can be removed from the leasehold and conveyed to the buyer in full ownership. We urge a study of this possibility because of the potentially important role of development companies in expanding the housing supply.

Without going into detail, we also urge studying the possibility of reorganizing municipal apartment buildings as condominiums with shares held by the individual owners of privatized flats and by the city on behalf of the remaining rental flats. The land code indicates that land used for housing, including state, public, and cooperative housing, is subject to taxation, but doesn't explain who pays. The proposed change in tenure would clarify the rights of apartment owners to common areas and their liability for land taxes. It would also clarify control over building maintenance and rehabilitation policies.

CLARIFY AND INTEGRATE PUBLIC RECORDS OF REAL ESTATE TITLE

The Land Reform Committees of Moscow and St. Petersburg have detailed plans for cadastral surveys and registration procedures that will clarify the boundaries of land parcels, identify the owners, and document their tenure. BTI has good technical descriptions of individual buildings and a register of their owners or leaseholders. However, plans for integrating these two record systems seem to be at the stage of pious hopes rather than realizable procedures.

We recommend that the cadastral re-registration presently planned in both cities be expanded to include re-registration of title to buildings as well as to land, and that a legal

16. This paragraph is based on the federal Land Code. Presidential Decree No. 301 allows a municipality to sell land in connection with privatization of state and municipal enterprises, "and also when these enterprises are expanded or additional objects are constructed." The quoted language doesn't seem to cover developing residential estates on raw land.

description of both land and buildings be maintained in a single centralized archive. (A legal description consists of a surveyor's report of parcel boundaries, building perimeters, and building height; current technology allows a digitized link between such a report and a map that can be printed on demand.)

Keeping this archive current will require a registry of real estate transactions. Presently, contracts for the transfer of property must be notarized, but the notarial record does not affect BTI's register of building titles. The transactions register will also serve other purposes, described later in this section.

We also recommend that both the title and transactions registers should be **public** records available to all--though a cost-recovery fee may be charged for record searches. The public availability of this information will help keep both public officials and private parties honest and scrupulous in meeting their obligations.

We do not think it is appropriate to suggest who should be in charge of an integrated record system. However, we do note that different skills are needed for designing such a system and for operating it. System design requires disciplined imagination; system maintenance requires rigorous adherence to carefully specified procedures.

INCREASE THE NORMATIVE VALUES OF LAND AND PROPERTY

Real estate taxes will generate significant revenue for Moscow only if the federal norms for land and property assessment are changed. The land assessment (and tax amount) is fixed in rubles whose value is rapidly being eroded by inflation. The property assessment is based on BTI depreciated replacement cost, which would work if properly indexed to reflect current construction costs; the indexed values would be about 35 times the currently reported values.

The Normative Assessment of Urban Land

The federal law on land payments specifies an average normative value for nonresidential land in urban areas, but allows city councils to differentiate values "according to location and zones of territory of varying city design and building value." Both Moscow and St. Petersburg have divided their territory into zones with different normative land values--in fact, Moscow's council adopted a land value map before the federal law was passed.

These maps are based on academic studies that tried to compensate for the lack of market data by direct analysis of factors that in principle should affect market values. We have not studied either analysis in detail, but note that they proceed from different principles and reach different conclusions about the geometry of land prices in the two cities. However, both yield peak values near the center of the city, falling toward the perimeter.

Because systematic studies were conducted in each case and because their results are basically consistent in relative prices with the evidence of actual urban land markets in other countries, we think the current land-value maps should be used provisionally to assess land for tax purposes. However, they should be used to assess **relative**, not absolute land values. The entire schedules of land values should be scaled up so that central land values are closer to those in market economies. This action will require amending the federal law on payments for land, which specifies the average land value for each city.

We also recommend equalizing the normative values of residential and nonresidential land. Federal law presently prescribes that residential land be assessed at 3 percent of the normative value of nonresidential land in the same area. A competitive land market would never produce such an outcome. If permanently embedded in Russian assessment practices, this provision will seriously distort the land market, discouraging municipalities from allocating land for much-needed housing because it will bring less revenue than other uses.

The Normative Assessment of Urban Property

The federal law on property taxes paid by natural persons calls for assessment of residential buildings at their depreciated replacement cost as calculated by BTI. In principle, replacement cost of a reproducible asset is a good proxy for its market value; in an efficient market, an existing asset would not sell for much more or less than the cost of producing a new one of similar design.

Our inquiries into BTI's procedure for calculating depreciated replacement cost indicate that the computations are crude but appropriate for the task of citywide assessment. (More complex methods would be appropriate for a market-value appraisal of a single building undertaken in preparation for negotiations to buy or sell it.) However, the central BTI of the Soviet Union did not fulfill its responsibility to provide valid corrections for changes in

construction costs over the years, and the Russian BTI has not compensated for this neglect. It is generally conceded that BTI's current estimates of replacement cost must be multiplied by factors ranging from 35 to 50 in order to approximate actual replacement costs.

We recommend that the federal BTI be required by law to create and maintain an annual index of construction costs based on systematic surveys of actual prices for construction materials. This index should be computed separately for regions of Russia where such costs differ sharply. The values of the index should be calculated on the basis of widely accepted scientific principles and published without regard for political sensibilities. When tools of public management are blunted or bent to conceal public problems, the resolution of those problems becomes more, not less, difficult.

The arguments given above concerning the provisional assessment of residential property apply also to nonresidential property, for which no method of assessment has yet been adopted. We recommend that urban nonresidential property be provisionally assessed at BTI depreciated replacement cost, indexed to reflect current construction costs.

MOVING TO MARKET - VALUE ASSESSMENT

The amended provisional norms described above will have to serve for a least a decade, while a private market in real estate develops and the city accrues information about actual market transactions, information that is needed to shift to market value assessment of real estate. We recommend that both federal and municipal authorities announce the provisional nature of the normative values described above and begin planning the subsequent shift to market value assessment.

The most urgent step is to create a register of real estate transactions that identifies the parties to the transaction, the land and property rights conveyed, the nature of the transaction (purchase of privately owned property, privatization transfer, gift or inheritance) and the price actually paid for the bundle of land and property rights that were transferred. As noted earlier, the register should be a public record, accessible to all.

The price data are crucial. It is impossible to devise a valid method of market value assessment without a large sample of actual transactions and purchase prices. The design of data

collection procedures for this transactions register is crucial to the reliability of the price information, so should be done with great care.

In Moscow, a few thousand transactions in residential real estate have been registered, first with BTI and later with the Registration Bureau of the Department of Housing, but without price information. Indeed, as explained in Section III, buyers and sellers have actually been encouraged to underreport prices in their sales contracts. We recommend that all real estate sales contracts be required by law to include affirmations before a notary by both buyer and seller that the reported price is the true consideration. The law should also provide an explicit penalty for fraudulent reporting--e.g., voiding the contract or forfeiture of the property.

In the United States, a sale of residential real estate usually entails cash payment of the purchase price by the buyer, who typically obtains most of the cash from a lending institution in return for a mortgage on the real estate just purchased. Thus, the purchase price is clearly stated. Because credit institutions are underdeveloped in Russia, private transactions in real estate may be more complicated and the consideration less easily expressed as a definite sum of money. For transfers of nonresidential real estate, the complexity of payment and the obscurity of price will be even greater. It should not be difficult to register the actual consideration, only difficult to translate it into a lump sum cash equivalent.

A second step that should begin soon is training a corps of professional assessors, to be housed in a nonpolitical agency such as the Department of Taxation. The assessor's job should be to examine the evidence provided by actual transactions and estimate the value of real estate that has not been sold recently. In the U.S., tax assessors and real estate appraisers use a number of different methods for this purpose, all of which entail some judgment. They often average the results of several methods. One method appropriate to the Russian situation is described below for concreteness.

To estimate the market value of a specific parcel of urban land and the buildings on it, proceed as follows:

1. Search the transactions file for sales of similar properties located near the subject property.
2. For each transaction thus located, subtract the indexed BTI replacement cost of buildings from the reported purchase price to obtain an estimate of the land price.

3. Convert the estimate land price for each transaction to a price per square meter, then average these standardized prices over all the transactions.
4. Obtain the land area of the subject property and use the average land price from Step 3 to estimate the total land value of the subject property.
5. Use the indexed BTI replacement cost for the building on the subject site as an estimate of property value.
6. Combine land and property value estimates to get an estimate of the total value of the real estate in question.

It is important that these assessments be made by qualified persons working on salary for a public agency that is insulated from policy making. The assessments should be generally perceived as impartial even if inexact approximations to actual market value, and a procedure should be provided for appealing assessments--first administratively, then in the courts.

This is not to say that everyone should be taxed alike. Tax exemptions and tax preferences are common even in market economies as tools of public policy, to encourage some uses of real estate or to help some types of users and to discourage others. But such policies should be implemented through differential tax rates, not through preferential value assessments.

DELEGATE TAX RATE DECISIONS TO LOCAL GOVERNMENTS

It was unwise to write tax rates for all of Russia into federal law and especially unwise to fix land tax amounts in rubles. Within a year of the passage of the federal law on payments for land, price inflation will have reduced the tax even on the highest-value land to a trivial sum, not worth collecting.

Ninety percent of land tax revenue and all property tax revenue goes to local government. Real estate taxation is one of the few sources of revenue available to support the infrastructure and public services provided by cities. We recommend that the federal government delegate to city councils the power to set real estate taxes within their jurisdictions. We further recommend that city councils be empowered to review these rates annually and alter them as seems appropriate in the light of the city's need for revenue and the citizen's ability to pay. Then, these difficult and painful decisions will be in the hands of those who must live with the consequences.

We further advise those who set tax rates to index them for inflation. This can easily be done by expressing the tax as a percentage of market value of the real estate. As market values rise with inflation, so will tax revenues; but the real burden on the taxpayer will be about the same.

Finally, we recommend that the city councils of Moscow and St. Petersburg act to capture a significant stream of revenue that is now escaping them--the tax on private real estate transactions. As explained earlier, both cities have allowed--even encouraged--the public to underreport purchase prices on residential transactions, though the law is clear. Enforcement of the law would yield about 522 million rubles annually in Moscow, and a somewhat smaller sum in St. Petersburg.

Appendix A

GLOSSARY OF WORDS AND PHRASES

Because of different political and economic institutions, some English words and phrases are likely to be mistranslated into Russian, and the reverse. Below is a glossary of those that came to our attention during this study. It explains the meaning of English words and phrases in language that is translatable into Russian, or gives the nearest English equivalents of Russian concepts.

appraisal. A formal estimate of the market value of real estate (land and/or buildings). An appraisal may be made for official or private purposes, by a civil servant or a private professional appraiser.

assessment. A value placed on real estate specifically for purposes of taxation. In the United States, assessments are made by municipal civil servants and usually reflect estimated market values--although in some jurisdictions the assessment may be only a specified percentage of market value. In the Russian Federation, assessments are based on normative values promulgated by the federal parliament in the case of land and calculated by the local Bureau of Technical Inventory in the case of buildings. These assessments are not closely linked to market values.

cadastre. An official register of the ownership, boundaries, and value of real estate, used as a basis for taxation. A **cadastral survey** maps or defines the boundaries of real estate and may describe the structures on it.

chartered organization. Our term for a membership organization that is not a part of the government but is officially recognized by it and is granted specified rights and privileges. Ex: trade union, academy of sciences.

condominium tenure. A common form of residential tenure in the U.S., but unknown in Russia. Usually, a multiple dwelling is built by a developer who then sells the individual apartments to families who plan to occupy them. Each buyer holds ownership title to his apartment and an undivided ownership share in the site, the common areas and the facilities of the condominium. Buyers form a membership association that selects a

manager and contracts for building services, assessing the members a monthly fee. A member can sell or lease his rights to someone else without the consent of the association.

cooperative tenure. A rare form of residential tenure in the U.S. but common in Russia, where it was introduced by the Soviet Union and continued by the Russian Federation. Members of a cooperative association supply equity capital to build or buy an apartment house, the title to which is held by the cooperative association. Each member has the right to occupy a specified apartment and, subject to the consent of the cooperative association, can transfer this right to some other person. Recent legislation of the Russian Federation allows members whose equity shares are fully paid in to transfer their rights without consent of the cooperative association.

corporation. Used here as a generic term for any organized group that is recognized by law as a legal entity or "juridical person" able to own property and make contracts. Includes chartered organizations, state and municipal enterprises, and public institutions such as museums, but excludes agencies of government. In the United States, the term is often used specifically to mean a business enterprise whose ownership is represented by transferable shares of stock; the stockholders are liable for debts or actions of the corporation only to the amount of their investment in stock.

depreciated replacement cost (DRC). An estimate of the current value of a building used in capital accounts of state and municipal enterprises of the Soviet Union, and now used by the Russian Federation as a normative value for purposes of transactions and taxation. DRC accounts for nearly all buildings have been maintained for 65 years by local Bureaus of Technical Inventory throughout Russia, pursuant to standards promulgated by the federal Bureau of Technical Inventory. A building's DRC is derived by depreciating the original cost of the building to reflect deterioration or shortening of useful life due to time, wear, and the elements; then indexing the depreciated value to reflect changes in construction costs since the building was erected. Currently, DRCs are badly understated because construction cost indexes do not reflect recent inflation.

executive. The branch of government empowered to implement and enforce laws passed by the legislature. In the U.S., the incumbent officers of this branch are often called ~~the~~ **administration**; in Russia, they are usually called **the government**. The president of the

Russian Federation currently has limited power to rule by decrees that have the force of law.

full ownership tenure. The most common form of real estate tenure in the U.S., but rare in Russia. In the U.S., either natural or juridical persons may hold both land and buildings in full ownership tenure; the owner has the right to use such real estate for any purpose permitted by municipal zoning laws; and the right to lease, sell, or bequeath the real estate to other natural or juridical persons. Under the Soviet Union, single-family houses could be owned by natural persons, though they had only **revocable right of use** to the site. The Russian Federation has made full ownership more widely applicable to property (buildings) and introduced it as a form of tenure for agricultural and residential land (Russian citizens only). The tenant has the exclusive right to use the land or property in question, and can sell, lease, bequeath, or give it to others without restriction as to family relationship. (The Russian constitution forbids sale of ownership rights to land for the first ten years of ownership, and land leases are limited to five years or less.) A recent presidential decree extends full ownership tenure for both land and property to real estate used for business enterprises, whether owned by natural or juridical persons.

government. As used in the U.S. and in this report, all institutions empowered to make, interpret, or enforce the laws for a territorial jurisdiction. Russians generally use the term to describe the current officers of the executive branch of government only.

hereditary life tenure. A form of tenure for land created by the Soviet Union and continuing under the Russian Federation. The tenant has the right to use the land during his lifetime and may bequeath his rights to his children, but may not sell, lease, or give the land to others. If he has no heirs, the land reverts to the state when he dies.

indefinite right of occupancy. Our term for a form of residential tenure introduced by the Soviet Union and continued by the Russian Federation. It applies to the residents of multiple dwellings owned by state enterprises and municipal governments. The registered tenant of such an apartment has the right to occupy it during his lifetime, paying a nominal rent; but he loses that right if he reregisters at any other address. He can be evicted for nonpayment of rent, but the state is obliged to find him another place to live. If children are registered at that address, they inherit the right of occupancy. Voluntary exchanges

of apartments and rights thereto are permitted by law. Russian documents usually refer to this tenure as "rental."

joint stock company. A business enterprise whose ownership is represented by transferable shares of stock. The stock may be held by natural or juridical persons or even agencies of government. In the United States, the owners of a joint stock company are individually responsible for its debts and actions. We assume that this liability also applies in Russia.

juridical person. Any organization endowed by law with rights and responsibilities that are distinct from the rights and responsibilities of the natural persons who currently belong to the organization as members or stockholders or employees. Both U.S. and Russian law use this concept. In this report, it is used synonymously with corporation. **land.** The surface of the earth, considered as the site of human activity. A **parcel of land** is a bounded area treated as a unit for legal purposes, including title record and taxation.

leasehold tenure. A common form of real estate tenure in the U.S. Also adopted by the Soviet Union for property (buildings) but not for land; and subsequently broadened by the Russian Federation to include land. The tenant has the right to use the land or property (perhaps with restrictions stated in the lease) for a definite period of time, and pays an annual rent for this privilege. The Land Code of the Russian Federation sets the maximum length of a land lease at 50 years; there seem to be no limits on property leases. In the U.S., the leaseholder can usually sublet to others, but remains responsible for the annual rental payment to the lessor. In Russia, the leaseholder does not have the right to sublet.

legislature. The branch of government empowered by the constitution to make laws applying to the jurisdiction and its inhabitants. A western synonym is "parliament" for national legislatures or "city council" for municipal legislatures; the Russian synonym in both cases is "soviet."

limited ownership tenure. Our term for a form of property tenure created by the Soviet Union and continued by the Russian Federation. It usually applies to structures and fixed equipment built specifically for the use of a state or municipal enterprise. The property is carried on the books of the enterprise as a depreciable asset, and the enterprise is

responsible for its maintenance. The enterprise generally has the right to lease the property to others, but does not have the right to sell it. This form of tenure is unknown in the United States.

market value. A western expression for an estimate of the value of land or property, used for taxation and other official or private purposes. In concept, market value is the best price a seller could obtain for a specific parcel of land or property offered to the general public, when both buyer and seller are well-informed about other recent transactions. For unusual properties, market value is an elusive concept.

municipality. In the U.S., a chartered or incorporated city. Russians generally use the term to refer to the executive branch of such a city's government.

municipal enterprise. An organization engaged in manufacturing or trade whose budget and activities are subject to the control of a department of municipal government. These are usually enterprises whose activities are confined to the municipal jurisdiction, such as retail stores or service establishments.

normative value. A Russian expression for an official standard value of land or property, used for taxation or other official purposes. Normative values are usually scheduled to reflect significant differences in the characteristics of different parcels of land or property, but are set by policy rather than by market processes.

passport. The Russian term for a dossier maintained by the Bureau of Technical Inventory on each building within its jurisdiction. The dossier contains a detailed physical description of the building, a running account of its depreciated replacement cost, and a list of its owners or leaseholders.

privatization. Transfer of title to land or property from the state to natural persons or to joint stock companies whose stock is owned by natural persons or other joint stock companies.

property. In the United States, property includes land, structures, movable equipment and even ideas--anything to which a person or corporation can have exclusive rights of use under the law. Land and structures are called **real property** or **real estate**; movable objects are called **chattels** (from "cattle"). Patented or copyrighted ideas are called **intangible**

property. In Soviet usage, **property** (manmade objects) was distinguished from **land** (natural resources). **Immovable property** consisted of structures attached to the land, such as a building. **Movable property** consisted of objects or equipment that could be freely moved about such as an automobile or household furniture. This usage is continued in the Russian Federation; recent legislation also introduces the concept of **intangible property**--rights to ideas, designs, processes, etc.

real estate. A bounded parcel of land and all immovable structures on it. Although Russian law sharply distinguishes titles to **land** and **property**, a joint title to **real estate** is more common in the United States.

revocable right of use. A form of tenure for land or property (buildings) created by the Soviet Union. The tenant had the right to use the land or property for an indefinite period without payment, but the grantor--an agency of government--could reclaim it at any time. In Russian documents, this tenure is usually called "right of use." This form of tenure continues under the Russian Federation, except that tenancy is subject to an annual land tax.

state. A generic term for "government," usually referring to the highest level of government--formerly, the government of the Soviet Union, now the government of the Russian Federation.

state enterprise. An organization engaged in agriculture, forestry, mining, manufacturing, or trade whose budget and activities are subject to the control of a ministry of the Russian Federation. These are usually enterprises whose activities are regional or national in scope.

tenure. A specific set of rights and obligations held by a natural or juridical person with respect to a particular parcel of land or item of property (building or part of a building). The principal forms of tenure in the United States are **ownership, leasehold, or month-to-month rental.** In Russia, the principal forms are **full ownership, limited ownership, inheritable life tenure, leasehold, indefinite right of occupancy, and revocable right of use.**

title. Evidence of legal rights to land or property (buildings), usually a notarized document conveying those rights from their previous holder. Such documents are often lacking in Russia, where private transactions are rare.

Appendix B

SOURCES OF INFORMATION

Monographs and Articles

Michael Alexeev, Lee Baker, and Matthew Westfall. *Overview of the Soviet housing sector*. Prepared for the Office of Housing and Urban Programs. U.S. Agency for International Development. PADCO, INC.: Washington, D.C., December 1991.

Charles Hanson, Nadezhda Kosareva, and Raymond Struyk. *Housing reform in the Russian Federation: A review of three cities and their transition to a market economy*. Prepared for the Office of Housing and Urban Programs, U.S. Agency for International Development. The Urban Institute: Washington, D.C., March 1992.

Nadezhda B. Kosareva. *Current problems of the transition to the market in housing*. Institute of Economic Forecasting of the Academy of Sciences of the USSR: Moscow, undated (c. December 1991).

Bertrand Renaud. *The housing system of the former Soviet Union: Why do the Soviets need housing markets?*. Public lecture presented at the Fannie May University Colloquium Series, University of California at Los Angeles on 5 March 1992. The World Bank: Washington, D.C., March 1992.

Laws, Decrees, and Regulations¹

Law of the RSFSR on privatization of housing and land. Supreme Soviet of the RSFSR. Approved 4 July 1991.

Leningrad housing reform guidelines. A report of the Standing Committee on Housing Policy of the Leningrad City Soviet of People's Deputies. 2 April 1991.

1. Russian texts of key federal and municipal documents have been translated in whole or in part by various interested parties, including newspapers, international agencies, and private organizations. Some items listed here were translated at my request by consultants to the Urban Institute. Available and commissioned translations used by this study are on file at the Moscow office of the Urban Institute. Translations of key passages were checked against Russian originals by Olga Kaganova.

Procedure for estimating land tax rates from normative land cost. Decree of the Committee on Land Reform [?] of the RSFSR. 25 February 1992.

Temporary regulation on land payments in the City of Moscow. Appendix No. 5 to Decree No. 174a of the Moscow Government. 31 March 1992.

Law of the RSFSR on payment for land. Supreme Soviet of the RSFSR. Approved 11 October 1991.

Procedure for valuing buildings, premises, and facilities owned by citizens. Order No. 87, Ministry of Architecture, Construction, and Housing of the RSFSR. 4 April 1992.

Law of the RSFSR on taxes on property of natural persons. Supreme Soviet of the RSFSR. Approved 9 December 1991.

Law of the RSFSR on the fundamentals of the taxation system. Supreme Soviet of the RSFSR. 27 December 1991.

Decree on land sales to citizens and juridical persons in the process of privatization of state and municipal enterprises. President of the RSFSR, Decree No. 301. 25 March 1992.

Decree on assignment norms for free transfer of land to citizens. President of the RSFSR, Decree No. 213. 2 March 1992.

Model regulation for privatization of housing resources in the RSFSR. State Committee for Housing and Public Services of the RSFSR. Approved 18 October 1991.

Land code of the RSFSR. Supreme Soviet of the RSFSR. Approved [DATE?]

Property Law of the RSFSR. Supreme Soviet of the RSFSR. Approved [DATE?].

Temporary provision on privatization of housing stock in St. Petersburg. St. Petersburg Soviet of People's Deputies [?]. Approved [DATE?].

Persons Interviewed by Study Team, 20 May - 10 June 1992²

Igor N. Rodionov, Director, Joint Stock Company "YUTA" (Real Estate Brokerage). Moscow, 20 May 1992.

Valeri V. Avdeev, Deputy Chairman, State Committee of Housing and Municipal Economy, RSFSR. Moscow, 21 May 1992.

Nikolai T. Lopatkiin, Deputy Chairman, State Committee of Housing and Municipal Economy, RSFSR. Moscow, 21 May 1992.

Tatiana Zhagulo, Director of Planning and Forecasting, Department of Privatization, Moscow Housing Committee. Moscow, 21 and 29 May 1992.

Andrei V. Lazarevsky, Advisor, Commission on Land Policy, Moscow City Council of People's Deputies. Moscow, 22 May 1992.

Igor N. Shoostov, Chairman, Commission on Land Policy, Moscow City Council of People's Deputies. Moscow, 22 May 1992.

Yuri A. Grafov, Director, Moscow Bureau of Technical Inventory. Moscow, 25 May 1992.

Nicolai V. Maslov, Director, Department of Privatization, Moscow Housing Committee. Moscow, 26 May 1992.

Sergei P. Melnichencko, First Deputy, Moscow Committee on Land Reform. Moscow, 28 May 1992.

Michael Petrovich, Head, Department of Land Cadaster, St. Petersburg Institute of General Planning. St. Petersburg, 1 June 1992.

Victor Danilov, Chairman, St. Petersburg Housing Committee. St. Petersburg, 2 June 1992.

2. All interviews were conducted with the aid of a professional interpreter. In addition, one member of the study team, Olga Kaganova, is bilingual.

Sergei Sai, Chairman, St. Petersburg Land Reform Committee. St. Petersburg, 3 June 1992.

Natalia A. Malysheva, Deputy Director, St. Petersburg Economic Development Commission. St. Petersburg, 3 June 1992.

Alexei E. Saharov, Director, St. Petersburg Bureau of Technical Inventory, St. Petersburg, 3 June 1992.

Vladimir V. Artemyev, Director, Petrograd District Field Office, St. Petersburg Bureau of Technical Inventory, St. Petersburg, 3 June 1992.

Lydia Korovko, Head, Department of Registration, St. Petersburg Fund for Property. St. Petersburg, 4 June 1992.

Andrei Pritkov, Vice Chairman, Housing Policy Committee, St. Petersburg City Council of People's Deputies. St. Petersburg, 4 June 1992.

Valentin Gorunoff, Director of Privatization, Moscow Department of Property. Moscow, 10 June