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**TRANSITION IN THE RUSSIAN
HOUSING SECTOR:
1991-1994**

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EXECUTIVE SUMMARY

As late as 1991, the Soviet Union may have had the most regulated housing market in the world. For generations regulation had almost completely replaced normal market relations in the production and allocation of housing, although informal, implicit market relations had some role. In mid-1991, the USSR, and then the Russian Federation, began the daunting task of reorienting the housing sector to market principles. The potential gains of succeeding are enormous. The housing sector was evaluated in the famous Shatalin report as the least efficient sector in the economy--as measured as the ratio of the cost of inputs to the price of outputs. Improving efficiency would have a major impact on the economy because of the size of the sector. Housing stock accounts for 20 percent of the nation's reproducible wealth; housing investment is about 25 percent of all investment; and 13 percent of the labor force is employed in housing construction and maintenance. At least as important, however, are the difficult living conditions for most Russian families: they queue for years for an apartment and then live in a small unit with undependable utility services, in a building that is very badly maintained. Thus, improving housing conditions means significantly improving the quality of life of the average citizen.

This volume inventories accomplishments to early 1994 in the housing reform program, dated as beginning in July 1991--the time of the passage of the version of the housing privatization law that had a real impact on unit transfers. The achievements are perhaps surprisingly formidable, and certainly compare favorably with any country in Eastern Europe.

Early 1994 is an appropriate time for such a review, as the combination of the surprisingly strong showing of the extreme right in the December national elections, the meeting of the new Federal Assembly, the changes in ministers with responsibility for economic policies, and the introduction of the new constitution could well signal a change in the pace, if not the direction, of housing reform.

Our general conclusions can be succinctly summarized. The Russian Federation has acted with dispatch to create much of the legal framework necessary for transformation of the housing sector to one operating under market principles. In the opening chapter we outline a series of policy changes that were defined in the spring of 1992 as needed for the reorientation of the housing sector. A critical review of accomplishments against this list shows an impressive record. While additional legislation in mortgage finance and land is needed, as well as the implementing codex for the Law on Fundamentals of Housing Policy in the Russian Federation, much can be done--and has been done--within the current legal foundation.

Equally important, progress is being made on the realization of the transition.

Housing privatization is a clear success in terms of the volume of units being transferred to their occupants (about 25 percent of eligible units by the end of 1993), although its momentum has significantly diminished since the peak in the first quarter of 1993. Additionally, the government has taken the critical step of creating the regulations on formation of condominiums, and associations have already been registered in Moscow.

Reform in the rental sector is well underway. Implementation began in January 1994 of the program of raising rents to cover full operating costs combined with the simultaneous introduction of housing allowances. The most severe problem for the sector remains the improvement of housing maintenance. The additional revenues from higher rents are essential but so is a change in the incentives under which maintenance firms operate. The positive results of the USAID-experiments in Moscow and Novosibirsk with competitively selected private contractors are stimulating other jurisdictions to emulate them.

Regarding housing construction, even over the past two years there has been a distinct shift away from the traditional panelized construction technology. Announced Federal government policy is in favor of low-rise and cottage housing. Privatization of the industry is well underway, although the largest firms appear to be resistant. At the same time small, new private firms have increased their market share significantly.

Russia began the transition with a particularly undeveloped finance system and a limited number of capable bankers. Housing finance as known in market economies scarcely existed. Against this backdrop and Russia's difficult inflationary environment, there has been a surprising interest in long-term mortgage lending by both the government and the banks. The signing of the Presidential Decree in this area has set the stage for establishing much of the necessary infrastructure for such lending. In addition, a mortgage instrument suitable for the Russian environment has been created. A few commercial banks have begun mortgage lending without government subsidies, using a variety of techniques to limit their risks. On the basis of this step-by-step progress, and the eventual passage by the Federal Assembly of the critical Law on Mortgage, a substantial volume of lending can be expected when economic conditions improve.

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1. THE SOVIET HOUSING LEGACY AND WHAT TO DO

As late as 1991, the Soviet Union may have had the most regulated housing market in the world. For generations regulation had almost completely replaced normal market relations in the production and allocation of housing, although informal, implicit market relations had some role. In mid-1991, the USSR, and then the Russian Federation, began the daunting task of reorienting the housing sector to market principles.

The potential gains of succeeding are enormous. The housing sector was evaluated in the famous Shatalin report as the least efficient sector in the economy—as measured as the ratio of the cost of inputs to the price of outputs. Improving efficiency would have a major impact on the economy because of the size of the sector.¹ The housing stock accounts for 20 percent of the nation's reproducible wealth; housing investment is about 25 percent of all investment; and 13 percent of the labor force is employed in housing construction and maintenance (Gosstroi, 1993). At least as important, however, are the difficult living conditions for most Russian families: they queue for years for apartments and then live in small units with undependable utility services, in very badly maintained buildings. Thus, improving housing conditions means significantly improving the quality of life of the average citizen.

This volume inventories accomplishments to early 1994 in the housing reform program, dated as beginning in July 1991—when the housing privatization law that truly spurred unit transfers was passed. The achievements are perhaps surprisingly formidable, and certainly compare favorably with any country in Eastern Europe.

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In the balance of this introduction we briefly review conditions at the beginning of the transition and set out a blue print for reforming the housing sector along market lines. The blue print is important as it provides a standard against which to measure the reforms actually undertaken. Subsequent chapters discuss reform legislation and policies and then developments, respectively, in housing construction, real estate markets, rental housing, and housing finance. The book closes with some brief conclusions.

¹ Cited in Kahn and Peck (1991), Table 3.1.

The Soviet Housing Sector²

In general, it can be said that Russia has had a continuous housing crisis for many years. This was the result of a policy of "state paternalism" directed at maximum socialization of housing and the near-exclusion of market forces from the housing sector. The key principles of this policy were:

- Centralized distribution of all resources and strictly formalized planning of the volume and distribution of new housing construction;
- Use in practically all regions of the country of standardized multi-floor building construction plans, with the housing constructed by a small number of big kombinants;
- Extreme state monopolization of the construction complex and housing maintenance facilities;
- Financing of all state housing construction exclusively from centralized assets of the state budget or of state-run enterprises;
- Near-total subsidization of housing and maintenance organization activity through various forms of state funding;
- The constitutional guarantee of housing provision at a low cost (strong rent controls);
- The dominant role of a single, state-operated system for distribution of housing which operated through local waiting lists.

Thus, the goal of housing policy was almost completely directed toward the establishment and development of only one form of housing—state-owned units.

"Official" methods for resolving the housing problem boiled down to an endless line in which people waited to receive state housing. In fact, the manner in which the line was administered greatly contributed to the housing shortage because of the lack of incentives in the system for adjusting housing consumption: elderly couples and widows continue to occupy the larger units obtained during the child-rearing years.

The Russian Federation currently occupies one of the lowest positions among developed nations in housing fulfillment, with an average of 16.7 square meters of

² For other descriptions of the Soviet housing system before the major reforms, see, for example, Andrusz (1990), Kalinina (1992), Bessonova (1992), and Ruble (1993).

total space for each occupant and an average of only 16.0 square meters in the cities in 1992.³ According to data from the 1989 All-Union Census, only 83 percent of families and single persons in the RSFSR (previous name of the Russian Federation) had individual dwellings—meaning a separate apartment, single-family house, or portion of a house. The rest of the population is forced to live in communal apartments or dormitories, or with no permanent home (see Table 1.1)

Table 1.1

Percent Distribution of Families and Single People According to Dwelling Type			
	RSFSR	Urban Settlements	City of Moscow
All families and single people	100%	100%	100%
Those living in:			
Private (self-contained) apartments	56.7	65.1	77.2
Single-family houses	23.8	12.0	0.1
Communal apartments	6.8	8.7	15.5
Portions of houses	2.8	2.7	0.1
Dormitories	6.2	7.7	5.2
Other housing or sublets	1.4	1.4	0.1
Type of housing not indicated by respondents	2.3	2.4	1.8

Source: Based on data from the 1989 All-Union Census.

However, even these figures do not fully convey the real picture. They do not, for instance, reflect the natural desire of "complex families" (composed of several married couples and relatives of several generations) to live in separate nuclear units. According to some calculations, taking the desires of these families into account, the number of families and single persons lacking a private dwelling is at least 35 percent, and in the cities it is at least 45 percent (Kosareva, 1992).

³ "Level of housing space provided" used to be the main indicator for establishing social norms, tabulating statistics, and making predictions.

The solution which the government proposed to answer the housing problem led in the end to an increasingly longer line for the issuance of "free" housing, a line in which every fifth family is standing today: in 1986 - 8 million, 1988 - 9 million, 1992 - 10 million families and individuals.⁴ The system of distribution itself—which encouraged families to overstate their housing problems to the maximum degree—was a constant artificial stimulant for increasing *measured* housing shortage. Only households having living space of less than 5-7 sq.m. per person can receive the right to rent a new heavily subsidized municipally-owned flat. The standard space allocation is 12 sq.m. of living space per person.⁵

The housing shortage has increased in the past few years due to a catastrophic drop in housing construction brought about by overall economic collapse, a sharp reduction in state subsidies, and the sudden reduction in purchasing power of the population. In 1991, new housing construction was down 33 percent from what it was in 1987 (Goskomstat RSFSR, 1991). In 1992 it dropped 23 percent from 1991 (data from Gosstroi of Russia).

Combined with the overall decline in volume of state housing construction, the sale of some new state units sharply reduced the amount of housing available to those awaiting rental units. In the first quarter of 1992, only 67 percent of families receiving housing moved into new apartments, compared to figures from January to March of the previous year (Goskomstat, 1992). Meanwhile, in 1992 every fourth family in Russian cities was waiting for a state apartment, with an average wait of seven to eight years.

If the problem of the city dweller is the quantity of housing and the availability of separate units, the country resident is in the main concerned with the condition of the housing stock. Housing quality tends to have an inverse relation with the size and category of the population center. The state policy of industrialization and development of large urbanized industrial zones totally ignored the problems of providing engineering infrastructure in small cities and rural population centers. As a result, every fifth house in cities and towns is without running water, sewerage, and central heating; for public housing in the countryside this figure is 55-60 percent of all apartments (Goskomstat of the Russian Federation, 1991, p.212).

A catastrophic situation has developed in the area of housing maintenance. In previous years, expenditures for maintaining state housing were paid primarily by direct and indirect government subsidies. Because of almost complete elimination of these subsidies from the federal budget, redirection of part of the rents from commercial space to other uses, increased cost of building materials, and higher

⁴ Goskomstat of the Russian Federation, 1992c), Goskomstat of the RSFSR, 1991, p.213.

⁵ On average, total space is about 150-160 percent of living space.

housing and utility labor costs, local budgets are not able to afford proper housing maintenance.

Rising energy costs brought with them residential utility bills that increased three- to five-fold in January 1992 alone. These costs doubled again between January and May and have risen further since. Actual energy costs have far outstripped what the population paid, necessitating increased subsidies. Without fundamental change in the financing system for housing and utilities, particularly rent increases, it is highly unlikely that city budgets will be able to survive the approaching crisis.

The Russian housing stock is rather new: 89 percent of all dwellings have been built in the last 40 years.⁶ However, the overall technical condition of the housing stock can be characterized as very bad. One indicator of this situation is that funds for capital repairs have consistently provided only for half of the repairs actually required.⁷ According to official statistics the share of the housing stock rated as dilapidated or condemned ranges from 1.2 percent⁸ to 7-9 percent.⁹

State-oriented housing policy pursued in the country in past years produced the overall housing crisis. Because of its importance in the total housing stock, the authors believe attention must be focused initially on reforming the state housing sector.

Characteristics of the State Housing Sector. One of the elements which sets the housing situation in Russia apart from other Eastern European countries is the nearly complete implementation of maximal government control of the housing sphere.

State housing represented 79 percent of housing in Russian cities in 1990, and 67 percent in the country as a whole (Table 1.2). Practically all the housing inventory in large cities was owned by the state. In Moscow, this accounted for 89.5 percent of housing; in St. Petersburg, 84.4 percent; in Ekaterinburg, 87.3 percent; and in Novosibirsk, 80.4 percent. Under the Soviet model, construction of new state housing was funded directly or indirectly by the national government.

⁶ Center for Economic Forecasting, 1992, p.74.

⁷ Goskomstat of the RSFSR, 1991, p.213.

⁸ Goskomstat of the Russian Federation, 1992, p.111.

⁹ Data provided to the authors by Gosstroi of the Russian Federation; Gosstroi is the State Committee for Architecture and Construction.

Table 1.2

Housing Structure of the Russian Federation and the City of Moscow, June 1990 (Percent of total area)				
Forms of Housing Owned	Total Housing	Rural Housing	City Housing	Moscow
Total housing, including:	100%	100%	100%	100%
State, of which	67	37	79	90
Local council (municipal) funds	25	2	35	70
Enterprise and institution funds	42	35	44	20
Public, e.g. kolkhozs	3	9	1	0
Housing construction cooperatives	4	0	5	10
Owned by individual citizens	26	54	15	0

Source: Goskomstat RSFSR, 1991; Moscow City Council Bureau of Technical Inventory, 1991.

State housing property is neither homogenous nor controlled by a single authority. According to the law (Housing Code of the RSFSR, 1991) "state housing was under the control of Local Councils of Peoples Deputies [Housing Fund of the Local Soviets] and the ministries, state committees and agencies [Departmental Housing Fund]." In 1990 the share of local soviets (municipal) housing within the state stock was 37 percent, with departmental units making up the balance. Apartments in buildings that belong to the state housing stock are rented to citizens for an unlimited time. Establishment of legal limits on rents and housing privileges were the prerogative of the USSR Council of Ministers (RSFSR Housing Code, 1991). Rents that were established in 1928 at 13.2 kopecks a month per square meter and 16.5 kopecks a month per square meter for space in buildings with high levels of amenities, remained largely unchanged until 1994. Thus, in 1990 rents constituted approximately 1 percent of income for a manual or office worker's family, and 2.5 percent if utilities are included. The remainder of funds for housing maintenance (80 percent) came from state funds: 60 percent from the state budget and assets of state enterprises, and 20 percent from the income of housing and maintenance organizations including rents from commercial space. Communal services (utilities) were also subsidized at 80 to 90 percent.

In spite of the ever-present subsidies, the total funds available for maintaining the stock were never sufficient to cover the estimated full cost of keeping the housing in good repair. Nevertheless, "profits" were routinely recorded by the state maintenance companies. In Moscow in 1990, for example, these organizations

actually showed a 27 percent profit (!).¹⁰ The management companies have a strong incentive to show a profit, even if funds are insufficient to provide decent maintenance, because special payments for vacations and "bonuses" come from profits.

The strategy of maximal socialization of the housing sector is also reflected in the extreme monopolization of housing maintenance by state housing, maintenance, repair, and construction services. For example, in Moscow the maintenance of municipal housing was carried out by 479 repair and maintenance boards. Each board employs 100 to 150 workers and serves 150,000 to 400,000 square meters of living space, with 8,000 to 25,000 tenants.¹¹ This monopolistic structure clearly discouraged efficiency and initiative.

Renters of apartments in buildings that belong to the state housing stock have a very wide range of rights. There are practically no legal means (or at least none that are actually used) to evict them without providing them another residence. Until the end of 1992 there was no provision for eviction for not paying rent. Past due rent owed by renters in the RSFSR is 10 percent of the yearly total (Goskomstat USSR, 1990). According to the latest data, rent arrears reached 40 percent in Moscow in the first quarter of 1990—although this figure overstates the severity of the situation as many families regularly pay several months' rent each time they make a payment.¹²

In a situation of total dominance of state-owned housing, the first step of reform, the transfer of housing to municipalities and private owners, was seen as the most obvious, simple, and cheap means of improving the housing system. In accordance with the declaration, "On Delimitation of State Property in the Russian Federation," of 1991 (and a subsequent act in 1992), together with the corresponding infrastructure, housing maintenance and repair and construction organizations, was transferred to the municipalities from local soviets. The housing stock of state enterprises and organizations (the "agency" housing stock) remained state property.

The transfer to the municipalities removed a burden from the federal budget and shifted responsibility for housing construction, distribution, and maintenance to local authorities. Unfortunately, this process was begun in conditions of strict state control of rents. High inflation led to a sharp increase in housing maintenance costs. When subsidies from the federal budget almost completely disappeared, local

¹⁰ Not taking into account capital repair. USSR National Statistics Office, 1991, Table 1.3; Moscow Engineering Support Department data, 1992.

¹¹ Moscow Engineering Support Department, 1992.

¹² Rents are small and the process of making payments at the State Savings Bank is time consuming. So there is a clear incentive to bunch payments.

budgets were not able to support the burden of maintaining the stock. A conflict began at the local level regarding the use of rent revenues from commercial space (previously these had been dedicated to housing maintenance), as other city agencies now sought these funds to support their operations. In 1990 housing maintenance budgets covered only 60-70 percent of the required amounts, but by 1992 this share had declined to a mere 25-30 percent.¹³

In addition to its other problems, the existing system is inefficient in the distribution of subsidies. State housing subsidies are higher for higher income families. As housing is virtually free, subsidy payment is based on the number of square meters of housing in an apartment; thus, the larger the apartment, the greater the subsidy. And higher income (where income includes both cash and in-kind payments) households do live in larger housing units.

Personal and Cooperative Housing. About 26 percent of the housing stock in Russia is single family housing that is the personal property of individual families, often referred to as "individual housing." In urban areas it makes up 15 percent of the stock and in rural areas 54 percent. Prolonged prohibitions on individual housing construction in cities of over 100,000 population, as well as universal difficulties in obtaining land plots, buying building materials, and securing loans virtually halted construction. Consequently individual housing accounted for only 5-6 percent of new construction during the 1980s. Much of this stock was not equipped with communal services—about two-thirds of the units lack piped water, sewerage, and hot water heat—and has nothing in common with modern single-family housing.

In addition, ownership rights were limited. First, without the possibility to sell and purchase land, families were allocated plots by local soviets in accordance with waiting lists. One could not be placed on such a list without the special residential permit (*propiska*). Second, according to the housing laws of the RSFSR, individual housing could not be exchanged, i.e., swapped, until recently for a state-owned dwellings. While important in the cities, this restriction had little effect in rural areas where state housing construction was negligible.

There were also restrictions on the right to rent private houses. Private rents could not be more than the rent in the state rental sector, i.e., more than 16 kopeks per square meter of living space per month. If higher rents were charged and the owner was caught, the property could be seized by the state, according the "housing codex."

¹³ According to data from the Program HOUSING (described in the next section), prepared by Gostroi and the Ministry of Economy.

With State rental housing strongly favored during most of the Soviet period, it is not surprising to learn that little financing was available for those who wished to build their own homes and were living in small towns and rural areas where such construction was permitted. It was only in the 1980s when policy changed to encourage some private investment in housing to supplement the State's effort that long-term financing became available, although in sharply limited amounts which were determined annually in the overall economic plan.

In the early 1960s house-building cooperatives began to develop under more permissive legislation. They are concentrated in urban areas and constitute about 4 percent of the housing stock.¹⁴

Under cooperative ownership, the flat is considered the collective property of all the members of the coop. Until recently the rights of any member were limited to receiving the cash payment of his contributions to the coop upon leaving it.¹⁵ The rights of cooperative as a collective body were also limited and were regulated by normative statements. Cooperative membership was not connected with the desire of joint living of some socially connected group of people. Membership was restricted to those who had less than an established norm (8-9 sq.m. of living space per person). The location, unit sizes, and design were all regulated by government bodies. Separate waiting lists were maintained for cooperatives, and families were often simultaneously on municipal, departmental, and cooperative waiting lists. The volume of construction was determined by the state planning agency.

Families living in housing cooperatives and privately owned individual houses in the end pay for most capital and maintenance costs, which according to our calculations (based on 1990 data) will be seven to eight times higher than similar costs for people living in state housing. Studies also show that those in state housing are not in the lowest income group. Rather, it is their social status that has gained these people access to "free" housing. Thus, in spite of the customary propaganda about Russia's having the cheapest housing in the world, the 30 percent of the Russian population in coops and individual houses is paying nearly the full price for housing, without having any greater freedom of choice than those living in free state housing.

¹⁴ For a general description of the history and financing of housing cooperatives, see Andrusz (1992).

¹⁵ In late 1988 the first steps in privatizing cooperative housing were made: flats whose owners had fully paid their share of the funds borrowed to build the coop were made the property of their owners. "On Measures to Accelerate the Growth of the Housing Cooperative Movement," Resolution of the CPSU Central Committee and the USSR Council of Ministers of March 31, 1988, no. 406; published in SP SSSR [Collection of Resolutions of the USSR], 1988, no. 16.

A Blueprint for Reform

The need for fundamental housing reform has been a topic of widespread discussion in the Russian Federation from the early years of political and economic reform of the Gorbachev era. The task of creating an economic mechanism to dramatically improve the housing system had become paramount by the beginning of the 1990s (Andrusz, 1990). For too long housing had been removed from the consumer market and considered nonviable. There had been no mechanism for allowing a family to have the housing that is appropriate to its needs and in accordance with its ability to pay. The goal of housing reform must be market regulation of housing relations. As early as May 1990, the president of the USSR formally declared the necessity for creating conditions for this move to the market.

By early 1992 it was recognized by experts that effective and consolidated housing reform had to take the following steps:¹⁶

- change the existing conditions of housing ownership by converting state housing into private and municipal ownership;
- clarify property rights for land and real estate as a whole;
- use the price mechanism to allocate dwelling units;
- establish principles for real estate assessment;
- develop new mechanisms for housing finance and credit;
- demonopolize and privatize construction, repair, and maintenance organizations;
- determine principles and methods for guaranteeing socially acceptable housing conditions for disadvantaged portions of the population;
- provide for an other solution to resolve the problems of those still in line for apartments from the old system.

Initially reform moved on only one front—shifting the ownership of housing away from the state. In a situation of state dominance of housing ownership, the transfer of housing to municipal and private ownership was seen as the most obvious, simple, and economical means of improving housing relations. This policy

¹⁶ Renaud (1991), Telgarsky and Struyk (1990).

was directed toward removing a burden from the federal budget and transferring responsibility for resolving the housing crisis to local authorities.

On June 4, 1991, the Russian Supreme Soviet passed the law establishing a new procedure for transferring state and municipal housing to private ownership of tenants. This type of low-cost or no-cost privatization program raises a number of issues. On the one hand, establishing such conditions for privatizing housing is in itself the most beneficial approach possible for mass privatization of housing. On the other hand, leaving housing rents unchanged and leaving renters with very wide-ranging rights gave the tenant few reasons to seek privatization, aside from the capital gains to be realized or rent to be received if the family emigrates or moves to another unit. (See Chapter 4 for further discussion of privatization.)

In early 1992 as the privatization process was just gaining momentum, the following reform agenda, including numerous actions for the federal government, was prepared for the City of Moscow. We summarize it here both because it still offers a useful blueprint for reform and because it provides a good standard for us to use in later chapters to measure the actual reforms achieved to date.¹⁷

Rental Housing

- Just as the Russian Federation moved to privatize the ownership of rental housing, it must privatize the maintenance of the municipal rental stock and increase tenant control of their buildings. This will improve both the quality of maintenance services and tenant satisfaction.
- Rents must be increased gradually over time (perhaps three to five years) to at least a full-cost basis. Without higher rents, funding for maintenance will always be insufficient.
- The introduction of housing allowances to protect the disadvantaged from the full impact of rent increases must be announced and implemented at the same time increased rents are announced.
- A market for private rentals will develop if the incentives are effective. There should be no controls on the rents of privately owned units. Occupants of private rentals should be eligible for housing allowance payments under the same criteria as families living in municipal housing. Payments should be on the computed on the same basis for all participants.

¹⁷ Based on Struyk and Kosareva (1992).

- Tenants of municipal and departmental housing enjoy extraordinarily strong rights of occupancy, in practice including protection from eviction for non payment of rent. These rights need to be reduced to create a more reasonable balance with those of owners.
- To encourage rational adjustments of housing usage, there should be no restrictions on exchanges of municipal units, including prohibitions against cash payments for occupancy of larger or better units.
- The rules for getting on the waiting list for improved housing should be changed. Only families whose income is low enough to qualify for a housing allowance subsidy will be added to the list.

The rules for receiving improved housing would remain in effect for those already on the waiting list. However, with the introduction of the system of higher rents coupled with housing allowances, higher income families who are allocated State units will soon pay the full cost of all services. It is likely under these conditions that such families will elect to obtain housing through purchase or through exchanging apartments rather than waiting years for the official allocation.

Privatization

- Continue privatization but take two additional steps to stimulate sales:
 - (a) Increase rents on municipal and department units. This will stimulate sales by increasing the tenants' estimate of the value of the housing asset that can be received free of charge.
 - (b) Announce a fixed time limit for free-of-charge privatization—perhaps a one year period beginning in the summer of 1994. This will focus tenants' attention on the privatization decision. Once ownership is clarified, property management in privatized and rental buildings will be easier.
- Immediately legislate and implement a good condominium law under which partially and fully privatized buildings will operate. This law will clarify owners' rights and encourage better maintenance.

New Construction

- Three principles should guide actions to stimulate production over the next two years:

- (a) With little funding for investment available for new municipal rental housing, production should be exclusively or largely of units for sale.
 - (b) Any subsidies for new construction should be through payments to purchasers to help them with their down payments. The subsidies would depend on the purchasing family's income and should not go to developers. Effective support for developers can come through construction period financing plus the guarantee of mortgage finance for completed units.
 - (c) To increase the effective demand for new units, mortgage finance must quickly be made available on reasonable terms but without subsidies on interest payments.
- All possible steps should be taken to demonopolize the residential construction industry.
- With regard to exclusively using subsidies to purchasers to stimulate new construction, the following should be noted:
- (a) There is evidence from countries around the world that subsidies to developers are inefficient compared to those given directly to consumers. Very often developer subsidies are not passed on to consumers in the form of lower prices. Rather, subsidies raise developers' profits or encourage them to be inefficient. Another problem with subsidies to developers is that they go, in effect, to all purchasers and are not targeted at those least able to pay.
 - (b) Using only subsidies to purchasers will lead developers to build housing of the type consumers want.
 - (c) Subsidies should be in the form of assistance with the down payment and should be fully paid at the time the family purchases its dwelling unit. Such subsidies have the advantage (compared to those on the interest payments on a loan for purchasing the unit) of being easy for the beneficiary and the state to value and of providing the maximum assistance to the family at the moment of purchase.
 - (d) The subsidy would be available only to families on the waiting list for improved housing; those having received a private flat would not be eligible as the state has already given them a large capital transfer. Larger subsidies would go to lower income families and those who had been on the waiting list for more years.

- With regard to mortgage finance, below are three key points:
 - (a) Banks making mortgage loans should shift to an indexed instrument that will dramatically increase the size of the loan for which a family can afford to make payments. These loans are commonly used in countries with high or volatile inflationary environments. They are now used in Poland and have been adopted in Hungary.
 - (b) Sberbank should provide an adequate volume of credit and should change to more suitable mortgage instruments.
 - (c) Any bank making mortgage loans must take extraordinary care to manage the risks associated with changing interest rates, especially divergence in the cost of funds and the interest rates on outstanding mortgage loans.

Allocation of Newly Constructed Units

- Sales of new units should be at market prices through an orderly process (subsidies are in the form of down payment grants, described above).
- Auctions should generally not be used because they will favor those who can pay cash over those who need to obtain the down payment subsidy and/or mortgage financing.
- Agents for developers should take applications for purchase during the construction period and be prepared to sign purchase contracts whose enforcement is contingent upon the purchaser obtaining mortgage finance and/or his down payment subsidy within a reasonable period, such as 60 days.

Characteristics of the Housing System of the Future. If the above actions were in fact carried out, how would the housing market appear? Within a period of seven to ten years (from 1992), Russia could have a housing market with the following attributes:

- It will be difficult to distinguish municipal from private rental units. Low-income families will be able to rent a unit from the municipality or private owners using their housing allowance payments. The competition from private owners will pressure public and private owners to more closely monitoring their housing stock.
- Housing maintenance will be better, supported by higher rents and new forms of management. District governments will be responsible for the municipal

housing in their regions, but they will not directly provide maintenance and other management services. Rather, they will contract for these services, either from those public enterprises that prove to be competitive or from private companies.

- Numerous firms will produce new housing of a variety of types. The demand for this housing will be fueled by a mortgage lending system that provides financing to most families at affordable interest rates.

The challenge in early 1992 of reforming the housing sector in the Russian Federation was hard to overstate. The foregoing should make clear the large number of different but related steps that must be taken and coordinated. The question addressed in this volume is the extent to which the Russian government has been able to meet this challenge over the past two years. As suggested, our overall assessment of the record is quite positive.

2. LEGAL AND BROAD POLICY DEVELOPMENTS

Since the summer of 1991 the Russian Federation has moved with alacrity to establish the basic legal framework for a market oriented housing sector. This section reviews the major pieces of legislation, as well as the major policy statement based on this corpus of legislation. Taken as a whole they represent an impressive accomplishment. Naturally, when legislation is enacted at this speed with responsibility divided both among numerous committees of the Supreme Soviet with imperfect coordination and between the legislative and executive branches, some defects will be present. These can be remedied; more important is that a solid basic structure has been established upon which one can build.

Major laws and the policy statement are summarized individually in this section. Later sections introduce the provisions of other laws important for certain aspects of housing reform, e.g., deductions in the income tax.

Before examining specific legal developments, three characteristics of housing law with the Russian legal framework are worth noting. First, housing policy is defined in the December 1993 constitution and before this in the treaties between the Russian Federation and the constituent republics, krais, oblasts, autonomous subdivisions of the Russian Federation and the autonomous municipalities of Moscow and St. Petersburg to be under the joint jurisdiction of the Federation and these lower level governments. (Often in this book we refer to these lower governments collectively as "republican governments.") This means that the Russian Federation passes broad enabling legislation and then the subordinate governments enact their own measures to implement the general provisions, through the adoption of both legislation and regulations.¹⁸ In some cases, such as the law privatizing housing, implementing legislation is needed at the lower levels.¹⁹

Second, even at the Federation level, legislation is sometimes two-tiered. The first law will be a broad enabling act. This will later be elaborated upon in a subsequent act, often called a "codex." Many countries handle this type of refinement through the issuance of regulations by the responsible ministry. In Russia, however, both options are available; and the codex is generally chosen as the vehicle for legislation that defines the whole policy structure for a sector.

¹⁸ In these attributes the allocation of responsibility resembles that in the Federal Republic of Germany and Canada.

¹⁹ Under the 1990 law, "On Local Self-Administration in the RSFSR," it was declared that housing, the engineering and utility infrastructure to support it, and communal enterprises serving the population located on a given territory would be municipal property. These provisions were later confirmed in 1991 under the law, "On Property Rights in the RSFSR."

Third, the President has had broad powers to issue decrees. Until the adoption by referendum of the December 1993 constitution, these had the force of law and y were valid unless vetoed by the Supreme Soviet or struck down by the Constitutional Court as contradicting existing law. The President retains the power to issue decrees under the new constitution. However, in principle the scope of such decrees will be more limited than previously.

Constitutional Provisions

Amendments to the Constitution. The Seventh Congress of People's Deputies, convened in December 1992, passed two amendments to the Constitution of the Russian Federation critical for housing reform.

Article 58, dealing with the rights of citizens to housing at a low price, was replaced with a much more market-oriented variant. In part, the new article stated that the state's obligation to provide housing can be satisfied by the household's purchase or construction of housing at its own expense, the provision of housing through the *naym* (social housing) contract, through payments of housing allowances, or subsidies for construction, maintenance or rehabilitation of housing.

The amendment to Article 12, part 3, removed the restrictions on the right in the housing sector to freely possess, use and dispose of land plots owned by individuals. This amendment struck down important restrictions on sale, including a substantial waiting period before the land can be sold after it is obtained—a provision designed to thwart speculation. Note, however, that even under this amendment land could only be sold completely without restriction if the use of land remains residential.

The New Constitution. The housing provisions of the new constitution (in Article 40) reaffirms the right to housing and state that the federal and lower levels of government "encourage housing construction and create the conditions for exercise of the right to housing." The final provision, however, gives the state the task to provide housing "free or at affordable cost to low-income and other citizens indicated in the law..." This represents a significant shift from the amendments to the prior constitution a year earlier in the direction of reassertion of state responsibility. Thus far this provision has not affected specific policy measures, but it could be used by those wanting to veer away from market-oriented reform.²⁰

²⁰ The constitution's provisions on land are discussed in the later section on land legislation.

Housing Privatization

This law—officially, "On the Privatization of the Housing Stock in the Russian Federation"—appears in retrospect to have been perhaps the key policy initiative in the sector. Its passage in July 1991 might be taken as initiating the shift to a housing sector operating on market principles. Importantly, the law built directly on previous legislation and the ideas put forth in the preceding months by several cities (Kosareva and Struyk, 1993).

Under the law tenants of municipal and departmental housing (housing belonging to enterprises and government departments) have the right to purchase their unit. The main features of the July law are:

- Only tenants officially registered as the occupants of the flat can purchase the unit.
- The tenant is given, in effect, a voucher free of charge. The value of the voucher is the price of a square meter of an average quality housing in the city in which the tenant lives times the number of square meters to which he is entitled. The entitlement is computed as 18 square meters of usable living area per person plus an extra 9 square meters for the households.
- The tenant pays the difference between the assessed value of the unit and the value of the voucher. Families living in a unit with a value less than the voucher receive no additional compensation.
- Those living in cooperative projects and in individual houses do not receive a voucher.
- During the transition period (length not specified), the old system for allocating units remains in effect. Those allocated a unit have the right to purchase it under the same conditions as listed above.
- Each family can only purchase a single unit under the privatization procedures.
- Some types of buildings cannot be privatized: those which are below the sanitary norms or are dangerous to inhabit, flats with shared kitchens and toilet facilities, and buildings of historical and cultural significance.

Within these provisions considerable freedom was given to local governments. They could, for example, increase the amount of space to be given without charge. Also, they ultimately determine the procedure for valuing the average square meter of housing in their locality and differences in values according to housing quality

levels. Local governments could, in addition, override the RSFSR law to permit some types of units on the prohibited list to be privatized. Indeed, the RSFSR law was written in such a way that local legislation was required for its implementation; and much time elapsed before such legislation was passed—often six months or more—significantly delayed program implementation.

The law was amended in December 1992, ostensibly to accelerate the privatization rate. The most far-reaching change was to make free-of-charge privatization mandatory, i.e., the whole idea of implicitly giving tenants a voucher was eliminated. While a few regions and cities, most notably Moscow, had embraced free-of-charge privatization from the start, these cases were exceptional. This shift obviously created a serious equity issue between those who had already privatized and paid something for their unit and those later privatizing similar units at no charge.²¹ The law is silent on whether those acting earlier should receive any compensation, and there are no reports to date of any government paying such compensation.²²

Law on Fundamentals of Federal Housing Policy.

The Law on Fundamentals may well be the most comprehensive and progressive major reform law enacted in Eastern Europe by the end of 1992. Its enactment at the end of December 1992 was paved by the passage of the key constitutional amendments earlier that month.

The law covers a number of areas. Especially important provisions include the following:

- The concept of real estate is clearly defined, and the rights of ownership of housing without limit is definitively clarified.
- Local governments are required to provide individuals and developers with plots of lands for housing construction within one month and two months, respectively, on terms to be determined by the local government; plots are to be provided within the framework of local urban plans (see Law on Urban Development, below).

²¹ In fact only a modest share of those privatizing made payments; see Chapter 4 for details.

²² The law also specifies that the state maintenance companies are to continue maintaining the buildings, seemingly limiting the ability of the new owners to select their own company. This provision is in conflict with provisions in the Law on Fundamentals of Housing Policy (see below). In practice, the monopoly of state companies has been broken and the privatization plan for 1994 calls for all of these companies to be privatized by the end of the year.

-
- Enabling provisions for condominiums are included.
 - In the social rental sector, the law
 - requires that republics, krais, oblasts and autonomous subdivisions and the autonomous municipalities of Moscow and St. Petersburg [herein called "republican governments] set fees for maintenance and payments for communal services so that they at least fully cover costs within five years;
 - requires republican governments to create housing allowances for the social housing stock²³ and permits them to create them for other types of housing;
 - requires republican governments set the social norm for housing, i.e., the size of unit which families of different sizes are entitled;
 - permits swaps of units without limitation;
 - states that those not making rental payments for six months can be evicted (following a court procedure) to housing meeting "dormitory standards;"
 - permits republican governments to rent any share of the municipal housing it chooses under a standard rent agreement (as opposed to the social rental or *naym* contract).
 - There is no control on rents of privately owned units.
 - Competition in the procurement by state bodies of maintenance services, rehabilitation and new construction of housing is mandatory.
 - Citizens are given the right to obtain mortgage finance for housing acquisition; the law specifies that loans can be guaranteed by government bodies.

This law is in the form of enabling legislation, i.e., it is designed to provide a general framework to be filled in by a more specifically regulatory and clarifying law or a "codex," to use the Russian term. Preparation of the codex has proven to be an enormously contentious undertaking, characterized by furious infighting among government agencies. No bill was ever formally sent to the Supreme Soviet, and there is no early prospect for resolution. In the absence of agreement on the general

²³ The Law states that the "Housing of social use is formed by local authorities out of state, municipal, and public housing stock provided publicly by state and municipal enterprises, institutions and public associations" (Article 12).

document, the Government has enacted the necessary measures (sometimes as Presidential Decrees, sometimes as issuances of the Council of Ministers) to implement key provisions of the law. These are reviewed below.

Increasing Rents and Introducing Housing Allowances. One of the most difficult decisions within housing reform has been to abandon the long-standing policy of low rents in State housing. However, high inflation placed such strains on local governments' ability to maintain the housing stock that in the end raising rents proved to be only moderately controversial.

The regulation implementing this provision of the Law on Fundamentals was issued by the Council of Ministers in September 1993, with rent initial rent increases scheduled for 1994.²⁴ Maintenance fees and fees for communal services were to be increased on a step-by-step basis over a five year period to cover full operating costs. The minimum share of such costs to be covered by tenants range from 15-20 percent in 1994, 20-40 percent in 1995, to 100 percent in 1998, with republican governments determining the exact amount each year.

Simultaneous with the first rent increase, each republic must introduce a housing allowance program to protect poor families from bearing the full brunt of the rent increases. Families occupying municipal or departmental units under the social (*naym*) contract are eligible to receive allowances. Republic governments can include other occupants, including unit owners, among those eligible. The allowance is computed as the difference between (a) the maintenance fees and charges for communal services based on standard consumption rates for an amount of space defined as the social norm for a family for a particular size and (b) a stated share of the family's income.²⁵ The *maximum* share of income to be paid by the family ranges from 10 percent in 1994 to 20 percent in 1998. The exact share of income to be paid is determined each year by local governments.

In December 1993 the program just described was significantly modified by another Council of Ministers' regulation which gave republic-level governments the power to increase rents at any rate they wish, i.e., they are not constrained to follow the step-by-step pattern specified in the earlier regulation.²⁶ The only requirement is for operating cost to be covered fully within five years. The initial experience with

²⁴ Council of Ministers Resolution, "On Transition to a New System for Rent and Communal Services Payment and the Procedure for Providing Compensations (Subsidies) to Citizens for Rent and Communal Services Payment," No. 935, September 22, 1993.

²⁵ Thus, the program employs a so-called "housing gap" housing allowance formula, of the type employed in the United States, Germany and many other countries.

²⁶ "On an Addition to the Resolution of the Council of Ministers, Government of the Russian Federation of September 22, 1993, N. 935," N. 1329, December 23, 1993.

the program of raising rents and introducing housing allowances is described further in Chapter 4.

Regulations on Condominiums. A significant limitation of the privatization law is that it does not deal effectively with the creation of condominium or other forms of homeowner associations for buildings in which some or all units are privatized. Therefore, the situation in Russia differed fundamentally from that in Hungary, for example. There, tenants of a certain share of units in a building must state that they will privatize their units before anyone can privatize (35-50 percent of units); and the necessary legal steps must be taken to create a condominium association *before* title to the first unit is actually transferred to the new owner. In Russia, there is no minimum share of units requirement and the creation of homeowners associations were left entirely up to the new owners.²⁷

The effect of this oversight was to deny the new owners some of the most important benefits of ownership: the ability to control the quality of maintenance services and the type and extent of renovation to the building.²⁸ As the volume of privatization increased, the urgency for addressing the omission of law explicitly dealing with condominiums became acute. For one thing, no bank would lend for the purchase of a privatized unit because the credit risk was simply too great owing to the lack of any provisions for the building to be adequately insured or maintained.

The Law on Fundamentals contains a very general provision permitting the creation of condominium associations (Article 8). Given this provision it was determined that republican level governments had the authority to create regulations for the creation of condominiums, even though the Russian Federation would also issue general regulations on them. In this context the Government of Moscow, with U.S. technical assistance, prepared regulations on condominium associations.²⁹ At the end of March 1993, Mayor Yuri Luzhkov signed a Decree of the City of Moscow which created the first detailed regulations for this type of housing. A few other

²⁷ To be accurate, the regulations on housing privatization promulgated by the Council of Ministers in the fall of 1991 did contain an annex that provided a simple form allowing for the creation of the an owners association. But the document was essentially silent on the benefits that could accrue to the new owners from creating such an entity.

²⁸ The legal situation regarding the rights of owners of flats in a multifamily building were in fact even more confused. The amendments to the privatization act stated that the existing state maintenance organizations would continue to maintain the common spaces (which according to the amendments could the property of unit owners or users of the common space, i.e., renters as well). At the same time unit owners could engage other firms to maintain their own dwellings. However, the Law on Fundamentals which was passed on the following day contradicted this law by directly stating that a condominium association could select its own management company (Article 8).

²⁹ "Basic Principles for Formation and Activities of Communities of Residential Unit Owners Intended to Manage the Housing Stock Subject to Joint Ownership (Housing Communities)."

jurisdictions, such as the Sverdlost Oblast (Ekaterinburg), have also enacted regulations.

The Moscow regulation is generally well-crafted. It provides ample protections to banks who might lend for the purchase of a unit in a building with an association, and the rights of the members of the association are protected. However, it has two significant limitations. First, condominiums continue to be voluntary associations; the city's lawyers were unshakable in their conviction that only voluntary associations were possible for existing buildings under existing Russian law. Condominiums *are* mandated in the regulation for new buildings. Second, it fails to provide a strong enforcement mechanism for collection of financial obligations from condominium members.³⁰

By issuance of a Presidential Decree, temporary national regulations for condominiums were established in December 1993.³¹ Four provisions of this regulation are particularly noteworthy. First, as few as two owners of property in a building can establish an association, and the local government must register an association within a one week period. Second, membership in the association is not voluntary; all property owners are members by definition and must pay their share of expenses. Third, responsibility for the management of the building transfers to the association at the time of its registration. And, fourth, if the municipality owns more than 30 percent of the property, it is limited to voting shares of only 30 percent of the total at the general meeting of the association.

These provisions make creation of associations much easier than under the Moscow regulation, make membership mandatory, and simply give management responsibility to the association eliminating the bureaucratic steps to obtain this responsibility. The regulations passed by Moscow and other cities will have to be revised to conform with the national regulation.

³⁰ The city embarked on a program of "licensing" condominium associations before agreeing to turn over management control. The requirements for the licensing are that (1) the appropriate organizational documents have been executed; (2) there is a sound financial management plan; and (3) an unspecified number of the housing association's members have participated in training course to be offer by the city's Office of Privatization. This procedure appears to be cumbersome and capable of discouraging associations from taking control of their buildings. The details for implementing the procedure also took considerable time to develop. Only at the end of 1993 were associations finally being registered. The pertinent regulations are: Moscow Government Resolution, N.813, "On the Procedure of Transferring Jointly-Owned Residential Buildings to the Communities of Residential Unit Owners for Management," and Instruction of the Departments of Municipal Housing and Communal Services, For Issuing Documents for Transfer of the Residential Buildings to the Management of Associations of Unit Owners."

³¹ Presidential Decree, "On the Provisional Regulations on Condominiums," No. 2275, December 23, 1993.

Home Purchase Subsidies. Article 25 of the Law on Fundamentals states that citizens have the right to mortgage finance when they purchase or construct housing and a right to subsidies, when such housing is purchased by families on the waiting list for improved housing. The source of the loans and subsidies is not specified in the law. In December 1993 the Council of Ministers issued the regulations for housing purchase subsidies. The subsidies will assist with the downpayment for purchase of a unit. The subsidy will be based on the cost of a unit of a standard size for the number of family members (i.e., the "social norm" for the family); larger subsidies will be given to families with lower incomes and more years on the waiting list. These subsidies, described further in the chapter on housing finance, will replace interest rate subsidies.

Housing Finance³²

The law governing mortgage lending is complex. In effect, the Laws on Collateral and Mortgage perfect provisions of the Civil Code, which deal with private commercial transactions.³³ Therefore, provisions of the laws specific to mortgage lending must be read with and understood in the context of the Civil Code. The Civil Code in particular details the procedures to be followed in enforcing the contract in case of default on the loan.

The Law on Collateral was passed by the Supreme Soviet in May 1992; the Law on Mortgage is under preparation by the Supreme Soviet and is likely to be introduced directly.

The Law on Collateral (LoC) is a statement of the general legal principles of security arrangements. It addresses other types of security agreements in addition to real estate, including, for example, pawn. The LoC states that property subject to mortgage includes any property that an eligible mortgagor has the legal right to alienate. The major exception to this statement is that mortgages on land are to be governed by other laws of the Russian Federation. The LoC carries out several tasks:

- the form of the mortgage is specified, including registration requirements;

³² This section draws heavily on Butler (1993).

³³ There are several laws governing private commercial transactions in Russia: (1) the Fundamentals of Civil Legislation of the USSR and the Republics, May 31, 1991 ("Fundamentals of Civil Legislation"; the Civil Code of the Russian Soviet Federative Socialist Republic, June 11, 1964, as amended (the "Civil Code"); and the Code of Civil Procedure of the RSFSR, June 11, 1964, as amended (the "Code of Civil Procedure). For an explanation of the role of these various laws in this context, see Butler (1993), pp. 5-9. In the discussion in the text, this corpus of law is simply referred to as the "Civil Code."

- the rights and obligations of the parties are defined; and
- provisions for enforcement of the contract and priorities for obtaining receipts from a foreclosure sale are stated.

Butler's (1993) statement succinctly summarizes the legal situation for mortgage lending after the enactment of the Law on Collateral:

The existing Russian law of real estate mortgages...can be marginally effective in its present stage of development. Much, of course, remains to be seen in how the laws are interpreted and enforced as the volume of residential mortgage lending increases. But the laws themselves give creditors and debtors a relatively clear picture of their rights and obligations provide a rational, though largely untested, system for enforcement of security rights in real estate; and attempt to strike a balance between the rights of debtors and creditors. (p.31)

Butler goes on to list a dozen areas in which the law could be clarified and strengthened to deal with existing weaknesses.

The Law on Mortgage (LoM) should be seen as a refinement of the provisions of Law on Collateral with respect to mortgage lending. Several drafts of the LoM have been prepared, including one by the relevant committee of the Supreme Soviet. Conflicts with agricultural interests about the scope of the law (would land mortgages be covered?) stalled action on the law by the parliament. By January 1994 it was determined that the LoM would be dealt with by the new Federal Assembly. Some of the important clarifications in the drafts produced thus far include:

- Provisions dealing with the assignability of mortgage security, and clarification that assignment is only valid in connection with assignment of the underlying debt.
- Provision for a non judicial process of mortgage foreclosure at well as for a negotiated deed-in-lieu of foreclosure.
- Variable rate and negative amortization loans have been dealt with by attachment of a mortgage schedule setting out formulas for calculation of the interest rate, outstanding debt, and other variable sums.
- The law adopts its own rules for foreclosure auction sales. While they follow closely those of the existing law of Civil Procedure, there was a question as to whether the existing law applied to real estate foreclosures.

- Issuance of bank securities or bonds secured by mortgages is specifically addressed.
- Mortgagees have been given priority liens on condemnation proceeds.
- The status of mortgages on apartments in commonly owned buildings as "real estate" is clarified.

Obviously, at this point much uncertainty remains about specific provisions. Much of the banking community is awaiting passage of the law as a signal that they can adequately control the risks of long-term mortgage lending. Hence, its passage is important for development of such lending.³⁴

Law on Fundamentals of Urban Planning

This law, enacted in July 1992, is to urban planning policy as the Law on the Fundamentals of Housing Policy is to housing policy—a broad enabling act. Like the Law on Fundamentals of Housing Policy, it is to be filled in through enactment of a codex by the Supreme Soviet and by laws passed by the constituent republics.

The law is dominated by a "master plan" perspective. Such plans are to be produced for all urban areas, and plans are required for successively lower administrative districts within a region. The master plan for a city is

the basic juridical document that defines ... the prerequisites for habitation, the directions and bounds of area development, functional zones, the development and provisioning [sic] of amenities and services for the region, and preservation of historical, cultural and natural heritage (Article 6(4)).

Importantly, urban planning is clearly stated to be a local function. And local planning documentation are public legal documents defining the rights and limitations of landholders and the government. In the past master plans and other documents were closely guarded secrets.

A developer is to have full range of choice on how to develop a project, provided that the project falls within the master plan. The law prominently cites that citizens and their associations and other non governmental organizations are to be active participants and partners along with the government in the planning process.

³⁴ While obviously true that passage of the law will strengthen lenders' position, as discussed in the chapter on housing finance, these risk can be controlled in other ways. And some banks have taken the necessary steps and begun making loans.

However, no public hearing process is mandated and the review of proposals is to be executed by expert consultants and officials.

But until the codex is developed and passed into law, it is very difficult to specify the actual guidance for the execution of the law's various provisions.

The Program HOUSING.

In August 1992 the Government of the Russian Federation assigned Minstroi the task of developing a comprehensive program for the reform of the housing sector along market lines.³⁵ Minstroi (and later Gostroi³⁶) took this task seriously, producing its first draft in November and a second draft in January 1993. In June 1993 it was formally adopted by the Russian Federation Government.³⁷ It is clearly the most comprehensive policy statement available for the sector as a whole.

The program statement is largely an amplification of the contents of the major pieces of legislation already enacted, but it also outlines new policy initiatives. The statement was formally adopted by Government on March 18, 1993. It gives a clear indication of the direction intended for housing policy by some of the most important policy makers for the sector in the executive branch.

A summary of the initiatives contained in the program is given in Table 2.1. Most of these are elaborations of existing legislation, but some, such as the creation of a new housing development fund (listed under housing finance) are new. The program also calls for a major shift in housing production, away from heavy panel buildings and to single-family, or "cottage housing" in the Russian vernacular. Many of the provisions in the program will require presidential decrees or government regulations to implement. It is far from certain that the more specific proposals will be accepted in their present form.

³⁵ Resolution no. 602, "On Measures for Realization of the Economic Reforms Intensification Program."

³⁶ Minstroi (the Ministry for Architecture, Construction, Housing Facilities, and Communal Services) was downgraded in the fall of 1992 into two lesser organizations: the State Committee on Architecture and Construction (Gostroi) and the Committee on the Municipal Economy. The Chairman of Gostroi has cabinet rank.

³⁷ Council of Ministers Decree, N.595, June 20, 1993.

**Table 2.1
Summary of Suggested Initiatives in the Program HOUSING**

Treatment of families on the waiting list for improved housing

- Give families on such lists the opportunity of receiving a subsidy to leave the waiting list and obtain housing for themselves; the size of the subsidy would depend on such factors as the time waiting and the size of unit for which the family qualifies. The form of the subsidy is not specified.

Elaboration of the program for raising rents and introducing housing allowances

- Guidelines are given for the five year transition period for the share of income renters should be required to pay for housing in order to obtain a housing allowance; guidelines are also given for the share of total operating costs that should be covered.
- It sets the eventual goal of having rents in state housing be set by the market.
- Cash increments, through increased wages or grants, are proposed to help offset the increased rent burden of families.
- Allowances are suggested to be "paid" as reductions in rent due, rather than cash payments to the renter who would then pay the landlord.

Housing Finance

- The expansion in the availability of housing finance is stressed as fundamental to reducing state support of housing construction.
- Different degrees of subsidies are proposed for households in different economic circumstances, with the highest income receiving none.
- Establish the Agency for Mortgage Lending to act as a liquidity facility and regulator for long-term housing lending.
- Various subsidy mechanisms, including assistance with downpayments, are suggested.
- Creation of the Housing Construction and Municipal Economy Development Fund, which would draw sources from a number of sources and then provide them for various housing investments, including development of building materials companies, construction of social housing, and development of residential infrastructure.

Housing Development

- Low density and single family construction is to be dominant in all but the largest cities.
- Development of building materials industries to support the construction of low density housing is to be encouraged.

Tax incentives for housing

- Several tax deductions are proposed, including exemption of dividends and shares of firms investing in the housing sector.
- An addition to the profits tax to support local government expenditures on housing development is proposed.

Policy Development

- Creation of a cabinet-level Coordination Board to oversee reform in the sector.
-

Despite its obvious merit, the lack of quantitative estimates, in the Program HOUSING, particularly of the budgetary implications of the various proposals for increased housing production, is striking. Many of these proposals would be extremely costly. The principal theme is clear: build housing. But the document fails to set forth whether the primary goal is to maximize production, which would imply shallow subsidies to those just unable to afford to purchase a new unit, or to maximize production for the middle class, which entails much deeper subsidies and consequently fewer units. The production maximization goal is consistent with using housing as a countercyclical macroeconomic tool and to assist the *kombinants* to continue operations long enough to restructure. But it is extremely difficult for the Government to make such decisions well without more information than is presented in the Program.

Land Legislation

The basic legal framework of laws relating to land rights, allocation and use in the Russian Federation consists of the December 1993 Russian Federation Constitution, the 1991 Land Code and a host of Presidential decrees enacted since the winter of 1991. While this framework represents major progress in the area of land reform since the Soviet era of complete state ownership of land and centrally-controlled decisions on land allocation and use, the current land reform does not allow widespread ownership of land and continues to tie property rights to land use designations made by governmental bodies. Although there is some gray area in the law which suggests broader categories of ownership rights, the only clear category of owners who may freely use, possess and dispose of their land are individual land owners who use their plots for individual housing or dacha construction or subsidiary farming. Even in this circumstance, full ownership rights are retained in land transactions only where the designated use of the land remains unchanged. All other owners are limited to more restricted leasing rights and permanent use rights. Additionally, major philosophical differences about the pace and content of land reform make this a highly contentious and slow to reform area of the law.

Background. Starting in 1990 President Gorbachev undertook measures to establish a property rights regime with the goal of demonopolizing the state economy. Two laws passed that year were extremely significant in reshaping property rights in land: the USSR Law on Property and the Fundamentals of the USSR and Union Republics Legislation on Land (Land Fundamentals). Both of these federal laws were supplemented by RSFSR laws that remain in effect today: The RSFSR Law on Ownership and the 1991 Land Code.

The USSR Law on Property was an extraordinary philosophical break from the concept of real property ownership contained in any of the existing policy or normative documents related to property ownership, significantly expanding the rights of ownership for individuals and certain categories of enterprises. It did, however, stop short of granting private property rights in land equivalent to concepts of ownership in market economies; citizens could own land only in life-long inheritable possession, which is not transferable, and only for individual housing or dacha construction and personal subsidiary farming.

The RSFSR Law on Ownership (still in force today) codified important guarantees and protections for property users, including, for the first time, providing for compensation to users whose land is confiscated for public purposes. The RSFSR Law on Ownership enacted in December 1991 superseded the USSR Law on Property on the territory of the Russian Federation. The law elaborated property ownership tenures into four categories consisting of private (natural and juridical persons), public ("social organizations"), state and municipal entities and joint ventures and foreign entities. The RSFSR Law On Ownership also established the principle of local municipal ownership of land. On its face, the Law also allowed individuals to own land subject, however, to the important caveat that land ownership must comply with the RSFSR Land Code. Consequently, this right is not as broad as it seems since the 1991 RSFSR Land Code, still in effect, allows private ownership only for individual home or dacha construction and subsidiary farming and prohibits alienation of land other than between private individuals where land is retained for its designated purpose.

The 1990 USSR Land Fundamentals is the basic law from which republics developed their own Land Codes. Like the Law on Ownership, it was significant at the time of its enactment for establishing a framework for land relations and property rights in land that departed substantially from prior socialist principles. The Land Fundamentals established four types of private property rights—permanent ownership, inheritable life tenure, permanent or long term use, or lease—could be granted depending on the designated use of the land and the characteristics of the owner or user. However, the Land Fundamentals again fell short of granting complete ownership of land to any category of owner. Citizens could own land plots in inheritable life tenure for individual or dacha, subsidiary farming, horticulture and other defined uses, but alienation rights were restricted to inheritance, resale to the

government, and temporary transfer of ownership under limited circumstances. Private market sales transactions were not permitted.

In 1991 the RSFSR adopted the Land Code of the RSFSR which remains one of the central documents regulating land relations in the Russian Federation.³⁸ The 1991 Land Code is modelled on the Land Fundamentals but expands on some of the provisions contained in the Land Fundamentals. It more fully distinguishes the roles of the respective federal and local administrative bodies in the land allocation process and defines the role of the newly-established State Committee of the RSFSR on Land Reform. The 1991 Land Code more fully explains the various categories of ownership and use rights, how natural and juridical entities may exercise those rights, and the duties imposed upon land owners and users. The 1991 Land Code elaborates a procedure for allocation and withdrawal of land plots in a way that served as the basis for more detailed Presidential decrees on land allocation. The Code also contains an exhaustive list of circumstances under which land rights may be terminated, and relatively detailed procedures for settlement of land disputes.

Ostensibly to reflect provisions of the December 1993 Russian Federation Constitution related to land, the 1991 Land Code was recently modified by the December 1993 Presidential decree "On Modifying Land Laws to be in Compliance with the December 1993 Russian Federation Constitution." The December 1993 decree modified and eliminated a number of provisions of the 1991 Land Code. Several changes are particularly significant. The December decree nearly entirely eliminates the first 23 articles of the Code which contain the basic provisions defining various categories of land ownership and use and spelling out the scopes of authority between federal and local administrative and elected branches in regulating land relationships. Commentators on this effect of the decree suggest that the result of the decree is to take from local administrations the authority to regulate land and leave all authority in the regional administrative body. The decree eliminates many of the specific provisions outlining the land allocation process, without replacing those provisions with new articles. This gap in the law may not cause cities and regions to halt their land allocation programs since there are other sources of legal authority, namely city and regional laws, that may be used as a legitimate legal basis to continue land allocation programs. The December decree eliminates from the 1991 Land Code all references to the role of the local soviets in the land allocation process. The decree grants some of the authority previously granted to local soviets to local administrations. This change reflects the move of President Yeltsin in October 1993 to disband the Supreme Soviet and all local soviets pending new elections scheduled to take place during upcoming months. It is not clear whether the local soviets will ever resume their role in the land allocation process. Considering the conflicting pace of reform typically pursued by the more progressive administrations versus the

³⁸ A revised Land Code, drafted by Gosstroi, passed in the Supreme Soviet in July 1993. It was never put into law, however, because President Yeltsin refused to sign the document.

local soviets, President Yeltsin's decree stripping the local soviets of their role in the land allocation process was as much a long-term political strategy as it was a short-term policy decision. Finally, the December decree eliminates the ownership category of life-time inheritable tenure. This tenure applies only to owners of agricultural land and serves no advantageous function in a market-oriented land allocation system. The present use of this tenure can easily be accommodated by replacing the life-time inheritable tenure right with long term renewable leases.

Despite the rather significant changes in the 1991 Land Code brought about by the 1993 Presidential decree, the Land Code remains the central normative document regulating land relationships in the Russian Federation today.

Constitutional Provisions. Land law was altered fundamentally, first by revisions to the existing constitution in December 1992 and then by the adoption of the new constitution in December 1993.

Constitutional Amendments. In December 1992 three constitutional amendments were passed by the Supreme Soviet directly affecting property rights for natural and juridical Russian citizens. Article 10 provided that four types of property ownership are officially recognized and protected in the Russian Federation - private (natural and juridical persons), communal, state and municipal, and property of public associations. This replaced a constitutional provision which stated that the state protects property rights, essentially meaning the rights the state delegates through lease and temporary or permanent use contracts. Article 11 stated that natural resources may be held in private (natural and juridical persons), communal, state and municipal ownership replacing language which stated natural resources were exclusively national property.

The most significant of the three amendments was article 12 which removed some of the restrictions on the rights of individuals to freely possess, use and dispose of land plots. Article 12 stipulated that owners may alienate plots of land used for individual housing or dacha construction, gardening or subsidiary farming to the state or in private sales transactions for a contractual price regardless of when the land is acquired. Land used for other purposes may be sold in private market transactions only after ten years if the land was acquired free of charge and after five years if acquisition was for a price. The replaced a provision which provided only for alienation to the state and established a ten year waiting period for alienation regardless of the circumstances under which the land was originally acquired. However, even after the moratorium period expired, land could be alienated only where the designated purpose of the land remained unchanged.

December 1993 Constitution. On December 12, 1993 at nationwide referendum, Russian voters voted to accept a new Russian Federation Constitution. Several provisions of the Constitution affect legal land relations in Russia. The

Constitution itself does not introduce any new concepts in the area of land reform, but incorporates the existing state of the law present in other normative acts. Article 9 states that land and other natural resources can be in private, state, municipal, or other forms of ownership, a change from the previous Constitution which stated all natural resources belong to the state. Article 36 states that citizens and their associations are entitled to hold land in private ownership. This seemingly broad provision is still circumscribed by provisions in the 1991 Land Code regarding private land ownership. In reality, private land ownership is still only the right of citizens to own plots of land for individual housing or dacha construction, gardening and subsidiary farming. Plots may be alienated or sold but only to other citizens who will retain the land for its designated use. It is not clear what "associations" means. Considered in the context of the general framework of land laws, it likely does not mean that juridical persons may own land. This conclusion is further supported by art. 36(3) which states "the conditions and procedure for the use of land are defined on the basis of federal law."

Presidential Decrees. Because of the extreme contentiousness of land legislation in the Supreme Soviet, most progress on land reform has been made through a series of Presidential Decrees.

On Urgent Measures to Implement Land Reform. In December 1991 the Presidential Decree "On Urgent Measures to Implement Land Reform" called for a reorganization and reallocation of state and collective farms to allow for free allocation of land to private, collective-shareholding or other cooperative entities for agricultural and other designated purposes. The decree describes general procedures for conducting the reallocation process and the property rights to which owners and users of the land are entitled (primarily lease and ownership with limited rights of disposition), and also calls for the establishment of a reallocation fund to distribute surplus land. A portion of the surplus land is to be made available for non-agricultural purposes, including private housing construction. The law provides further that surplus land allocated for subsidiary farming, gardening and individual housing construction should be allocated free of charge.

Some cities and regions have established these surplus land funds and have distributed a small number of plots to citizens in non-urban areas. However, the lack of surplus land in urban areas (and the poor quality of the land even when it does exist), the difficulty of determining land boundaries because no effective title registration system exists, and the administrative expense of creating a workable system to maintain and distribute the land are all practical reasons why these redistribution funds have not been more widely established.

Enterprise Land. The issue of land ownership and privatization in urban areas was first specifically addressed in two Presidential decrees signed in March and August 1992. Presidential Decrees 301 and Presidential Decree 631 allow privatized enterprises or citizens engaged in entrepreneurial activity to acquire land

appurtenant to the enterprise. These same entities may obtain additional tracts of land for expansion of the enterprise through auction or tender. The property rights granted to juridical or natural persons acquiring land under this law are ownership (permanent use) or lease with the option to acquire ownership. Chapter II of Decree 631 sets forth the procedure for acquiring tracts of land in compliance with Decrees 301 and 631, and includes auctions, investment competitions and negotiated transactions.

On its face decree 631 seems to give juridical persons the right to own land. However, in reality it has not been the case. The 1991 Land Code states that juridical person may only use or lease land. This conflict between 631 and the Code is probably the reason 631 has not seriously been used to advocate for land ownership rights for juridical person.

Housing Principles. Provisions of the Housing Fundamentals specifically related to land relations include: (1) recognition that the concept of real estate includes land and structures on land; (2) real estate may be private, state and municipal property, communal property or the property of public associations, and there is no limit to the amount of private real estate that may be owned; and (3) a "developer" has a right to acquire land for housing construction in accordance with other relevant established laws and procedures.

Private Sales Transactions. Beginning in December 1992, Presidential Yeltsin issued a series of three decrees designed to elaborate the procedure for allocating to citizens plots of land for defined purposes and the mechanism through which private sales of those plots could take place. The December 1992 the Presidential Decree "On Citizens Rights to Own and Sell Land" was issued which permits the private sale of land plots used for private housing or dacha construction, horticulture and subsidiary farming. The decree permits citizens to sell land to other citizens regardless of the circumstances under which the owner acquired the land or how long the owner has possessed the plot, but the land must continue to be used for the designated purpose unless the purpose is changed in accordance with law. Private sales may occur (1) through a negotiated contract with the seller on a form designed by the Russian Federation Committee on Land Resources and Land Management (Rozkomzem); (2) by competitive bid; or (3) an auction administered by the local government committee overseeing allocation of land resources. All land sales must be notarized and registered with the local office of Rozkomzem and ownership rights are ineffective until registration is complete.

In May 1993 President Yeltsin finally issued regulations for private purchase and sale of land plots for individual housing or dacha construction, gardening or subsidiary farming on which his two prior decrees depended for implementation. Presidential Resolution No. 503 provides the procedure for effecting land sales between Russian citizens. The Resolution requires that all transactions must be formalized by registration of bills of sale and an attached plot layout. The price of the

plots as well as terms of payment may be arranged between buyer and seller or by competition or auction. Title passes from buyer to seller only after the sale has been notarized and registered with the Committee for Land Resources and Land Use Management (Rozkomzem). In June 1993 the Rozkomzem created and the Ministry of Justice approved a form to be used for private land transactions. Resolution 503 also calls for the establishment of a procedure for assessing a transfer tax on land sales. This transfer tax procedure has yet to be developed and is the final impediment to implementing Resolution 503 and private land sales transactions.

In April 1993 the Presidential Edict "On Additional Measures to Grant Plots of Land to Citizens" was issued. This Edict reinforces the earlier decrees requiring that local governments make land available to citizens for individual housing or dacha construction, gardening or subsidiary farming. The Edict stipulates that citizens may determine the form of land tenure they desire - ownership, life-long inheritable possession or lease. Local governments are required to (1) inventory land available for distribution; (2) adopt a system for registration of land titles; (3) issue appropriate documents of title; and (4) re-register in the form chosen by the citizens land that was previously granted to the citizen for use.

On Regulation of Land Relations. On October 27, 1993, President Yeltsin issued the decree "On Regulation of Land Relationships and Development of Agricultural Reform in Russia." This decree was intended primarily to address the reallocation of agricultural land from the state and collective farms to individual farmers. It accomplishes that goal essentially by providing for the issuance of shares representing land interests to the collective farmers individually and permitting them to request an in-kind allocation of land or to trade the land shares among themselves.

With respect to urban land issues, the new decree appears to clarify and restate some principles that can be found in earlier laws. Soon after its enactment commentators began to hail the decree as authorizing market land sales for natural and juridical persons in Russia. In reality, the language of the decree has not been interpreted this broadly. On its face the decree:

- (1) defines the concept of "real estate" to include both land and the structures or improvements located on it. (This concept had been raised in the earlier Fundamental Principles of Federal Housing Policy, but its implications in that law were unclear);
- (2) authorizes citizens and juridical entities that "own" land to sell or mortgage it freely. In this respect, the new decree can be viewed as an amendment to the 1991 Land Code, in that it expands the rights of ownership for individuals and juridical entities, appears to abolish the present limitations on the purposes for which citizens may own land, and appears to abolish as well all waiting periods for the sale of land;

- (3) establishes a registration system based upon the "Certificate of Title," which is to be issued with respect to each parcel of land and registered with the local komzsem (land committee). All initial allocations and purchase and sale transactions occurring after the date of the decree are invalid in the absence of registration of a certificate of title. Holders of land rights existing prior to the decree have the right to demand that their prior right be elevated to full ownership and to have a certificate of title issued and registered;
- (4) subjects all disputes concerning land to court proceedings, whereas previously all such disputes were subject to administrative resolution by the local soviet before entry to court was permitted;
- (5) specifically provides that land may be allocated by competitions and auctions, and requires the government to develop uniform regulations governing land competitions and auctions. It appears that competitions and auctions are not established as the mandatory means of allocating land, and that other means are permissible.

Based on this October 1993 decree federal procedures for competitions and auctions were promulgated in December 1993. However, these procedures were repealed in December 1993 in the Presidential decree "On Modifying the Land Laws of the Russian Federation to be in Compliance with the Constitution of the Russian Federation."

The October 1993 decree also calls for the establishment of a uniform land registration system. This provision was restated in the December 1993 Presidential Decree "On State Land Cadastre and Registration of Documents on the Rights to Real Property" requiring Rozkomzem and GKI to work cooperatively to develop this title registration system. Although draft procedures were under consideration in February 1994 by Rozkomzem and GKI, no official procedures have been developed. There are serious bureaucratic battles between GKI and Rozkomzem about the role each agency will play in developing and instituting a title registration system. Each bureaucracy sees its role as the agency responsible for title registration. According to various laws, Rozkomzem is responsible for maintaining a title registration system for all land plots. GKI is responsible for registering all the privatized property within its domain. The historical division between real property and land, rather than an understanding of real estate as including land and the structures on it, is one of the main points of contention in this struggle for control.

Conclusion

The Russian Federation has succeeded in establishing much of the essential legal framework for the development of urban housing markets in the period since the enactment of the housing privatization law in July 1991. This is a major

accomplishment. Still, critical additional legislation is needed, including the Law on Mortgage, the Law on Fundamentals of Land Policy. The necessary codexes and additional regulations will have to be produced for these laws as well as some already on the books. Based on the record to date, however, there is good reason to believe these legal steps will be taken. Meanwhile, the challenge is to implement the provisions already enacted—a formidable undertaking.

3. DEVELOPMENTS IN THE RESIDENTIAL CONSTRUCTION AND REAL ESTATE SECTORS

Housing construction was an important part of the Soviet economy, with residential construction accounting for 25 percent of investment. Even at this level, however, investment was insufficient to erase the country's large housing deficit. Production levels in the Russian Federation in the past three years have been considerably lower than under the previous regime as a consequence of economic restructuring.

This chapter treats two closely related topics. First, developments in residential construction in the past three years are examined. Secondly, the chapter reviews developments in the financing of multifamily housing, the new phenomenon of marketing units not kept by investors for their own use, trends in the prices of new units, and the development of the real estate industry.

Additions to the Housing Stock

This section first gives a brief overview of the Soviet housing production system. Then it reports on the volume of residential construction, changes in the "customers" for new housing, the dynamics of production costs in the industry, and restructuring of the residential construction industry.

The essential elements of the previous policy on housing construction were: centralized distribution of capital resources; strict standardization in the planning of the volume of housing made available and of its distribution in the country; and extreme monopolization of the construction industry by the state, primarily in the form of large construction enterprises (so-called "kombinats"). As a result, the same large multi-story prefabricated standard buildings of precast reinforced concrete were constructed in all regions of the country. The only variety introduced in 35 years was four generations of design standards for these building plans. The state was the monopolist and acted as investor, client, contractor and owner at the same time.

At the local level the pivotal actor was the "zakazchik" organization or, loosely translated, the "unified customer." A World Bank report has stated that "the difference between the "zakazchik" organization in Russia and the developer of a market economy is the most crucial distinction between the construction process in a market economy and under Soviet central planning."³⁹ Local governments and enterprises who wanted new housing placed their orders with the office of the unified customer. The unified customer secured the building site, had building designs

³⁹ World Bank (1993), p.172.

prepared, obtained the necessary permits from the Chief Architect and other offices, selected the building "kombinat" (although there was often little choice since builders specialized in different types of structures), arranged for building materials and negotiated the price of the housing. In this system those placing the orders, i.e., the clients, were captive and had very limited influence on what they received for their money.

Trends in Construction. The trend in housing construction can be tracked with three indicators: total square meters, units built per 10,000 population, and investment expenditures. All show a sharp decline in production in the 1990s.

The high point of housing construction was reached after two years of the "Housing 2000" program initiated by Mikhail Gorbachev. Under it the Russian Republic mobilized sufficient state budget funds to produce 72.8 million square meters of overall housing space in 1987. After this, however, production volume fell off sharply, as shown in Table 3.1. Only in 1993 did production finally stabilize at about 57 percent of the 1987 level.

year	square meters produced
1987	72.8
1991	49.4
1992	41.5
1993	41.8

In terms of dwelling units per 10,000 persons of the population, the scale of the construction during the stable Soviet era of the 1980s was about 80-90, with the specific level being 93.5 in 1988, for example. The construction slump concomitant with general economic reform reduced the number of apartments constructed per 10,000 persons to 70.3 in 1990 and 50.5 in 1991 (54 percent of the 1988 level).

Finally, total investments in housing from all sources displays the same pattern. In 1990 it was 205.3 billion rubles; in 1991 this amount was only 89 percent of the previous year level; and in 1992 only 49 percent of the 1990 level.⁴⁰

⁴⁰ Calculations of Ministry of Economy in 1991 prices.

Composition of Demand. Perhaps the most telling change in the demand for housing has been the fall in the importance of the state sector, for additions to both municipal and departmental housing. Until 1991, the main share of housing construction (no less than 80 percent) was accounted for by the state. The remainder was individual construction (7.5 percent in 1990), construction by collective farms and public organizations (7.5 percent), and housing cooperative construction (5 percent). However, by 1993 the state was the customer for only 43 percent of total production.

A second clear pattern has been the relative decline in housing construction in rural areas. In 1991 rural "customers" ordered 28 percent of total housing. By 1993, this had fallen to 21 percent. Indeed, the decline in total production since 1991 has largely been a rural phenomenon: while rural production decline by 40 percent, there was only a decline of 6 percent in housing constructed in urban areas, i.e., from 35.1 to 33.0 million square meters.

In rural areas the customers registering the biggest declines were state enterprises and organizations (down 32 percent) and collective farms (down 24 percent). These two customers accounted for over 60 percent of all units in 1991, and hence the decline in their purchases have correspondingly had a devastating effect on total production. On the other hand, the growing source of orders in the countryside are joint stock companies and private firms, which by 1993 accounted for 24 percent of units produced, up from negligible amounts just two years earlier.⁴¹

The pattern of urban demand has also been dynamic. As shown in Table 3.2, declines have been registered by state enterprises and organizations, whose purchases in 1993 were only two-thirds of those in 1991, and housing cooperatives, whose 1993 demand was about 79 percent of the 1991 level. These declines have been largely offset by huge increases in the units going to joint stock companies and private firms, and a smaller rise in the volume of units purchased by private families.

In assessing these patterns two qualifications should be borne in mind. First, the privatization of state enterprises effects the classification of the same firms' purchases as being in the state or private sector. Thus, the shift from state to private outcomes is in part artificial. Second, as described more fully in the section on real estate markets, the financing of multifamily buildings is today often quite complex, with several investors—some public and some private—participating in most projects.

⁴¹ It should be noted that some of the apparent new demand from these private entities results simply from the privatization of some firms.

It is probable that the data assembled on "customers" do not accurately capture this complexity in classifying customers.

Table 3.2 Dynamics of the Introduction of Housing Space from All Sources of Finance in Urban Areas, 1991-1993 (as percent of housing completed in 1991)			
"customer" or funding source	1991	1992	1993
total new housing	100 (71.1) ^a	88.3	94.0
state enterprises and organizations	100 (59.9)	81.8	66.6
private persons	100 (4.0)	95.0	115.0
housing cooperatives	100 (4.9)	87.5	79.2
collective farms	100 (0.2)	100	100
joint stock companies	100 (1.6)	312.5	950.0
private & corporate organizations	100 b	100.0	1,400
public organizations	100 (0.5)	50.0	0.0

- a. Share of national production in 1991; i.e., state enterprises in urban areas were customers for 59.9 percent of total housing production in 1991.
- b. Less than 0.1 percent of total production.

Construction Costs. Increases in construction costs have been in line with those of the rest of the economy. In 1985 the construction cost of one square meter of a multi-family multistory large-panel building built with the state capital investments was about 260 rubles, in 1990 - about 320 rubles, in 1991 - about 800-1000 rubles. Estimates from Gosstroj and Ministry of Economy of Russia for 1992 are 16.1 thousand rubles. For the end of 1993, Belkina estimates the average

national cost per square meter at 468 thousand rubles.⁴² These costs are different in different regions and cities. For example, at the end of 1993 in the Central Region it was about 390 thousand rubles, but in the East Siberia Region it was 560 thousand rubles.

Financing. The main sources for financing housing construction under the Soviet system were always centralized state capital investment distributed between the budgets of local governments and enterprises and investment by enterprises from their own funds. In 1987, the year in which some real attempt was made to begin the state housing program, the share of central state investments was 78 percent. Then the centralized funds began to fall. Through 1993 the government chose a macroeconomic reform policy pursuing a reduced budget deficit. In this case the reduced federal budget expenditures were used mainly for construction of houses for retired military officers, refugees, persons living in the Far North Region, and for victims of the disaster at Chernobyl. According to the estimates of Gosstroj and the Ministry of Economy (Program HOUSING), in 1992 only 14 percent of all investments for housing construction was made from the federal budget.

The task of providing units to those families on the waiting lists for housing has become completely the responsibility of local authorities, which also do not have budget resources for this purpose. According to government estimates (Program HOUSING), in 1992 the investments from the local budgets constituted only 9 percent of the total. Cities could only sustain production with extraordinary actions. For example, in Moscow (where 3 million square meters have been constructed annually for the past several years) the municipality in 1992 used a unique Central Bank loan and sold about 10 percent of the units constructed at auction to finance construction. Many cities in 1993 supported their construction programs by auctioning a substantial share of the units produced; Moscow, for example, sold about one-third of its additional 3 million square meters.

The dynamics in housing construction from the funds of state and municipal enterprises can be explained in the following way. In the former centralized system the enterprises constructed residential buildings using mainly state distributed funds: in 1987 the share of their own investments was only 7 percent. But, during the first years of the economic reform, policies were followed that permitted them to pile redundant resources into the so-called "funds for social development of enterprises." Funds were directed to this account because wage controls restricted their use for wage increases. The enterprises began to invest these funds in housing

⁴² T. Belkina, unpublished estimates prepared for the Urban Institute. Note that the figures for the earlier years are not comparable with those prepared by Belkina and very likely understate the full cost. This is because the figures for the earlier years are based on the actual costs of constructing buildings. The costs are compiled only for completed buildings. Buildings often take well over a year to complete and no adjustment is made for inflation over the construction period; therefore, early costs are understated in current prices.

construction. In 1988-1989 this building activity was particularly evident, and the share of enterprises' investments reached 46 percent of total housing construction investment.

After 1989 the economic and regulatory situation changed and the enterprises preferred to use these funds to increase wages. Today public and private enterprises remain the main investor in housing: their share in 1992 was 56 percent (estimates from Program HOUSING). According to Goskomstat data for 1992, 72 percent of all housing construction was done through state enterprises and organizations (using both central capital investment funds and their own funds, including cheap funds distributed by the Central Bank).⁴³

To stimulate investment, beginning in 1993 all kinds of investments are deductible from the profits tax. But it is difficult to predict whether housing investments will be a main priority of the enterprises. The chief problems are the significant increase in the price of construction and the declining resources of many enterprises.

As noted above, production of individual housing has increased in recent years (from 1988) because of the removal of the ban on construction of such units in the large cities, a relative reduction in the red tape in land allocation, and the possibility of receiving land as personal property for constructing a single-family house. After a slump in 1992, private purchase of new units increased, perhaps stimulated by generous deductions from the personal income tax—but probably more important was the development of a high money incomes by the highest 10-15 percent of the population and the suppressed demand for better housing at all income levels.⁴⁴

Industry Dynamics. During the period of centralized economic planning in Russia, a powerful state base of the construction industry was created. It was capable of producing of building materials for an annual construction of 70-75 million square meters of housing, including over 40 million square meters in large-panel structures. In 1992 there were 218 huge "kombinats" in Russia with average capacity to produce the prefabricated construction materials and to build 127 thousand square meters of total housing space. These "kombinats" constituted only 1 percent of all contractor construction organizations in 1992.

⁴³ Easterly and Vieira da Cunha (1994) document that "enterprises were flush with resources in 1992, despite all of the dire notices of impending bankruptcies." (p. 9).

⁴⁴ The personal income tax deductions, and their impact on housing affordability, are discussed in Chapter 5.

In addition there were 73 enterprises with capacity only to produce large-panel construction elements; each could produce 152 thousand square meters annually. There are also 127 residential construction divisions within the other, typically very large, enterprises with the same purpose but somewhat less capacity. The result of this industrial capacity was that in recent years about 50-55 percent of the total volume of housing construction in Russia was erected from precast reinforced concrete. One of the perhaps surprising characteristics of the residential construction industry in the past few years has been the absence of any change in the type of structures built (Table 3.3).

type of material	1985	1990	1991	1992
all materials	100	100	100	100
brick and stone	32.1	30.7	29.1	31.2
large panels	53.3	52.1	55.9	54.4
skeleton-panels	1.1	1.7	1.4	1.8
blocks	.6	.6	.6	.7
large blocks	3.7	3.8	3.8	3.2
wood	8.7	10.0	8.0	7.7
other types	.5	1.1	1.1	1.1

As noted, a disastrous situation has emerged in the construction industry because of the sharp reduction in capital investment for housing from all sources. Large state building enterprises are today in a state of severe stress. With the costs of inputs mostly determined by the market, the large multi-floor panel construction buildings that are the usual production of these enterprises have become the most expensive housing produced and production is often unprofitable. Because of the deep depression in construction of both residential buildings and public building (e.g., schools, clinics, hospitals) constructed using large panels, the industry is now working below capacity. According to Ministry of Economy figures, large panel plants in 1992 operated at only 36 percent of capacity in that year; nevertheless this material still accounted for half of all housing construction.

The main construction strategy outlined in the Program HOUSING is the significant reduction in the production of traditional forms of housing construction, the conversion of the capacity of precast reinforced concrete plants to schools and

other buildings for "social" purposes, and the development of low density and cottage construction. Through 1992 little movement was seen in this direction. More may have happened in 1993 but at the time of this writing the relevant data had not been compiled.

The process of privatizing and demonopolizing the construction industry is moving quite quickly. It is reportedly one of the two fastest privatizing sectors.⁴⁵ According to 1992 estimates of the Ministry of Economy about 25 percent of state construction enterprises were privatized and another 20 percent are in the formal planning stage. (These figures exclude municipal firms.) Reportedly the shares doubled in 1993.

Nevertheless, the state may still own most of the available capacity. Forty-nine percent of new housing construction for 1992 was performed by large state construction firms, with another 21 percent by leasehold organizations, 22 percent by joint-stock companies and 5 percent by cooperative enterprises [Goskomstat of Russia, 1993]. The joint-stock form of housing construction has been the most dynamic as state enterprises shift to this form of ownership, with some firms on their way to full privatization.

The demonopolization of the large construction enterprises is underway, through the separation of some kinds of activities and some divisions. Meanwhile, the early, small cooperatives, private companies, and joint ventures in housing construction have spent the first brief interval fulfilling the needs of the highest income population group. As suggested by the data in Table 3.2 on the trend in units purchased by different clients, this market expanded smartly in 1993.

Still, our sense, from field visits and discussions with knowledgeable observers, is that progress is extremely varied across regions in moving away from the production dominance of the former state enterprises (many now relabeled as joint stock companies). In some regions the large state or former state enterprises retain both their dominance in production and monopolistic ties to the local or regional Administration. The "unified customer" system remains largely undisturbed and prices are set through bilateral builder-"customer" negotiations similar to those of the

⁴⁵ Interview with Jonathan Hay, USAID consultant in the State Property Committee of Russia. It is worth noting that Wallich (1994, p.91) argues in general that oblasts may resist privatizing their enterprises because this may be less profitable for them in terms of total revenues generated for the oblast than privatizing.

past. In other regions, production is more diverse and the old system, if not replaced, is much less dominant.⁴⁶

Conclusion. Housing production has fallen dramatically since the initiation of the economic reform program in 1990. Production levels in 1993 were about half of those in 1987. The bright side is that overall production has stabilized at this lower level. Within the smaller volume of production, state enterprises emerged early as the primary source of demand, with money from the federal government having been severely cut; but 1993 witnessed a sharp increase in demand by joint stock companies and private firms.

Although federal government policy is in favor of low-rise and cottage housing, there has been little shift away from the traditional panel construction. Privatization is well underway, although the largest firms appear to be resistant. Small, new private firms have increased their market share to a significant level. Nevertheless, it is very difficult to judge the extent to which genuine restructuring is occurring as a general phenomenon.

Real Estate Markets

The real estate market has developed rapidly during the period of reforms. The current policy environment is a far cry from the previous policies which discouraged individual housing and private sector development, and suppressed demand for housing. Under the old system, the size of individual housing was limited in 1958 and later, in 1961, the construction of individual housing in cities with a population of more than 100,000 was completely prohibited. Restrictions on eligibility for new state units served to further suppress demand for housing: in Moscow, for example, only those households with less than 5 m² per person were eligible for improved housing; those with less than 6 m² were eligible to buy a cooperative unit.

The real estate market which has sprung to life with the easing of restrictions on private ownership and market transactions is developing on two fronts: new housing construction and the sale of existing units. The primary real estate market emerged when the government began selling newly-constructed municipal units by auction. Slowly, as land and property laws create a more favorable environment for private construction, private sector housing development is expanding. The secondary market, on the other hand, evolved out of the system of swaps of state-owned units which existed, and now involves transactions dealing with privatized state-owned units and second sales of newly constructed units. Thus, the real estate

⁴⁶ In one oblast near the Baltic Republics, the Administration awarded contracts to construct several new residential buildings to Baltic firms in order to break the monopoly pricing of the regional construction enterprise.

market deals with the following types of sales transactions: secondary sales of new and privatized units; the sale of newly constructed municipal units by government agencies at auctions; sales of units through housing construction cooperatives; and the sale of individual housing through real estate developers. The procedures for buying these types of housing vary widely, as do prices.

Sales of Existing Units and the Secondary Market. For years before the transition there was a thriving network of housing exchange that was the precursor to the real estate market developing today.⁴⁷ For example, through the Moscow Housing Service, a quasi-governmental agency, citizens were allowed to exchange state rental units with others, and to register the transfer of occupancy rights from one family to another. In addition to registering exchanges, brokers working for the service helped the families to locate a new unit and to negotiate the terms of the trade. Other unregistered, or illegal, brokers acted in the same capacity. These exchanges were legal as a straight trade, and were permitted solely for the convenience of the households involved. However, these exchanges very much resembled market transactions. Payments related to the value of housing units were made despite official prohibitions, and legally permitted commissions were paid to brokers. In 1992, the volume of exchanges in Moscow was 95,000 units per year, or 3 percent of the city's housing stock. In June 1993, one real estate company offered 60,000 units for swap through its database. Thus, through this system there was a flourishing black market "real estate" industry, which spawned the secondary housing market after privatization and market transactions became legal.

Sources of units. Privatization of state rental units is one of the major reform elements which has contributed to the emergence of the real estate industry. The law "On Privatization of the RSFSR Housing Stock", passed by the Supreme Soviet in June 1991, permitted privatization of state-owned rental units to registered tenants. As described in Chapter 4, privatization did not really get underway until early 1992. The number of units increased steadily each month and by the end of 1992 total of 2.55 million units were privatized, among them, 366,000 units in Moscow, or about 13 percent of the 1990 state housing stock. These new "owners" were consequently accorded the rights of property ownership, that is, among others, the right to sell their flat. Including the large number of units privatized in 1993, the housing privatization program is well on its way to achieving one of its primary objectives: transferring a sufficient number of units to private ownership so as to form the basis of a private secondary market.

Meanwhile, in early 1991, the sale of private units became legal. Flats offered on the secondary market were either privatized municipal or departmental units, or

⁴⁷ For details of the system of exchanges of state-owned units see Khadduri, 1992.

cooperative units for which there is no outstanding loan balance.⁴⁸ These units were generally owned by emigrants, those who had inherited units from relatives, or those either trying to improve their dwelling conditions (buy a better flat) or improve their material situation (move to a cheaper flat). However, there is only a small number of the latter, that is, households selling in order to move to a different unit in the city. Traditional motives for real estate transactions in market economies—changes in job location, family demographics, and family income—are not yet significantly represented. These motives were commonly served by exchanges of state-owned units and, households have, perhaps not made the change to market transactions.

Another source of units on the market, particularly in Moscow and St. Petersburg, is the vacated communal flat, following relocation of tenants to individual units. These formerly communal units are generally components of large flats in the city center, and are in great demand as both residential and commercial space. Once vacated as part of a development scheme, communal flats, reassembled into the original units, typically become the property of an investor who rehabilitates the space into high quality apartments or offices. Units are then sold typically to foreign companies. The price differential between the center and outskirts of Moscow, and between the price of smaller units and these large units, allows at least a 40 percent profit (Kaganova and Berezin, 1993), even after the developer hands over a share of the rehabilitated units to the city as its payment for the property.

In Moscow, data on transfers are available from "Mosprivatizatsia," created by the Department of Municipal Housing, which began registering secondary deals with privatized flats in March 1992. About 20,000 secondary title transfers were registered from March to October 1992. More than half were listed as inheritances or grants, and not all transactions involved a move to a new unit. By the early months of 1993, more than 5,500 transactions were being registered monthly. This number more than doubled to 13,000 in December 1993.⁴⁹ In St. Petersburg, real estate transactions in all of 1993, including sales and gifts, involved 14,400 privatized cooperative units (6 percent of those units) and 34,700 privatized municipal units (16 percent of all privatized units). Thus, over the year about 10 percent of the private housing stock in St. Petersburg was involved in real estate transactions.⁵⁰

⁴⁸ The right to private ownership of cooperative units, for which the loan balance had been paid off, was established by a resolution of the Council of Ministers of the USSR in March 1988. (Kosareva, Struyk)

⁴⁹ Interview with Deputy Director of "Mosprivatizatsia."

⁵⁰ St. Petersburg Developers Survey, 1993, completed by AUREC and commissioned by the World Bank and USAID.

Problems with the Market. The secondary real estate market, although enabled legislatively, is not fully legal due to the volume of sales made for hard currency. Hard currency transactions are illegal for both private citizens and companies. However, with the current rate of inflation in Moscow and the falling value of the ruble, most sales are made in hard currency. The rental market is also mostly in hard currency. In St. Petersburg the share of hard currency leases is about 70 percent. Adherence to the law is further undermined by taxes and the cost of legal transactions. Gains from sales are included in taxable income, and are taxed at about 40 percent. Notary fees for certification of a sale, although now negotiable, are often about 10 percent of the sales price. Instead of declaring the sales price, however, sellers substitute the book value of the unit determined by the Bureau of Technical Inventory, which is the historical production cost indexed by a construction cost adjustment minus depreciation. In Moscow, notaries require an official reference on the book value of the unit by the Bureau of Technical Inventory which encourages this practice.

Another impediment in Moscow is the waiting period for notarizing sales, resulting from the limited number of lawyers authorized to notarize sales. As a result, households may be reluctant to sell or rent their unit and buy another because of the difficulty in coordinating the timing of the sale and purchase. With such delays in a highly inflationary environment, there is a risk that the terms of a sale will no longer be acceptable. Finally the lack of available information on sales prices due to the 10 percent transfer tax and for purposes of income tax evasion creates uncertainty on the part of both buyers and sellers about reasonable sales prices.

Industry development. Despite these obstacles, thousands of sales have been completed and the infrastructure of the market has emerged: thousands of real estate brokerage firms have been established; private developers have started to deal with the whole process from obtaining land to selling the final product; and lawyers specialized in real estate are available to provide assistance. Some firms are spin offs from the government agencies responsible for swaps, others are new private firms, and some are individuals who deal in real estate on an ad hoc basis.

The real estate industry is also slowly organizing and, through the Russian Guild of Realtors established in July 1992, is attempting to develop industry-wide practices and standards through legislation to create a "transparent environment" for professional activity. Among the goals of the organization are the creation of a multiple listing service, or appraisal data base, and clarification of federal and local laws concerning real estate. During the II Congress of the Guild in March 1993, the licensing of realtors through the Guild or a license for Guild to conduct training was also stated as a new goal. In February 1994 an agreement on the licensing of agents between the Guild and the Moscow government was signed. The Guild currently has over 200 full members representing 34 regions throughout Russia and including 99

percent of all real estate firms in Moscow. Members of the Guild of Realtors account for approximately 50 percent of all real estate transactions in Moscow.

Organization of the industry is also evidenced by the creation of the Russian Society of Appraisers. Appraisal offices have opened in several Russian cities as, with the increasing market activity, there is a need for estimates of unit value. Consequently, there is a need to ensure high quality appraisal services. The Russian Society of Appraisers was established in 1992, as an independent non-profit organization, for exactly this purpose: to "provide education, testing, designations, standards and a code of ethics for the members of the society." Members of the society will become certified appraisers following completion of a series of courses and a written examination, offered for the first time in the fall of 1993.

Another indicator of market development is the formation of a multiple listing service by a local broker in Ekaterinburg, with 18 brokers participating as of February 1994. Seven other brokers were advertising through the multiple listing but without listing specific properties. At least two of the Ekaterinburg real estate firms are members of the Russian Guild of Realtors. During the same time, February 1994, there were 289 flats offered for sale through the multiple listing, and 221 flats for exchange. A database compiled by the multiple listing service includes 2,000 secondary sales which occurred between April 1992 and December 1993.

Despite the fact that brokerage is quite lucrative with commissions typically 6 - 10 percent of the sales price, or one month's rent, business practices remain diverse. Some firms use their own capital to buy and sell units, while others are involved in other unrelated business activities. Most real estate firms engage in other activities because of the limited supply of secondary sales. Other activities are related to, but often on the periphery of, the real estate market such as completion of unfinished construction, renovation of office space, relocation of tenants and rehabilitation of communal units.⁵¹ Many firms have little activity and gradually leave the sector, but in most markets there are a few well-established firms. The number of such firms in Moscow and St. Petersburg is around a dozen.

Despite the emergence of numerous real estate agents, the majority of households who moved found new apartments by other means. Of those surveyed in the 1993 Moscow Household Survey⁵² only about 6 percent moved to another

⁵¹ In March 1992, there were an estimated 30,000 unfinished construction projects in Russia, which constitutes a potentially substantial supply of new housing units and office space. However, only 200 projects sold in 1992 due to legal problems with appraisal and ownership. Conflicts over revenues arose between the prefectures which own the projects and the State Property Committee, or Goskomimushchestvo (GKI), responsible for the sale of state property, other than land, which includes disposal of plots on which there is state property.

⁵² For a description of the survey see ANNEX A.

unit during the year, representing 180,000 Moscow households. The highest percentage of those households, 27.2 percent, were provided units from the waiting lists (e.g. municipal, departmental and cooperative lists), or about 49,000 households. Another 22.8 percent reported finding their new unit through friends or acquaintances, while other households found units through newspapers or magazine (8.1 percent), official billboards (11.0 percent), their employer (9.6 percent) and through exchanges with relatives (7.4 percent). Only 3.7 percent, or 6,600 families, found their unit with the help of an individual agent.

However, the number of real estate agents and the organization of the industry exemplify the evolution and expansion of the secondary market.

Prices. This section covers three topics: sales prices of new and existing units; rents in the private and state sectors; and the affordability of both rents and sales prices for the average household. The section draws primarily on information from Moscow.

Prices for housing units in Moscow have increased dramatically over the past several years, spurred by unsatisfied demand even among high-income groups, the soaring cost of inputs, and a limited supply of both new and existing units on the market, especially units of high quality and in a central location. Over the past three years, hard currency prices in Moscow have increased at least seven times. The price of a one-room flat in Moscow went from \$1,500 - \$3,000 in June 1990 to about \$12,000 - \$20,000 in June of 1993. At the same time, June 1993, a two-room flat was \$17,000 - 29,000, with a three-room flat at \$24,000 to \$45,000.⁵³

Real estate prices rose considerably in 1992 (see Table 3.4). In the 1992 report of housing indicators for Moscow (Pchelintsev et al., 1993), both the prices at the beginning of the year and the year-end prices are included to demonstrate this inflation in the housing market. The beginning of the year prices are from the first half of the year and the year-end prices are from the fourth quarter. The difference, therefore, does not reflect the total inflation of house prices over the year. The auction price of a newly-built two-room municipal unit rose almost five times during this period. The average price of an existing two-room unit sold through a broker increased four times during this period, while the average 1991 price less than doubled by the beginning of 1992. House-price-to-income ratios for both state-owned and free-market housing are also presented in the table and will be discussed below.

⁵³ Morozov, Mikhail. "Unchecked Inflation Marks Moscow Housing Market." Commersant, September 22, 1993, pp.12-14.

	<u>First half of the year</u>		<u>Last quarter</u>	
	Price (rubles)	Price/ income	Price (rubles)	Price/ income
Cooperative unit	385	7.2	1210	5.0
New municipal unit (auction prices)	2750	51.1	11550	47.2
Private unit ("black-market broker" prices)	3250	60.4	13500	55.4

Source: World Bank and UNCHS (1992), and Pchelintsev et al. (1993).

For comparison, we have calculated house price appreciation from December 1992 to December 1993 using estimates of the value of units in the Moscow Household Surveys for each year.⁵⁴ A 60 m² (non-communal) unit in the center of Moscow had an estimated value of 16.9 million rubles in December 1992. By December 1993, the same quality unit was worth 165.9 million rubles, an increase of about 900 percent. This increase in house prices demonstrates that inflation for existing units has indeed kept up with general inflation over the year.

Interestingly these price increases are not universal throughout Russia. In cities other than Moscow, sales prices are considerably lower and the ratio of sales price to costs is lower as well. The average sales price per square meter in Ekaterinburg has actually been falling since January 1993—from an average price per square meter of \$1,131 to \$447 per square meter in February of 1994. The number of transactions recorded each month has increased significantly, from 50 transactions in May 1992 to 153 in December of 1993.⁵⁵ Thus, it is possible that a sufficient increase in the supply of housing for sale has caused prices to fall.

⁵⁴ These estimates were determined using the coefficients of a hedonic regression model in which housing characteristics were regressed on values reported by the occupant of the unit. Estimates of the value of a fixed quality unit—that is, the same housing characteristics—were calculated for 1992 and 1993. The following characteristics were used: 60 m² of total space, a 1.5 ratio of total to living space, a separate bath and toilet, a 7 m² kitchen and 250 cm ceiling height, and located in a brick building. The hedonic regression model is explained in more detail in the description of the demand analysis discussed in Chapter XX. For details on the survey see Appendix A.

⁵⁵ Data on Ekaterinburg was provided by Mark Brown, the USAID Resident Advisor to the city on housing sector reform.

The ratio of sales price to construction cost of a unit provides another interesting comparison across cities. In Moscow sales prices rose faster than construction costs in 1992, as the ratio in the first quarter was 7.3 compared to 8.5 in the fourth quarter. These prices reflect the increasing demand for housing, due not only to the growing foreign community but also to the return of wealthy Russians from other regions and cities. In other cities this ratio is significantly lower. In St. Petersburg, the sales price to cost ratio was only 3.2, and in Novgorod only 2.6.⁵⁶

If developments in Moscow are indicative, the combination of rapidly increasing costs and the expanded supply of high quality units has worked to reduce the ratio of housing prices to construction costs in the past two years. By early 1993 in Moscow, the ratio had fallen to between 2 and 4, still uncomfortably high. But by early 1994, the ratio was hovering in the 1.2 to 1.4 range. Thus the super overheated demand for high quality housing appears to be abating.

With the increase in activity in the real estate market, explicit price differentials are emerging where they had formally not existed, and not merely differentials between private and state-owned units. Prices may vary according to the floor on which a unit is located: in Ekaterinburg, units on the first and second floors and those higher than fourteen sold for considerably less per square meter. In Moscow, a unit in a panel building in the suburbs is considerably cheaper than a unit in a low-rise building in a central location. While the average price per square meter for high quality housing in the more prestigious areas near the center was \$1000 in January 1994, units in "Krushchevkas," buildings from the Krushchev era, sold for \$760 per square meter.⁵⁷ The market should respond to these price signals with construction, conversion, and rehabilitation of the housing stock creating higher density and better quality units in more valuable locations.

The extreme disparity between controlled rent for state-owned units and private rents is the most dominant characteristic of the rental housing market. The right of citizens to low cost housing was written into the Constitution, and the rent, or maintenance fees, for state-owned housing has not increased since 1928. Under provisions of an April 1992 law localities could raise rents but few did so before this was prohibited in mid-1993. Constitutional amendments passed in December 1992 provide for a more market-oriented approach to housing and much of the enabling but strict controls in the state rental sector remain in effect throughout Russia. Only in January 1994 did a phased increase in rents on state-owned housing begin (see Chapter 4 for details).

⁵⁶ These figures were collected for the 1992 Report on Housing Indicators on each of these cities.

⁵⁷ "Startling Prices for Municipal Housing Increases" Commerzant, February 12, 1994.

Rents in the emerging private rental sector are not controlled and the shortage of such rentals has contributed to a huge price differential between state-owned and private rentals. Over the past three years hard currency rents have increase considerably. In rubles, inflation of private rents has been even more marked: the median market rent was 7 rubles per square meter in 1989, increasing to 547 rubles per square meter in 1992 (Pchelintsev et al., 1993).

Considerable differentials in rents are also emerging based on quality, size and location. For example, units in the Moscow suburbs rent for considerable less than those in the center⁵⁸ (see Table 3.5 below).

TABLE 3.5 MARKET RENTS FOR PRIVATE FLATS IN MOSCOW: 1992		
Monthly Rent (dollars)		
	Central Moscow	Moscow suburbs
one room	250 - 350	150 - 200
two rooms	350 - 500	200 - 320
three rooms	700 - 1200	350 - 480
more than three	1500 - 3000	500 - 700

Source: *Commersant*, November 13, 1992.

Inflation in the private housing sector has eroded housing affordability for most households in Moscow. The rent-to-income-ratio in the private market, the ratio of the median annual rent of a dwelling and the median household income of renters, has increased in Moscow from 0.42 in 1989 to 1.03 in 1991 and 1.72 in 1992. That is, the vast majority of households in Moscow cannot afford to rent an apartment in the private rental market. The price-to-income ratio, the ratio of the median unit sales price to the median annual income, further illustrates the limited affordability of housing for sale as year-end auction and broker sales prices were 47.2 and 55.4 times the median income, respectively. Table 3.6 shows the rent-to-income ratios for Moscow and several other countries and illustrates the limited housing affordability in Moscow compared to these cities, except in the state-owned housing sector. Affordability in Moscow did, however, improved slightly, as shown in Table 3.4 above, as real incomes rose over the year, and the house price to income ratio fell.

⁵⁸ "The Former USSR Creates a Rental Market of Moscow Apartments," *Commersant*, November 13, 1993, p. 12.

TABLE 3.6		
COMPARISON OF HOUSING AFFORDABILITY: 1990		
	Rent-to-Income	Price-to-Income
Bratislava	0.11	4.57
Munich	0.18	9.60
Budapest	0.06	6.62
Warsaw	0.06	3.60
Washington, D.C.	0.23	3.53
Moscow ^a		
public	0.005	4.27
free-market	1.03	148.50

Source: World Bank and UNCHS (1992), and Pchelintsev et al. (1993).

Note: a. Figures for Moscow are for 1991.

In sum, as Jaffe (1993) has observed, in urban Russia the housing market has become sharply segmented. Private rentals and newly constructed units are available only to the highest income group. The balance of the population continues to rely upon state rentals for their housing, with improvement being achieved through apartment swaps or queuing on the waiting list.

New Construction and the Primary Market. The primary real estate market effectively became operative with the auctions of newly-constructed units, and the recognition that existing units and construction commissioned by municipalities and state enterprises were insufficient to meet current housing demand. Moreover, because public funding was cut dramatically, extreme pressure developed to sell at least some of the units ordered by the traditional clients of the "kombinats." Beginning in 1992, local authorities and state-owned enterprises began offering for sale newly-constructed units, primarily to obtain funding for project completion. About thirty percent of municipally-constructed units in Moscow were sold at auction that year. Furthermore, the federal government espoused private housing development and the growth of low-rise or cottage construction as part of the new housing program to alleviate the housing shortage in Russia. Incentives such as exemption from the profit and value-added taxes were even offered to those investing in housing.⁵⁹

⁵⁹ Speech by Samoshchenko, Chief of the department in the Ministry Economy, at the II Congress of the Russian Guild of Realtors.

Land allocation and development. Expansion of the primary market and large scale housing development is largely dependent on new land reform legislation. In this section, we review the current processes of land allocation primarily in Moscow and St. Petersburg: how does it work; and what are the actual practices? Although some of these methods may seem convoluted or unethical, they have developed as a means to overcome the remaining obstacles to land development.⁶⁰

Federal law permits local soviets, regional governments, and the governments of the cities of Moscow and St. Petersburg to establish their detailed procedures for land allocation. In Moscow, legislation relevant to land allocation was promulgated by the Mayor's office, while in St. Petersburg rulings were passed by the small soviet of the municipality. Both cities established procedures for allocation of land plots for development according to three different types of development: developer-initiated projects, investment competition, and individual housing. The process for developer initiated projects proceeds in two phases: Phase I is approval of the location of the land for the type of development proposed; and Phase II is the approval of the specific project design and conveyance of property rights.

Before rights to land vest, prospective land developers must complete the entire land use and building permit process, including infrastructure issues, building orders and planning assignments from the municipality and design and approval of the project, with work undertaken at the expense of the developer. The procedure for obtaining a building permit in St. Petersburg is arduous, requiring 80 to 90 official signatures. Even then, the official plans can still be detailed down to the individual project level. In Moscow, for lots offered at auction, the use of the plots and design of the project was pre-determined by the city including the building space, number of floors, and function. Not surprisingly, this bureaucratic process and centralized planning proves to be a disincentive to would be developers.

In both Moscow and St. Petersburg proposed projects must be reviewed by the economic development committees of the respective cities for compliance with the city's economic and social development needs, and for adequate financial backing to complete the project. A development project must then meet local urban development and town planning regulations, primarily the Master Plan, and finally, it is submitted to the mayor for approval.

Despite the current Regulations on Land Relations which states "that citizens and legal persons who are land owners have the right to sell, bequeath, gift, mortgage, rent, or exchange land...", one of the major inadequacies of land law remaining in Russia is that legal entities may not own or sell land for individual

⁶⁰ Land legislation is reviewed in Chapter 2. For more detail, see Butler and O'Leary (1993).

housing⁶¹ due to the precedence of older laws which remain in effect. However, informal methods of land acquisition have evolved to allow for individual housing construction by developers without directly violating the law. For example, a developer may acquire land for a project through lease or permanent use, usually through an intermediary who has connections with the local land authorities. Then, in order to "sell" the individual plots, the developer builds the foundation of the house, which legally constitutes a structure, and sells this to the buyer. Only land with a structure may be placed in private ownership. The buyer can then claim rights to the property on which the foundation is located and can receive title to the land. The developer then completes the house for the new owner. These developer-initiated projects and individual housing construction are the predominant method of land allocation.

Auctions, or investment competitions, are more common in Moscow or St. Petersburg than in other cities. Procedures are much more transparent in these cities than in outlying jurisdictions, in part, due to the visibility and political pressures in larger cities. However, the system is still based on the Soviet system of land use planning, and the concept that rights to land follow and are dependent on its use. One does not obtain rights to land unless the proposed project conforms to the master plan and until the entire development project has been approved. Thus, numerous players in the process have the ability to delay or prevent the realization of the project.

Still, the use of auctions as a means of land allocation is spreading to other cities. A recent demonstration project in Ekaterinburg auctioned the lease rights for two land parcels. The distinguishing feature of the demonstration was, although the use was predetermined, the developer was given a range of options and was permitted, with approval, to deviate from the original development plans. The result was a range of bidders, two construction cooperatives, two construction divisions of larger enterprises, and the local "kombinat." Bids from the cooperatives illustrates their emergence as viable developers, with the resources to bid on such a project (Bowz and Brown, 1994).

In smaller cities and to some degree in Moscow, the "informal" process of land allocation often precedes the formal procedures. The informal process involves working with key individuals, such as the head of administration, or chairman of the local land committee, or *komzem*, who assist in the approval process and facilitate the coordination between players. According to developers, the formal procedures become a means of "legalizing" decisions already made.⁶²

⁶¹ Butler and O'Leary, 1993, p. 72.

⁶² Butler and O'Leary, 1993.

Individual citizens, on the other hand, can acquire land for housing construction in several ways. Citizens can receive title to the land which they currently possess under lessor rights (e.g. lease, perpetual use) by applying to the local administration. Plots of land up to an established norm are granted free of charge; any excess of this norm is available for purchase or may be occupied under life-long inheritable possession. Once the transfer is registered with the local state property committee the property rights are effective.

Those not occupying a plot of land may obtain a plot by three avenues: (1) application and allocation from the local redistribution fund; (2) unofficial sales of plots between citizens through reregistration of land plots; or (3) purchase from a developer, as described above.

Although at first glance one may note shortcomings in the new laws and regulations concerning land, the progress in terms of the evolution of actual practice throughout 1992 and 1993 has been considerable. The market is truly working and, in many regards, actual practice is ahead of the law. The number of active developers and the volume of new construction both attest to the progress made. The next step is now to bring the laws into line with existing practices.

Finance. This increase in activity in the real estate market is not surprising as there is considerable financial incentive to enter into real estate investment. Potential gains are considerably higher than other investment opportunities⁶³ especially through transactions made in hard currency. Table 3.7 gives some illustrative figures for early 1992.

Real estate	400 - 500%
Investment in stock portfolios	200 - 230%
Interest on bank deposits	30 - 90%
Average dividends per share	100 - 120%
Investment in shares of one company	115 - 130%
Interest from auction deposits	100 - 125%
Investment in hard currency	850%

Source: *Commerzant*, March 31, 1992

With increasing interest in real estate investment and the limited institutional financing for new housing construction, several investors or buyers often contribute

⁶³ "Construction Costs Pushing Up Investment Risk," *Commerzant*, March 31, 1992, pp. 14 - 18.

to the financing of a housing project (see Figure 3.1). The developer begins construction either using private capital or funds from an enterprise or firm. However, if funds are insufficient for completion of the project, the developer seeks "share participation," and sells off some of the units during construction to another enterprise or firm. Both the developer and the other company, the second source of funds, contribute funds as construction continues, or as costs of construction change. During later stages of construction or after construction is complete the investors:

- sell part of the building or an apartment to a third company, which in turn either sells units or transfers its units to employees or households on the waiting list, if this is a state-owned enterprise;
- sell individual apartments to households, either directly or through a real estate broker; or,
- transfer the title of apartments or sell apartments at low prices to their employees or those on their waiting lists (if these are state-owned enterprises).

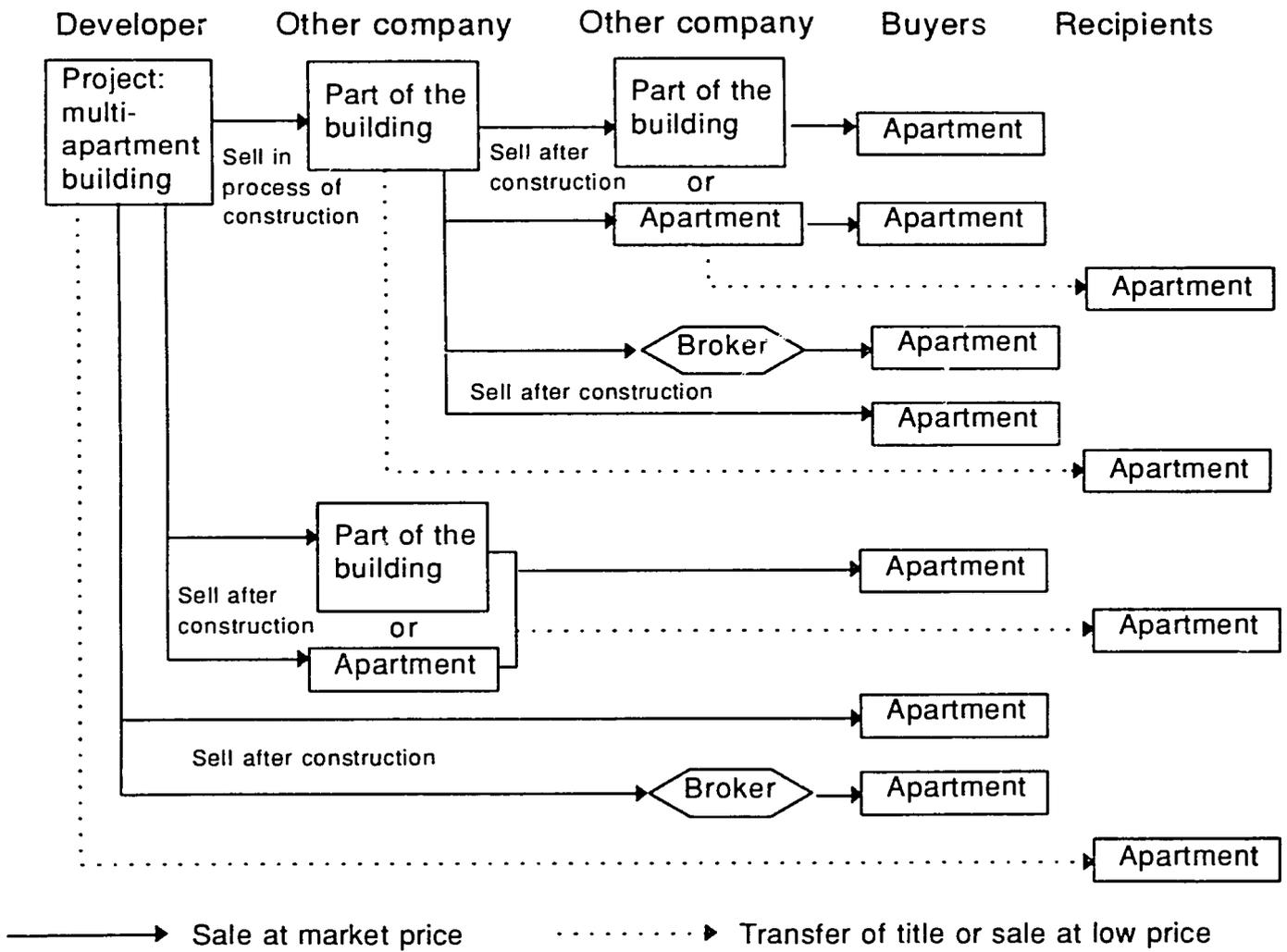
In St. Petersburg no less than 50 percent of new housing construction is financed through "share participation": of the 51 buildings constructed in St. Petersburg in 1993, more than 20 were officially registered with the Property Fund as financed through "share participation"⁶⁴.

Although widely used, "share participation" and, more specifically, the non-performance of one or another of the parties to a construction contract, is one of the impediments to private sector construction. The higher the inflation rates and the increase in prices, the more participants are likely to be involved in a project, and the more likely are financial difficulties which cause delays. Rapidly changing inflation rates and relative prices contribute to contract problems when initial estimates of both nominal and real costs prove inaccurate.

Conclusions. Although tracking the real estate market is not an easy task, the available information suggests that the market is developing, if slowly. With the number of real estate agents and transactions constantly growing, the market is off to a good start. Legislation has enabled the emergence of the market, but further legislation easing restrictions on land allocation is necessary in order to continue its

⁶⁴ St. Petersburg Developers Survey, 1993, completed by AUREC and commissioned by the World Bank and USAID.

**FIGURE 3.1
Construction Finance and Unit Transfer**



growth. Most disturbing is the fact that current land allocation practices have progressed more rapidly towards the market than current legislation permits, creating an impediment to legal development and inviting irregular practices that are hard to extinguish.

The lack of financing is also major constraint on both the secondary market and on real estate development, as it limits effective demand in the former and supply in the latter. It is most inefficient for developers to have to piece together funding for a project, which serves to keep supply down relative to demand, as evidenced by market prices. High price to cost ratios such as there are in Moscow further encourage inefficiency in construction. A developer is less likely to monitor costs given the current profit margin on sales of new units. Thus, it is imperative to facilitate the increase in the supply of housing on the market through better financing and clear, market-oriented laws and practices of land allocation.

4. RENTAL HOUSING

Until the transition, officially the only rental units in the Russian Federation were those rented by the state, and the magnitude of the state rental sector (67 percent of the national housing stock) dwarfed the corresponding sectors in Eastern European countries at the beginning of economic reform. For example, in Hungary the state sector accounted for only 20 percent of the housing stock in 1989; Bulgaria, 9 percent; Poland, 34 percent (possibly plus 14 percent of units that were in rental cooperatives); and Czechoslovakia, 45 percent (Baross and Struyk, 1993: Table 1). The importance of state-owned housing—housing owned both by municipalities and by enterprises and government agencies (departmental housing)—means that any reorientation of the housing sector along market principles must begin with profound changes to this sector. Moreover, the fundamental problems of this sector, which have been frequently recounted,⁶⁵ would demand it be given priority attention even if constituted a smaller share of units.

The Russian Federation has adopted a two-track strategy for effecting this change: a maximum effort at privatizing this stock and reform of the pricing and delivery of services in those units that remain in the public inventory. The two tracks of privatization and reform are closely related. Raising rents is critical to increasing the attractiveness of privatizing a unit. It is also the linchpin of sector reform, because raising rents permits the market to achieve a more efficient utilization of the stock by allocating available housing to those with effective housing demand. Higher rent revenues will support improved maintenance, which in turn will increase tenants' willingness to absorb further rent hikes. However, improvements in the quality of maintenance services only seems likely if the existing monopolies of state maintenance firms are decisively broken and replaced with procurement of services on a competitive basis. Two other key reform elements in promoting privatization are decreasing tenants rights so that unit owners have demonstrably greater security than renters, and promoting the creation of condominium associations so that owners have more control over their property, including the quality of building upkeep.

This chapter examines five aspects of this transition: privatization; the program of raising rents and introducing housing allowances; initial results of reforming the management of the existing stock; tenants' rights; and, some special considerations involving department housing.⁶⁶

⁶⁵ See, for example, Renaud (1991), World Bank (1992), Struyk, Kosareva et al. (1993).

⁶⁶ For more on the place of privatization in housing reform, see Struyk and Telgarsky (1992).

Privatization

In one sense the privatization program is the *sine qua non* of housing reform in Russia: unless a significant volume of housing is in private hands, available for sale and rental in the market, there will be no market. Russian policy makers decided the gains from rapidly establishing a housing market (and giving a large number of families a direct stake in the overall economic reform program) outweighed the considerable costs which the policy of low-charge and no-charge privatization entailed. These costs include the adverse distribution of the nation's wealth, i.e., those who had obtained the best units through positions of influence in the old system (i.e., the *nomenklatura*) now realize the largest windfall gains. Additionally, cities are denied the possibility of collecting substantial revenues badly needed for capital projects or even to fund housing maintenance.

We begin this section by examining what has happened, particularly in 1992 and 1993, i.e., how extensive has privatization been? what is the trend? who is privatizing and why? and, is this pattern changing over time? We then discuss an emerging policy question: is there some amount of free privatization that is enough; should further privatization be discouraged?

Developments. How has privatization fared? In examining the experience one must first realize that in practical terms the process did not really start until the beginning of 1992, when local governments had passed their laws necessary to implement the Federation law.⁶⁷ Second, one must try to weight the benefits and costs of privatization from the perspective of the tenant. On the one hand, the price was right: units could be acquired with a minimum of red tape at little cost or no cost beyond a truly minimal processing charge. The obvious gain from privatizing was the ability to dispose of the unit freely: to sell or rent it on the market, or to bequeath it to a relative or friend not registered as living in the unit.

Still, despite the generous terms, tenants in most cities were very reluctant to seize the opportunity to "buy." This can be explained largely by the combination of two factors. Tenants enjoy very strong rights: they are almost impossible to evict, even for non payment of rent; and they have the right to bequest the occupancy right of their unit to adult children or grandchildren registered as living in the unit. So the gains in tenure security from privatization are minimal. In addition, the poor condition of the buildings in which many units are located is a powerful deterrent—taking a unit is essentially receiving the right to pay for future rehabilitation. Moreover, uncertainties about the cost of the new property tax and

⁶⁷ The possibility of renters privatizing their units had existed in various forms since the end of 1988, but few units were transferred. Official data indicate that before 1992 only about 204,000 units were privatized under all programs.

future fees for maintenance clouded the decision. The results of a survey taken at this time are confirmatory:

Surveys [in 1988] showed that only 10.7 percent of Soviet citizens were dissatisfied with their living conditions because their apartment was not their personal property, and, accordingly, would like to purchase it from the State. The majority (51.2) percent of people surveyed stated categorically that they did not want to buy the apartment they occupied. (Vysokavsky, 1993, p. 277)

Hence, the number of units privatized in the early months was modest. For example, the number of units privatized in February 1992 was 96,000. However, throughout 1992 there was a steady acceleration in the volume privatized.

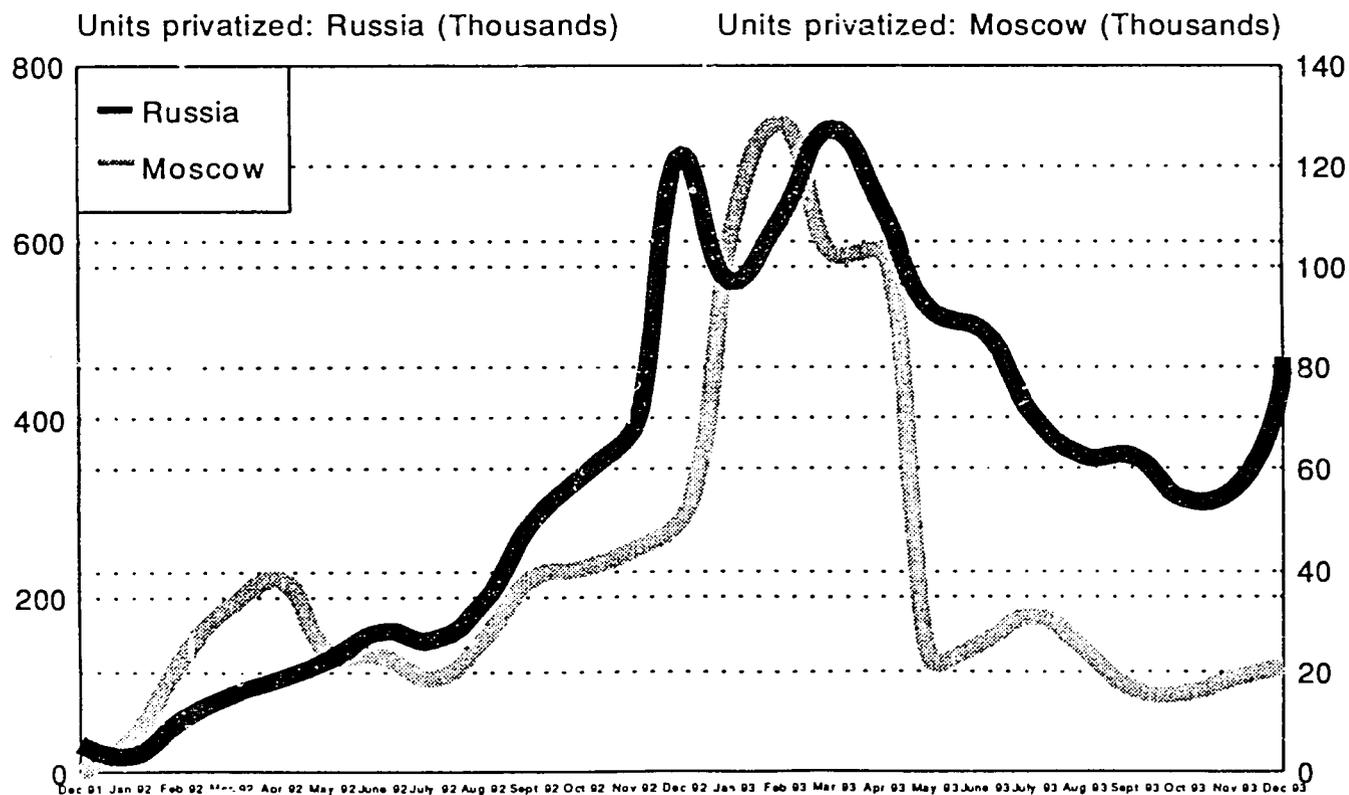
Tables 4.1 and 4.2 summarize the results of the housing privatization process through the end of 1993. Most impressive is the overall trend in privatization: the number of units privatized increased to 5.8 million in 1993 from 2.6 million in 1992 and only 178,000 in the years before 1992 (Table 4.1). In total, by the end of 1993, 26 percent of the state housing stock had been transferred into private ownership by the end of the 1993 (Table 4.2).

The data in the tables also tell an important story about the composition of units privatized, as between municipally and departmentally owned units. While in both 1992 and 1993 a large number of departmental units were privatized, in fact the rate of privatization of this stock is substantially behind that for the municipal stock. By the end of 1993, 37 percent of municipal units had been privatized compared with only 20 percent of departmental units (Table 4.2). Also, the difference in privatization rates between departmental and municipal units increased between 1992 and 1993, from 6 to 17 percentage points. Many housing experts believe that the enterprises have generally discouraged their workers from taking title to their units. This pattern is discussed further below.

These data also confirm the leadership role of Moscow in housing privatization. Overall, 36 percent of the Moscow stock has been privatized. While in part this can be attributed to the high share of municipal housing in the city's housing stock, the city has succeeded in shifting departmental units into higher ownership at a higher rate than other localities—25 percent of Moscow's departmental housing had been transferred to private ownership by the end of 1993 compared with 20 percent for Russia as a whole. If one adds the 10 percent of Moscow's housing units that are in cooperatives to the 36 percent of state units that have been privatized, the conclusion is that nearly one-half of the city's housing is now in private ownership.

There is no doubt that the privatization program has been successful in meeting its objective of shifting a large number of units into private ownership so that a real housing market can emerge. At the same time, an examination of the month-to-month trends in the number of units privatized suggests that the number of units

FIGURE 4.1 Privatization in Russia and Moscow December 1991 - November 1993



Source: Goskomstat

... the Housing Stock, Dec. 91 - Dec. 93.

that will be added in 1994 will not approach the 5.8 million of 1993. Figure 4.1, which presents data for December 1991 through December 1993, shows that for the country as a whole there has been a large decline in monthly privatizations since the peak volume of about 700,000 units in the first quarter of 1993. A similar downturn is shown for Moscow. While in the last couple of months of 1993 the national numbers turned back up, again reaching about 450,000 units, there is no way to know whether the recovery will be sustained.

The reasons for this downturn in privatization are far from clear. It may well be that the more attractive units have been privatized and the financial gain from owning the remaining stock is much less. It could also be that the increasing political instability of the spring and summer of 1993—and the possible adverse effects on the entire reform process—caused tenants to be more cautious about joining the ranks of property owners. Ruble (1994), based analysis of developments in Jaroslavl, has suggested that the December 1992 amendments to the privatization law which made free-of-charge privatization mandatory had the effect of diminishing the perceived value of housing to tenants: if the government is giving this housing away, how valuable can it really be? In other words, Ruble believes the charges mandated in the original program for space above the social norm were important in defining value. Consistent with this hypothesis, one could argue that the sustained high rate of privatization in the early months of 1993 were due to emptying the pipeline of pending applications, not with new decisions to privatize.

Table 4.1
Housing Privatization Summary
(thousands of units)

	totals				1993					1992				
	1993	1992	prior	total	municipal housing		departmental housing		total	municipal housing		departmental housing		total
					except Moscow	Moscow	except Moscow	Moscow		except Moscow	Moscow	except Moscow	Moscow	
applications filed	5,518	3,993	236	9,747	2,318 (3,993)	388	2,737	74	5,518	1,997	477	1,463	56	3,993
privatized units	5,804	2,612	178	8,593	2,428 (2,612)	519	2,760	97	5,804	1,086	337	1,160	29	2,612
average square meters of space	48	49	49	48	na (49)	40	na	43	48	48	43	53	42	49

Source: Goskomstat, Annual Reports on Privatization of the Housing Stock, 1992-1994.

Table 4.2 Privatized Units as a Percent of the 1990 State Housing Stock (cumulative)		
	1992	1993
All units		
Russia	8.4	26.0
Moscow	13.3	35.5
Municipal units		
total	12.4	36.8
Moscow	15.7	39.8
other	11.7	36.2
Departmental units		
total	6.1	19.7
Moscow	4.8	25.3
other	6.2	19.7

Source: Goskomstat, Annual Reports on Privatization of the Housing Stock, 1991-1994, and authors' calculations.

In fact, even before the passage of the amendments to the law which made free-of-charge privatization the law of the land, this was already the practice. In 1992 for the country as a whole 82 percent of units were privatized without charge, except for a nominal processing fee; excluding Moscow, the share was 78 percent.⁶⁸

In short, it is very difficult to forecast the future rate of housing privatization. One factor that could be important, however, is the shift of a large number of units from departmental to municipal ownership as a consequence of enterprise privatization. As discussed further in the context of developments in the departmental housing sector, this could set off a "second wave" of privatizations. Another factor could be actions by cities to encourage further privatization. Moscow, for example, in designing its program of rent increases which come into effect in 1994 (see the next section), added a small surcharge to maintenance fees for state rental units compared with the fees for privatized units in order to encourage privatization.

The opportunity cost of low-cost and no-cost privatization to local governments appears to have been high. The data compiled by Goskomstat include the estimated value of the units sold. This is an artificial figure that is constructed by the local Bureau of Inventory Control (BTI) which maintains detailed physical records on all buildings. The value of a unit is computed on the basis of historical costs updated

⁶⁸ Why such a large share of units are sold without charge is illustrated in Kosareva and Struyk (1993) for Ekaterinburg and Novosibirsk, using the rules these two cities adopted for their programs.

to 1990 using a construction cost index and then reduced for the extent of depreciation. Using data for Moscow Lowry (1992) made a rough estimate that the BTI figure was about 3 percent of the market value in May 1992.⁶⁹ If we apply this rule of thumb to the R40.9 billion figure reported by Goskomstat, then the value of units privatized at the end of 1992 was about R1.3 trillion (in 1992 prices). Against this, R2.4 billion, or about 2 percent, was received in cash from purchasing tenants.

This figure indicates both how little difference the national shift to no-cost privatization has made to local government revenues and the large foregone revenue from the give away. In assessing revenues losses, however, one must recall the initial reluctance of Russians to accept title to their apartments at any price. In other words, a more aggressive pricing policy may well have resulted in a still-born program.

What do we know about which units are being privatized and who is doing the privatizing? We can give a limited answer to this question based on information from a panel survey of occupants of 2,000 units in Moscow in December 1992 and 1993 that were state rentals at the beginning of 1992.⁷⁰ By December 1993 about 32 percent of these units had been privatized or tenants were awaiting certificates of transfer by the time of the survey. Another 13 percent said that they plan to privatize their units within the next six months. The balance—55 percent—said they have no interest in privatizing their units.⁷¹

Daniell et al. (1993b) analyzed the patterns of privatization in Moscow through 1992, with the maintained hypothesis being that the decision to privatize was determined by economic factors. They obtained a good fit of a logistic model in which the dichotomous dependent variable took the value of 1 if the unit had been

⁶⁹ BTI/Moscow's ratio of estimated to market value has been increased systematically since then, although we do not know the average value of the ratio nor whether it has been increased in other jurisdictions.

⁷⁰ This is a random survey of units in Moscow with access to a telephone, i.e., either a phone in the unit, or in the case of communal units a shared phone, which covers 92 percent of units plus an additional random sample of newly constructed units awaiting phone service that accounted for another 3 percent of units. See Annex A for a more complete description.

Privatizers (those who "did")--those who have received a certificate of ownership through the privatization process, plus those who have applied to receive their unit, their application has been accepted and they are waiting for their certificate.

Interested (those who "will")--those who express a strong interest in privatizing their unit, i.e., they state explicitly that they intend to privatize within the next six months.

Uninterested (won't)--those who have no plans to privatize their units.

privatized and was zero otherwise and the independent variables was the market value of the unit.⁷² In another specification of the model, an independent variable was added which was highly significant: it took the value of 1 if the tenant said that both increased maintenance charges and higher maintenance fees were reasons for people not privatizing and was zero otherwise. Thus, the hypothesis of economic motivation was supported: higher unit values increase the odds tenants privatizing and worries about cash flow reduce the odds.

The pattern of differences in unit values is illustrated by the following figures which show values by income quintile for all units and privatized units by December 1992.

income quintile	all units	privatized units
lowest quintile	7,556	6,766
2nd	7,885	8,646
3rd	9,068	11,898
4th	9,232	13,038
5th	9,840	13,244

Source: Authors' calculations with December 1992 household survey data.

The units privatized are clearly more valuable, except among the lowest income group, which is dominated by pensioners who have a strong motivation to privatize to be able to leave something to their children or grandchildren.

Tables 4.4 and 4.5 display privatization rates for different socio-economic groups and occupational groups (based on the most prestigious occupation held by

⁷² Details of the estimation of unit value are given in Annex C.

a household member).⁷³ In Table 4.4, "pensioners" are elderly persons or couples living alone, and "singles" are non elderly persons living alone. The "higher" and "lower" income groups for each demographic group was formed so as to have about the same share of households in each income group. The figures show that pensioners have been by far the most likely to privatize their unit—with about 60 percent having done so. As suggested above, the elderly appear to be doing this to insure their ability to bequeath their unit to a family member. At the other end of the spectrum, simple nuclear families of parents and children (labeled "adults with kids" in the table) have the lowest incidence of privatization. This group is followed closely by singles in their reluctance to privatize. Importantly, both of these groups also have very high incidence of households who said they were not interested in privatizing their units ("won't"). Note that high or low income does not make much difference in the likelihood of privatization.

**Table 4.4
Percentage Distribution of Privatization Status
By Socio-Economic Group:
Moscow, December 1993**

	Did	Will	Won't
pensioners — lower income	58.0	6.8	35.2
pensioners — higher income	60.8	11.1	28.1
singles — lower income	26.5	7.1	66.4
singles — higher income	27.0	18.0	55.0
adults with kids — lower income	20.6	10.9	68.4
adults with kids — higher income	15.1	13.2	71.7
adult with parent — lower income	33.1	15.1	51.8
adult with parent — higher income	43.4	15.1	41.5
complex family — lower income	26.2	12.2	61.6
complex family — higher income	31.5	18.1	50.5

Source: authors' tabulations of data from Moscow housing panel survey of 1993.

⁷³ Annex C contains information on the share of households in each of these categories, and for the socio-economic group, the average December 1993 household income of those in each group.

	Did	Will	Won't
directors	29.2	15.8	55.0
intelligentsia	37.9	14.7	47.4
military	17.4	10.1	72.5
white collar workers	33.5	9.6	57.0
skilled workers	15.6	14.7	70.3
blue collar workers	19.8	14.0	66.1
pensioners	55.5	10.8	33.7
others	25.6	7.7	66.6

Source: authors' tabulations of data from 1993 Moscow housing panel survey.

The incidence of privatization varies substantially by the highest occupation of the workers in the household (Table 4.5). Among these employed, higher rates of privatization are recorded for members of the intelligentsia, directors, and white collar workers. The lowest rates are for skilled and blue collar workers and for members of the military. This pattern suggests that those in lower prestige jobs may as a group be refusing to participate in the new housing market, and this in turn may reflect a more general disillusionment with economic reforms.

Should Free Privatization Continue? Housing privatization is clearly well underway; its success has certainly exceeded early expectations. With the enormous volume of units now in private ownership, the foundation for a real housing market has been established. In Moscow, for example, if we include cooperatives, about one-half of the housing stock (including cooperative units) is now in private hands.⁷⁴ Secondary sales are plentiful and private rentals are beginning. At the same time, the rate of privatization has diminished sharply in recent months. Under these circumstances it is appropriate to ask if localities should be give the right to change the terms of privatization to preserve some of the stock as rentals and to generate some revenue for the cities from future sales. This could be done through legislation

⁷⁴ A cooperative unit is defined in the official statistics as privatized when the loan used to finance purchase of the unit is fully repaid. If all cooperatives are considered to be privately owned, then the figure in the text increased to about 39 percent.

that permitted municipalities to announce that free privatization would be halted after six to twelve months. But should such a law be proposed?

Three arguments can be advanced for giving municipalities this option. First, low income families may privatize their units and then not be able to pay the cost of maintaining them and the property tax. In this case they will be forced to sell their apartment and return to being renters. Only able to pay low rents, they will move to the worse housing and the least desirable neighborhoods. These low quality apartments will be vacated by families who can afford to purchase the flats offered by the low income owners.

Republic governments can prevent this scenario from becoming a reality by making those who privatize their units eligible to receive a housing allowance under the new program, if they meet the income test. This certainly changes the terms of the debate,⁷⁵ but it does not eliminate the possible problem. In order to achieve equity and control costs, allowance payments for owners and renters will be determined using the same parameters. Now, assume a low income family finds itself in a building in which the condominium association votes to spend substantially more for maintenance than the amount provided by the municipality for rental units. In this case the family is supposed to pay the maintenance charge above that covered by its housing allowance subsidy. If it cannot do so, and assuming the other members of the association will not make the payment on the family's behalf, then it could be forced to move. Raising the price of privatization may discourage some low income families from taking this step and prevent future problems. As seen above, many lower income households have privatized their units and therefore could be at some risk as members of condominiums.

A second argument advanced for limiting privatization by raising purchase prices is to preserve a significant rental stock. Clearly, Russian cities are not yet in danger of eliminating their rental sectors. But should steps be taken to keep some share—25-30 percent—as rentals? Because of the lower costs involved in moving between rentals, many housing economists have argued that rentals serve an important function in promoting labor mobility and for newly formed households who begin with a "starter" unit and move more permanently to another unit later. We do not find preserving the rental stock a compelling argument. The supply of rentals can come from privatized units as well as from the existing social stock. With the introduction of demand-side subsidies, it is not essential to preserve a "social housing stock," although it is arguable that cities should be able to do this.

⁷⁵ Analysts who have considered this issue have not foreseen the possibility of those privatizing receiving an allowance payment. See Buckley et al. (1992) and Hegedus et al. (1992).

The third argument in favor of raising purchase prices to slow down sales is to pour badly needed funds into coffers of local governments. The argument against this proposition is that at higher prices the number of takers may be quite small. If those most interested in purchasing have already done so, as seems the case, then only a modest price increase could cut sales very sharply indeed.

Finally, while an across-the-board price increase on units to be privatized may not be advisable, some thought must be given to whether those now being allocated apartments should have the same right to privatize as others. This has been the policy thus far, including families who have occupied newly constructed units. Broad equity considerations would suggest that "right" answer is "yes." There are two rather compelling objections, however. First, confronted with giving away newly constructed units many local governments are electing to sell the majority of their new production instead, in part in order to pay fully for the units added to its inventory from non budget sources. This combined with privatization of the stock has resulted in a much reduced flow of units to those on the waiting list.⁷⁶

Second, the economic gains to a family now receiving a unit are so enormous that many families will be quite willing to make a side payment, perhaps a very large one, to obtain a unit and especially a good unit. In this situation, it may be wise to allocate new units without a right to privatize—at least until demand and supply are in better balance. In this regard, a very positive development is that those on the waiting list are now being offered a sizable subsidy for home purchase in the form of downpayment assistance which can be thought of as buying out their right to housing provided under *naym* social rental contract.⁷⁷

On balance, we see merit in limiting the time for free privatization to a one year period beginning in the summer of 1994 and thereafter giving localities the decision on whether to continue privatization and, if so, on what terms. The time limit will force the decision about privatizing for many tenants and should produce a new surge in the rate of privatization. By the summer of 1995 the ownership distribution will be defined and the responsibilities for maintenance and rehabilitation expenditures substantially clarified. This in turn should promote the formation of condominium associations for greater control of buildings with a significant share of privatized units. Cities will also know the buildings for which they will have continuing responsibility and can focus their rehabilitation activity accordingly.

⁷⁶ In 1990 13.5 percent of families on the waiting list for municipal housing in Moscow were taken from the list; in 1992, the corresponding figure was 9.1 percent. For Russia as a whole the parallel figures are 12.3 and 9.7 percent.

⁷⁷ See the section on housing finance in Chapter 2.

Raising Rents and Implementing Housing Allowances

While privatization is an important part of the story, it is far from the whole drama of reform of the state rental sector. As indicated above, a substantial number of families say they will not privatize their unit. Directly changing the basis on which the rental sector operates is, therefore, essential.

Fundamental in this process is the dual policy of raising rents and introducing housing allowances (means-tested payments to low income families to assist them in paying rents). With higher rents, there will be enough income to fund good, competitive maintenance of the housing stock. Additionally, as rents rise to market levels, there will be no attraction to families who do not qualify for housing allowance payments to wait to be allocated as state unit. Similar units, whether private or state, will cost the same; why wait? The same, of course, will be true for those who do qualify for a housing allowance, i.e., they can find a unit they can afford with the allowance payment in the open market, they will be able to rent it. Consequently, over time as the supply of private rentals grows the seemingly infinite waiting lists will simply quietly disappear, and along with them a major source of inequitable treatment and corruption.⁷⁸

Note that "rents" consist of two components that are charged and paid separately. Until 1994 maintenance fees remained unchanged since 1928 and cost 16.5 kopeks per square meter of living space.⁷⁹ Charges for communal services are computed separately for about a dozen different services. Of these, only electricity and telephone usage are monitored for individual units. Charges for communal services have been raised fairly frequently in the last few years; charges for some of the less important items now cover full cost.

In 1992 and 1993 tenant payments made a wholly insignificant contribution to the costs of providing services. Moscow officials estimated that they covered less than 1 percent of maintenance costs at the end of 1992 and even less in 1993. This contrasts with 35 percent in 1990. A similar picture emerges from data on tenant's expenditures. In March, 1992 the average tenant devoted about 2 percent of its income to rents (maintenance fees and communal services); for the poorest 25 percent of the population, these expenditures accounted for only 4.2 percent of

⁷⁸ See Alexeev (1988) for a summary and references to the literature of the actual allocation of units under the Soviet system.

⁷⁹ Actually, beginning in April 1991 it was possible for local Soviets to increase maintenance fees, and a few, such as the one in St. Petersburg, did.

income. By November 1993, the poorest households spent only 0.8 percent of their income on housing.⁸⁰

Local governments have adjusted in three ways to the sharp reduction in total costs covered by tenants: cutting services, increasing subsidy payments from their budgets, and imposing a new tax on enterprise turnover to pay for housing maintenance. Earlier it was noted that on a national basis funded maintenance budgets were sufficient to cover only 25-30 percent of estimated requirements in 1992. In Moscow in 1993 the figure was 45 to 50 percent. Even so the City still devoted about 17 percent of its total budget to existing municipal housing: 2.8 percent for current maintenance; 10.1 percent for capital repairs, and 4.1 percent for communal services subsidies.⁸¹ If maintenance services had been adequately funded, they alone would have accounted for 6 percent of the City's budget. As it is, deferred maintenance is piling up, which implies additional capital repairs in the future.

To help cover the rising cost of maintenance and communal services many local governments have enacted a 1.5 percent tax on enterprises' turnover, based on a law enacted by the Supreme Soviet in early 1993.⁸² Each locality decides whether to implement the tax. They also decide on the distribution of revenues collected, i.e., whether they go solely to maintain municipal units or they are shared with enterprises who have their own housing for workers. Enterprises that have their own housing must pay the tax but their own expenditures on housing maintenance and communal services are deductible. While there are no national data on the number of localities which have adopted the tax or the revenue generated, our sense, based on visits to oblasts in the western part of Russia, is that many local governments have implemented it.⁸³

These figures highlight two realities. First, the cost of providing services is a substantial drain on cities' current resources, making them anxious to acquire revenues to cover these costs. The apparent alacrity with which localities have

⁸⁰ The figure on the share of income spent on housing is from Struyk, Kosareva et al. (1993); parallel data for 1993 are from author's calculations using data from the monthly households income and budget survey conducted by Mosgorstat for November 1993. The figure on the share of total costs covered by tenant payments was provided by the Moscow Department of Engineering and Communal Services.

⁸¹ Data supplied by the Moscow Department of Engineering and Communal Services.

⁸² Law of the Russian Federation, "On Foundations of the Tax System," N.2118-1, February 25, 1993.

⁸³ Moscow only adopted the tax at the end of 1993. Moscow Government Order, "On the Structure of the Moscow City Budget for 1994," N.1135-A, December 14, 1993.

embraced the new turnover tax for maintenance supports this point. Second, the great majority of families can afford to spend a substantially greater share of their incomes for housing. This combination suggests that one can expect a rapid implementation of the program of increasing rents and introducing housing allowances.

The Law on Fundamentals requires that rents be raised to fully cover operating costs within a five year period; local governments are required to introduce housing allowances for social housing at the time of the initial rent increase. During the five year period, state support for capital repairs is to continue.⁸⁴ The Government's Program HOUSING makes clear that raising rents to market levels is the eventual goal, and Moscow's plan has the same objective.

As noted in Chapter 2, in September 1993 the Council of Ministers issued the regulation on the program of raising rents and implementing housing allowances, thereby putting this provision of the law into effect on the first of January 1994. Perhaps its most distinct feature is the step-by-step approach to increase rents, i.e., fees for maintenance and communal services, to cover full operating costs over a five year period. Beginning in January 1994 rents can be increased but housing allowances must come into effect at the same time. The schedule specified for the share of costs to be covered by rents was:

	percent of operating costs to be covered by rents	maximum share of income to be paid for rents^a
1994	15-20	.10
1995	20-40	.15
1996	40-60	.15
1997	60-80	.15
1998	100	.20

a. Payment for housing of the social norm for household of particular size and compositions. This is further described in the text below.

At least four reasons can be advanced for the Government rejecting a "shock therapy" approach of raising rents. First, it was simply politically infeasible to pass a law that would mandate such an abrupt policy change. Second, there are severe

⁸⁴ Similarly, the various benefits allocated to citizens under the old system are to be preserved. No Federation-level guidance has been prepared on how to incorporate the old benefits into the housing allowance structure, and localities are using various methods. For a description of the myriad benefits enacted during the Soviet era, see Institute for Communal Economy (1993).

data limits for a faster approach. Perhaps most importantly, no one knows what it costs to maintain housing in the Russian Federation. As described below there are now private companies that do a good job of maintaining municipal housing at a price that is much lower than the currently estimated "full costs." If the official estimates were used, then the true cost of efficient maintenance could be overshot, leading to further inefficiency. There are also enormous uncertainties about developments in maintenance and communal services costs and incomes in the years ahead. The step-by-step approach permits adjustments to the original plan to be made as needed.

Third, the step-by-step approach permits more time for increases in income. Hopefully within the five year period, real incomes increases will result from productivity gains; in addition, cash incomes will rise as workers receive more of their total compensation in cash rather than in in-kind services. The fourth reason concerns the administrative apparatus. Housing allowances are the first income-tested program in Russia of any scale or sophistication. The step-by-step approach controls the volume of participants and gives the time needed to perfect administrative procedures. An immediate increase to full cost coverage would result in essentially universal participation—meaning in Moscow three million participant households at the start. The jump to full cost coverage would also result in about the same net (after allowance payments) increase in rent revenues as a smaller increase, because after a moderate increase allowance payments are required to pay all of the additional rent increase.

The housing allowance payments are to be made using a "gap formula:" $S = MSR - tY$, where S is the subsidy payment to the tenant; MSR is the "maximum social rent," i.e., the fees for maintenance and communal services per square meter of total space times the number of square meters defined as the social norm for a family of a given size and composition; t is the share of income deemed reasonable for the family to spend on housing; and, Y is household income. Thus, the allowance covers the gap between the cost of an adequate accommodation and what the family can reasonably afford to pay.⁸⁵ The household pays the full cost of housing above the social norm, creating a clear incentive for low income, overhoused families to move to smaller units. Families with incomes greater than MSR/t are not eligible for the program, as they would not receive a positive payment.

The Council of Ministers' Regulation divides responsibility for the specific features of the program among the federal, republican and local governments, permitting significant choices to be made at the sub-federal levels (Table 4.3).

⁸⁵ A detailed explanation of this formula and simulation results for Moscow for a program using it are in Struyk, Kosareva et al. (1993). This same type of formula has been adopted in Estonia and Hungary and is being used in the experiment being prepared in Bulgaria.

Table 4.3 Distribution of Policy Responsibilities Among Federal, Republic and Local Governments Specified in the September 1993 Regulation		
Federation Government	Republican Government	Local Government
<ul style="list-style-type: none"> - rent increase, i.e., the maximum and minimum share of operating costs which must be covered by tenant payments each year during transition period - maximum share of income tenants can be required to pay for rent and receive the subsidy, i.e., maximum value of "t" 	<ul style="list-style-type: none"> - program regulations, e.g., which households are eligible to participate (renters in private units, cooperatives, etc.) - social norms 	<ul style="list-style-type: none"> - actual rent increase - actual share of income that subsidy recipients must spend on rent, i.e., "t"

The law mandates that tenants in state units, both municipal and departmental, be eligible for allowance payments. Republic governments can expand the definition of those eligible as broadly as it wishes.

In December 1993, the Council of Ministers enacted a major revision to the initial regulation in which republic governments were permitted to replace the mandated step-by-step approach to rent increases with any alternative.⁸⁶ The only restriction is that rents must fully cover operating costs in 1998. Under this scheme republic governments can set rents for each municipality and district (*rayon*) separately, presumably in consultation with the local government.

Lastly, the Law on Fundamentals (Article 15) foresees that overhoused families will be under increasing pressure to move to smaller units as rent payments are increased. The drafters of the law were deeply concerned about overhoused tenants being "trapped" in units they could not afford. The law, therefore, provides that local governments must provide "overhoused" families who request smaller units with

⁸⁶ Council of Ministers Resolution, "On Addition to the Resolution of the Council of Ministers, Government of the Russian Federation of September 22, 1993, N. 935," N. 1329, December 24, 1993.

units that meet the social norm. While the new unit is being found, the family pays only for the social norm of housing, thus putting the city under pressure to find a suitable unit. Given the high volume of apartment swaps—for example, about 95,000 or 3 percent of the stock per year in Moscow—and the large number of families seeking larger units, effecting these transfers should not be problematic.

With the program of rent increases and housing allowances only possible at the start of 1994, many republic and local governments are still making decisions about program design. Still, some localities, Gorodetz in Nizhni Novgorod Oblast, for example, were anxious to obtain the additional revenue and raised rents to cover 20 percent of costs in January. They coped with the housing allowance requirement through the expedient of publishing instructions in the newspaper for tenants to use in determining whether they should not pay more than 10 percent of their incomes for maintenance and communal service fees. The Moscow program, scheduled to begin on the first of March has been delayed at least a month by a combination of an unexpectedly long decision-making process between the new Duma and the Administration and additional time needed to finalize administrative arrangements.

Overall, systematic information is lacking on the number of localities raising rents and by how much. Of special interest is how republic governments will respond to their greater freedom to set rents given by the December regulation. Some observers believe that they will use their power to raise rents more slowly in the first couple of years of the transition period. Others think that revenue-starved local governments will press higher authorities for bigger rent increases than that needed to cover 20 percent of operating costs which was specified in the original regulation.

What are the expected impacts of implementing the rent increase-housing allowance package? In fact, a large volume of simulation analysis has been undertaken to respond to this question. One perspective can be gained from the results expected for Moscow. After a small initial increase in maintenance fees earlier in 1994, the Government's plan calls for these fees to be set at R117 per square meter of total space in July, with the fees for communal services set so that the combined fees for maintenance and communal services cover 20 percent of operating costs. Households receiving housing allowance payments would have to spend 10 percent of their incomes for maintenance and communal services fees. All households regardless of tenure are eligible for allowances.⁸⁷

Under this program 11 percent of the city's three million families would receive housing allowance payments: 43 percent of households in the lowest income quartile

⁸⁷ Moscow Government Decree, "On Transition to a New System of Rent Payment and Charges for Utilities and on Housing Allowances to Residents," December 1993.

and 4 percent of those in the next quartile.⁸⁸ The average payment would be about R3,900 per month in July 1994 prices. After taking allowance payments into account, on average families in the lowest income quartile spend about 8.5 percent of their incomes on housing. Those in the highest two quartiles spend 4.0 and 2.6 percent, respectively. The net revenue to the city after making the housing allowance payments is R49 billion per month.

More information is available from a recent "guidebook" for republican and municipal governments which outlines six different programs that could be implemented over the five year period (Daniell, Puzanov, Struyk, 1993). The six strategies vary two parameters: (1) the speed at which rents are raised so as to cover operating costs fully, and (2) the magnitude of the net (after allowance payments) increase in revenues to the city from increasing rents. Three options for the speed of increasing cost coverage are combined with two variants for the relative size of the city's net revenues to form the six strategies.

Implementation of these programs was simulated for three cities: Moscow, Novosibirsk, and Ufa. As shown in Table 4.4 the conditions in the three cities differ markedly.

⁸⁸ Simulations done using as the base data set the data for about 3,200 households included in the monthly income and budget survey conducted by Mosgorstat in November 1993. Results of these calculations were provided to Moscow's Department of Engineering and Communal Services but were not published.

indicator	lowest value	highest value
household income (R/mo.)	Novosibirsk R6,112	Ufa R10,530
individual units	Moscow 0%	Novosibirsk 9%
self contained units	Ufa 74%	Novosibirsk 86%
"overhoused" families ^b	Ufa 18%	Novosibirsk 36%
av. unit size (sq.m.)	Ufa 40	Moscow 46
full operating cost ^a (R/sq.m./mo.)	Moscow 49	Novosibirsk 115
tenant payment (R/sq.m./mo.)	Novosibirsk 1.1	Ufa 2.5

Note: a. Income and maintenance cost figures are for October 1992; other figures are for March 1992 (Moscow) or the fourth quarter of 1992 (Novosibirsk and Ufa).

b. The definition of "overhousing" is approximately the "social norm" adopted for Moscow's program.

Among the factors with substantial effects on the results of raising rents and implementing the "gap type" housing allowance program is the percent of families overhoused (since overhoused families experience larger increases in rents); the absolute costs of providing services particularly in relation to current tenant payments (since high cost places will have to increase rents more); and, the level and distribution of household incomes, which obviously affects ability to pay.

Key findings of the simulation analyses include:

- The program of raising rents and implementing allowances is self financing during the transition because increased rent collections are larger than the allowance payments—often by a substantial amount.⁸⁹ This assumes that the same program is implemented for departmental and municipal housing and that the city receives the rent payments and makes the allowance payments.⁹⁰

⁸⁹ When the market rents are reached and if profit margins are low, then the cost of services will approximately equal rental payments and the housing allowances will largely be "on budget."

⁹⁰ This finding may not hold in cities where a large share of the stock is composed of individual units and the owners of these units are made eligible to receive allowance payments.

- The program does an excellent job of protecting the poor, while at the same time encouraging overhoused families to move to smaller units, because the participant pays the full cost of space above the program standard.
- There are important differences in outcomes across the three cities of implementing exactly the same program. These differences argue against any single national program with rigid program parameters. Even the guidelines such as those contained in the Program HOUSING, which indicate one-half of all expenses should be covered in the first year: are very likely a mistake as they could cause cities like Novosibirsk to have overhoused households spending a large share of their incomes on housing with little time to adjust; moreover, in Novosibirsk 100 percent of families would be eligible for payments—an enormous administrative burden at the start of a program.

Improving Maintenance

Even a casual observer is struck by the poor condition of the housing stock in Russia. The December 1992 survey of 2,002 Moscow units that were state rentals at the start of the year discussed earlier also provides the most detailed, systematic information to date on the conditions under which Muscovites live (Daniell et al., 1993a). The survey generated data on two types of outcome: (a) building conditions and interruptions in services (e.g., heat), and (b) the experience of tenants when they requested help from the responsible state maintenance company (REU), which provides services to about 7,000 units. Obviously, the outcomes are the product of both the treatment by tenants of public spaces and their apartments and the quality of maintenance provided by the REUs, i.e., all problems cannot be attributed unequivocally to the REUs. Still, the general patterns suggest extraordinarily poor quality of services provided by the REUs:

- Both interviewers' observations and tenants' opinions agreed that the entryways in 14 percent of the buildings were in such bad conditions as to require full rehabilitation; about another one-third need some rehabilitation. Combined, nearly one-half of the entryways in state rental housing are so beaten up as to need at least partial rehabilitation.
- For the previous two months, lights were reported not working in the public spaces most of the time in most of the buildings; fully 40 percent of respondents reported lights were off for the whole month. The situation is even worse for security systems (numeric code systems or a concierge to watch the door): three-fourths of all systems were simply not working.
- 30 percent of respondents report rubbish in the halls or stairways frequently, and about the same share report frequent breakdowns in lift services, i.e.,

either the whole month or, during the past two months, 3 or more breakdowns or for more than 1-2 weeks at a time.

- 10 percent of tenants reported that their heat was off frequently in the preceding two months—3 percent were without heat for a whole month. Similarly, 9 percent reported that their toilets leaked most of the time.
- Fully a quarter of all respondents who reported having a problem that should have been corrected by the REU said they had not even bothered to report it.
- Looking at all the cases in which tenants ask for assistance from the REU, the repair was eventually made in 55 percent of the cases (35 percent of the time the repair was made more or less on the schedule promised by the REU). In 39 percent of these cases the repair was simply never made.

Poor maintenance is a product of several factors. Most conspicuous is the monopoly position the REUs hold in providing services and the obvious lack of incentives they have for providing good service. This was compounded in the Soviet system by the complete separation of responsibility for unit construction and future maintenance. Those supervising construction had little reason to concern themselves with the expense of future maintenance and replacements. Indeed, the buildings handed over to municipalities and enterprises were often of extremely poor quality and required additional work and repairs even before they could be occupied (Andrusz, 1990).

The federal agency responsible in 1992-93 for improving services has not shown much initiative. The Committee on Municipal Services of the Russian Federation limited its action to recommendations to municipalities to changing their relationship with the state maintenance companies to a contractual one. The contract would specify terms and conditions, including penalties for poor performance. However, the Committee suggested nothing to break the monopolies enjoyed by the state companies, and thus these reforms ring hollow at best.⁹¹ Indeed, the Committee has expended considerable energy trying to prevent the REUs from losing their favored position.⁹²

⁹¹ Committee on Municipal Economy of the Russian Federation and the Institute of Economics of Housing and Communal Services: "Regulations for the Procedure of Formation of Contractual Relations in the Municipal Economy," and "Model Regulations for the "Customer's Service" in Housing and Communal Services in the System of Local Soviets of People's Deputies " 1993.

⁹² For example, the committee in drafting the amendments to the privatization law inserted language making impossible for condominium associations to use a management company other than the REU for the building proper, although they permitted owners to engage private firms for their individual units.

The abolition of the Committee in January 1994 is symbolic of the positive changes underway. First, the 1994 privatization plan requires that municipal maintenance companies (REUs and similar organizations) be privatized during 1994.⁹³ Second, the Government regulation on rent increases and housing allowances mandates a shift in the relation between owners of departmental and municipal housing, on the one hand, and maintenance firms, on the other, to a contractual basis in which performance standards are specified, as are financial penalties for not meeting them. (Of course, the Soviet maintenance system was replete with norms that were never followed and the impact of this new arrangement is highly suspect.)

A third development in the offing may increase the chances of real change. A regulation is being prepared for Council of Ministers' approval which would implement the provisions of the Law on Fundamentals of Housing Reform which shift the procurement of maintenance services to a competitive basis. In particular, owners of departmental and municipal housing would select the firms to maintain their housing on a competitive basis with private as well as public firms permitted to compete. Because of the small number of existing private maintenance firms and the necessity to give localities time to organize such competitions, the draft regulation envisions a several year period at the end of which all departmental and municipal housing is maintained by firms selected on a competitive basis.⁹⁴

Partial impetus for the shift to introducing competition has been supplied by the success of two pilot projects, one in Moscow and one in Novosibirsk. The launching of the Moscow is described in Box 4.1. By the end of 1993, 7,000 units were being maintained by private firms; another 18,300 were added in the first quarter of 1994.⁹⁵ The city's goal is to have 250,000 under private maintenance at the end of 1994. Mayor Luzhkov issued an Order in October instructing all City's regions to participate.⁹⁶ In Novosibirsk, 3,200 units were placed under contract with private firms in 1993 and another 3,200 at the start of 1994.

⁹³ Presidential Decree, "On the State Program of State and Municipal Enterprises Privatization in the Russian Federation," N.2284, December 24, 1993.

⁹⁴ The Regulation includes as an attachment regulations on the procedure to be followed in holding the competitions which are patterned on those used in the pilot projects described below in the text.

⁹⁵ About 3,500 of these are the first units completed in the new *mikro rayon* of Mitino. Eventually there will be more than 25,000 units in the district, all under private management.

⁹⁶ "On Extension of the Pilot Program for the Privatization of Management and Maintenance in Municipally-Owned Housing," October 13, 1993, N.1886-RP.

**Box 4.1
Moscow Housing Management Demonstration**

On March 1, 1993, the Western Prefecture signed three contracts with private firms. The pilot was implemented after 8-months of planning and training. The pilot explores private and competitive alternatives to traditional public management and maintenance. The premise is that private management will be less expensive, and will lead to a better quality of life for the tenants. The contracts are written for a one-year, renewable term.

Until now, all Municipal management and maintenance has been provided by about 500 public entities, known as REUs. Organizationally, each Prefecture is divided into Sub-Prefectures (equivalent to large neighborhoods), and there are numerous REU's within the Sub-Prefectures.

The Pilot introduces several new concepts in Russia:

- The first time that private management will be used in municipally-owned housing.
- The first time that a "Request For Proposals" (RFP) process was used to solicit services in the municipal housing sector. New concepts introduced include: advertising for proposals, freedom of information, open meetings, equal opportunity employment, deadline for proposal submission, objective rating criteria, "Notice to Proceed," and termination for non-performance.
- The first time that Contracts for real estate management used performance factors such as "clean and attractive," "removal of hazardous conditions," and "preventive maintenance". These concepts had to be operationally defined.

Structure of the Initial Pilot. 2,000 units were selected for inclusion in the pilot: 600 in the Kutusovsky Sub-Prefecture, and 1,400 in the Fili-Davidkova Sub-Prefecture. The Kutusovsky units are in Central Moscow, and the Fili units are in suburban Moscow. The units also vary in terms of age, construction type, and building type (high-rise versus mid-rise). This diversity provides for a sample that is representative of all building types in Moscow, and insures that the Pilot is easily replicable on a City-Wide basis.

The "Board of the Unified Customer" (or DEZ) acts as the Owner for the purpose of the Pilot. There is one DEZ for each Sub-Prefecture, and the Chiefs of the DEZ signed the contracts for the Municipal Owner. Personnel from the DEZ's and the Prefectures were trained in real estate management and maintenance techniques. The training consisted of 16 classroom sessions conducted from October-December 1992. In addition to the classroom training, three representatives of the Owner attended a one-week "Owners Study Tour" to experience how management works in the United States.

The pilot is specific to management and maintenance tasks; it excludes non-management tasks with which the REUs were encumbered, such as passport control, communal services charges calculations (these include heat, gas, and water), and draft registration. This specificity will allow the private managers to concentrate on the management areas of greatest need, such as security; routine and emergency maintenance response times; rubbish and snow removal; cleanliness of the common areas; removal of hazardous conditions; preventive maintenance; and landscaping.

The procurement of the Contractors was patterned after a U.S. style "Request For Proposals" (RFP). To solicit bids, advertisements were placed in Moscow newspapers of wide circulation. Twenty-three expressions of interest were received, and eleven formal proposals.

Monitoring Evaluation is a key component of the Pilot Program. The Pilot is "results" rather than "process" oriented; i.e., the Owner is not concerned with how the common areas were cleaned, but whether the common areas are clean.

Performance is measured against the Contractor's approved work plan and budget. Monthly budget reports (cumulative, year-to-date) must be submitted to the Owner. In addition to holding regular meetings with the contractor, the Owner is to make regular inspections to assess and verify site conditions.

The two experiments differ somewhat in their approach. In Moscow, private firms have contracts for building maintenance, while the REUs continue responsibilities for certain tasks, such as rent collections and tenant relations. The Moscow program also divided the groups of buildings being placed under contract into packages of 600 to 1,000 units, in order to involve more firms in new procedures and to diversify the risk of poor performance. In Novosibirsk, the contract was for building management not just maintenance and only one contract has been awarded for each of the three competitions. Hence, the private firms are managing about 1,000 to 3,200 units. The two approaches are coming together, however, as the Moscow program is giving firms more management responsibilities in the contract for the second year and as the program expands contracts are for a larger number of units.

Positive evaluation results are driving the expansion of both demonstrations. In Moscow, data from the following three surveys were used for a three part analysis/evaluation of the program: the December 1992 survey of 2,002 randomly selected State rentals in Moscow (referred to earlier), a February 1993 survey of 300 randomly selected households in the pilot program buildings, and a May 1993 follow-up survey of the same 300 households in the pilot program buildings (Struyk and Angelici, 1993). The evaluation includes a rough comparison of the pilot units with those of the overall municipal housing stock, a comparison of the cost of the private firms with that of the REUs, and, most importantly, a comparison of conditions before and after the introduction of maintenance by the private firms. For the third part of the evaluation, the authors predicted that they would observe little change in the short 10 week evaluation period, because the firms' activities are mainly restricted to routine maintenance and repair.

The results of the first part of our analysis indicate that, prior to the start of the demonstration, the buildings included in the demonstration could not be considered better maintained than the average municipal building. The second part of the analysis and subsequent data show that the private firms are not costing the city more than the REUs.

Contrary to the working hypothesis, results from the "before and after" analysis evidenced a substantial, overall improvement in the condition of public spaces.

certain conditions in the flats, the reoccurrence of breakdowns in services, and the speed and quality of execution of repairs. Not only were the common areas kept cleaner and apartments more pest-free, but services, such as water and elevator, were more reliable. For example, in May 50 percent of the respondents reported that their elevator was always functioning whereas in February, under the REUs, only 27 percent could report its continual functioning. In no category were conditions worse under the private firms. Also, the private firms did a better job in setting a concrete time for making repairs than the REUs and they did a better job of keeping their promises. In February under the REUs, only 42 percent of the respondents reported that repairs had been made within the promised time, while in May the percentage jumped to 59.

The Novosibirsk demonstration was also subjected to evaluation. A similar before-and-after survey was conducted of the tenants in the first 2,000 units brought under private management. The results were summarized in a recent report as follows:

Preliminary results show that residents view the contractor's performance as better in a number of areas, chiefly those which the NHMC [city agency] had targeted in its contract: grounds and common area maintenance and resident relations. Whereas 20% of residents were satisfied with grounds and common area maintenance before the project began, 40% now indicate they are satisfied and 25% report that staff attitudes and responsiveness towards residents are better. (O'Sullivan, 1993, p. 5)

The report also cites other important changes in project management: a cut in staff from 65 to 37 people and a corresponding increase in productivity and staff payments, elimination of rent arrears, and collection of rents by management to avoid paying fees to Sberbank and the central computer processing center.

The shift to private firms, however, has not been without problems; and the ultimate success of this transfer is not certain, even in Moscow where the demonstration program was launched with substantial technical assistance from USAID. Two difficulties are worthy of note. First, the private firms have experienced consistent and significant delays in receiving payments, including tardy adjustments for inflation. The delays have been sufficiently severe as to cause contractors to lay off staff on occasion. A continued pattern of such problems may well result in contractors being unwilling to renew their contracts. Second, the DEZs, who are acting as the owner (see Box 4.1), have exhibited a reluctance to leave their offices and inspect the buildings and grounds to be certain that good maintenance services are being provided. During the pilot phase the USAID resident advisor filled this gap on an episodic basis. However, it is clear that without proper monitoring, contractors will tend to reduce services and the old system of unresponsive maintenance will be recreated. The city is seeking systemic solutions to these problems, including contracting for on-site inspections.

It is worth noting that in both Moscow and Novosibirsk there has not been a shortage of firms willing to bid on the maintenance contracts. In Moscow, for example, there were 23 expressions of interest in the RFP for the management of three "packages" of buildings in the first pilot project and eleven actual bids. This is consistent with the general experience in Eastern Europe, i.e., such firms readily emerge when there is a demand for their services. In Prague District II, the first district in that city to contract with private management companies, there were 25 expressions in response to its initial announcement.⁹⁷

These pilot projects seem likely to develop rapidly and other cities are beginning to adopt similar procedures. Still, the goal of a general improvement in housing maintenance is on the far horizon. Perhaps the best hope is that the newly-forming condominium associations select quality maintenance firms for their buildings. In addition, over the next several years, with the increased maintenance fees for municipal buildings permitted by the program of rent hikes, private firms should be able to offer their services at profitable fee levels.

Tenants' Rights

Under the "housing codex" enacted during the Soviet era,⁹⁸ tenants in both departmental and municipal housing enjoyed extraordinary protections against eviction. Even in those few cases in which eviction is permitted, the occupant must be provided with similar quality housing. Non payment of rent can only result in being shifted to another unit. Importantly, but not surprisingly, even the provisions in the law are employed only in rarest of cases. The Soviet era codex remains substantially in force, although the enabling legislation upon which it was based has been superseded by the 1992 Law on Fundamentals of Housing Policy in the Russian Federation. While replacing the codex has ostensibly been a high priority, severe conflict has surrounded the drafts prepared. In early 1994 there is no sign of early passage of a new codex.

Nevertheless, rent collection is the one area in which action is being taken to reduce the rights of tenants. Two legal actions are noteworthy. First, the Law on Fundamentals (Article 18) specifies that if a tenant fails to pay his rent for six months he can be evicted from his apartment following a court hearing to a dormitory quality unit. Such housing is extremely low quality; so a sharp penalty is being imposed. In principle, federal regulations should be issued to activate this provision, but it is possible for lower governments to create their own regulations, although they would have to be brought into line with Federation regulations when they are issued.

⁹⁷ Kingsley, Tajemna, and Wines (1993).

⁹⁸ "Fundamentals of the Housing Legislation of the USSR and Union Republics," June 1981.

Second, the regulation on housing allowances specifies that the penalty for late rental payments is 1 percent each day the payment is delayed—or 365 percent a year. It is not clear the extent to which localities are now using these new tools.

In contrast with social housing, the rights of tenants in private units are regulated primarily by the rental contract and the rent is freely determined. The Law on Fundamentals states that tenants of private units can be evicted after a court proceeding for failure to pay rent for six months.⁹⁹ However, in practice, private owners appear to have very substantial power in their relations with tenants, some garnered through understandings with the local militia. According to news accounts and brokers, tenant-owner disputes are more often settled by force than judicial procedure. Obtaining use of the property at the end of the lease period seems not to be a problem. In effect, private owners are being strongly encouraged to lease their units in the open market.

Departmental Housing

From the early years of the Soviet regime, resources were allocated for the construction of workers' housing in the national plans to high priority sectors. Indeed, priority enterprises played the dominant role in the provision of a whole range of social services in many cities.¹⁰⁰ In 1990 departmental housing accounted for 44 percent of all urban housing and 56 percent of state housing in urban areas (table 1.2). A limited survey conducted by the World Bank of benefits provided by enterprises to their workers in 1992 and 1993 confirms that housing is a common benefit and one that accounts for a significant share of total worker compensation.¹⁰¹

As enterprises are under increasing competitive pressure they may wish to stop providing housing and other costly ancillary services to their workers and concentrate more on business. Consequently, they would want to shift as much of these responsibilities to municipal and other authorities. On the other hand, these firms have enjoyed enormous prestige and political influence in their communities precisely because of the non production assets they control and the services they provide. And this may make them very reluctant to divest these assets. This section looks at

⁹⁹ Article 18. Regulations on landlord-tenant relations should logically be part of the "housing codex." While movement on the codex has been stymied by conflict about how progressive it should be, Gosstroï has drafted regulations on lease arrangements. These have not yet, however, be submitted to the government for action.

¹⁰⁰ Grava (1993), Ruble (1992), Shemina (1992).

¹⁰¹ Commander and Jackman (1993). Forty-one enterprises in the Moscow region were surveyed in November 1992 and April 1993.

developments in departmental housing, concentrating on issues of ownership and rents and maintenance.

Ownership of Department Housing. Have enterprises been rapidly divesting themselves of their housing inventories as hypothesized above? The answer to this question is quite complex because of the impact of enterprise privatization on housing ownership. Matters were clarified substantially in a Presidential Decree issued in January 1993,¹⁰² which contained two key provisions for housing. First, when an enterprise is privatized, the housing stock cannot be included in the property privatized. Second, regarding use and maintenance of the housing, the enterprise and local authorities are to negotiate and sign an agreement on use and financing. If an agreement cannot be reached voluntarily, then an arbitration procedure is to be invoked, with a representative of the Federation participating.

Because more enterprises have been continually privatized over the past two years, it is very hard to document the flows of units from one ownership status to another. Lack of data further aggravates the difficulties of tracking developments. Below we report, to the extent possible, on three developments within this general area.

First we examine the extent of privatization of departmental housing. We saw earlier that privatization of departmental housing proceeds more slowly than for municipal housing. Numerous housing professionals have asserted informally to us that enterprises actively discourage their workers from privatizing their units. The only systematic information we have on this point is from the December 1993 survey of the occupants of 2,000 Moscow state apartments cited earlier. Because of the limited volume of enterprise (versus ministry) housing in the City, information for Moscow is not the best for this purpose. Nevertheless, these data show that as a percentage of units that remain departmental housing, occupants in 23 percent of these units reported that it was their understanding that their unit was not eligible to be privatized and 9.1 percent of those who actually applied to privatize the unit they occupy had been rejected. The parallel figures for municipal housing are 4.3 and 1.0 percent, respectively. Consistent with this pattern, Ruble (forthcoming) reports that in 1993 only 102 of 449 Moscow enterprises and federal government agencies with housing for their employees had initiated housing programs. He also reports a similar pattern for Yaroslavl.

¹⁰² Presidential Decree no. 8, January 10, 1993, "On Use of Socio-Cultural and Communal-and-Everyday Service Facilities of Privatized Enterprises." Article 9 of the Law on Fundamentals of Housing Policy of the Russian Federation also addresses changes in ownership; it states that the upon privatization, the ownership of the housing stock will be transferred to the enterprise's designee, if there is one.

The second development is the transfers of housing from enterprises to localities. National data are not available on the extent to which this is occurring.¹⁰³ We do have information for Moscow and some impressions about broader patterns. In 1991 the city accepted departmental housing containing 1.6 million square meters of space in flats, or about 5.5 percent of the total departmental stock as of 1990. In 1992 it accepted less than 100,000 square meters because of its lack of funds for subsidizing maintenance and for most of the year had a ban on accepting units.¹⁰⁴ In 1993, however, the city again began taking departmental units.¹⁰⁵ Moscow's behavior indicates the difficulty of interpreting figures on transfers as an indicator of enterprises behavior: transfers are only completed when enterprises offer the housing *and* cities accept them.

Our impression is that most localities have accepted units offered to them. In Nizhni Novgorod, for example, the municipality gave enterprises the choice of continuing to maintain their housing and not paying the 1.5 percent turnover tax or of giving their housing to the city and paying the tax. The result was that in 1993 20 percent of departmental units were transferred to the city—mostly older buildings in poor condition. In some instances the enterprises have given the city a "dowry" of maintenance payments to accept the units. The World Bank survey of enterprises in the Moscow region noted earlier reported that 50 percent of the firms had transferred housing to local authorities. Note that it is nearly impossible in discussing these patterns with city officials to distinguish between two cases: (a) one in which a state enterprise has been privatized and some agreement must be reached between the enterprise and the city about the maintenance (and ownership) of the enterprise's housing; and (b) one in which in advance of privatization the enterprise wishes to transfer its housing.

Importantly, the government's privatization plan for 1994 provides some clarification on the procedure to be followed by privatized enterprises in transferring housing from their "balance" to the balances of the municipalities. This document makes clear, however, that the municipalities can conclude agreements and contracts with the enterprise for contributions to the cost of maintenance.¹⁰⁶ Additionally, a Council of Ministers' Resolution of December 1993 orders republic-level governments

¹⁰³ The Committee on Municipal Economy reports that it assembled these figures for 1991 but that the one copy of the document has been lost. Data for 1992 are expected in May.

¹⁰⁴ Information from the Department of Engineering and Communal Services, City of Moscow.

¹⁰⁵ Because of the expenditure implications, this was a formal government decision. See Government of Moscow Orders N.165, March 2, 1993 and N.293, May 12, 1993.

¹⁰⁶ Section 6 of the Attachment to the Presidential Decree, "On the State Program of State and Municipal Enterprises Privatization in the Russian Federation," N.2284, December 24, 1993.

to reimburse local governments for the cost of taking over housing and certain other facilities.¹⁰⁷

The third development is the extent to which enterprises are constructing new housing for their workers. In fact, enterprises have continued to construct a substantial volume of new housing from their own resources. Recall that in Chapter 3 we reported that in the past few years enterprises have emerged as the dominant customer for new residential construction. While the absolute volume of housing commissioned by enterprises has declined roughly in line with total production, they clearly have not radically reduced their investments in housing. Housing built by a privatized enterprise belongs to it; i.e. it is not eligible to be privatized. However, while some newly constructed housing is being retained by firms for their workers,¹⁰⁸ a significant but unknown share of units constructed by enterprises is being sold at market prices. In this case the enterprise is simply acting as an investor, and there is no relation between the housing investment and the use of new housing to attract workers.

On balance the evidence points to a clear reduction in the volume of housing belonging to enterprises, although the magnitude cannot be documented. Units are leaving the balance sheets in three ways: individual families are privatizing their units, the enterprises are transferring their housing to local governments independent of the enterprise being privatized, and housing assets leave the balance sheet when the enterprise itself is privatized. Combined these three flows may well have resulted in a major change in Russia's housing ownership structure. While departmental housing is very likely to diminish, the share of units in municipal ownership may remain substantial or even increase, depending on the balance of the flow of departmental units to the municipal stock and the flow of municipal units into privatization. Lastly, one might anticipate a resurgence in privatization rates as departmental units move to the municipal balance, because municipal authorities in the past promoted privatization much more than their colleagues in enterprises. Such a resurgence may, however, require local authorities to engage in aggressive marketing and it is far from clear that this will happen.

¹⁰⁷ The Resolution states certain sources of funds that should be used for this purpose. But if funds available from these sources are insufficient then the Federal budget will cover these costs. "On Financing Recreation and Everyday Facilities Conveyed in the Course of Enterprise Privatization to the Local Bodies of Executive Power for Operational Management," N. 1325, December 23, 1993.

¹⁰⁸ Ruble (forthcoming), for example, reports that enterprises in the Yaroslavl area have continued to build more housing for their workers.

Maintenance of the Departmental Stock.¹⁰⁹ With such a large share of the total housing stock in the departmental stock, the quality of maintenance provided to these units has a profound affect on the housing satisfaction and on the rate at which the existing stock will have to be renovated or replaced. Since rehabilitation and new construction are so expensive, strong incentives for maintenance of this stock should be an important topic of public policy.

The general view is that departmental housing was better maintained than municipal housing under the central planning regime. On the other hand, due to the radical change in incentives faced by self-financing enterprises since 1990, when the profits tax was introduced, experts believe there has been a sharp reduction in maintenance and housing quality. Because non self-financing entities (on-budget organizations), such as government ministries, have not been subjected to the change in incentives, the direction and extent of change for them is much less clear. However, the general cuts in budgets would suggest reduced maintenance for this stock as well.

Under the *old regime*, each enterprise operated under strong norms specified by Gosplan and administered by the relevant branch ministry. All budget line items were specified by the ministry, subject to negotiation with the enterprise. Housing maintenance and communal services appeared as a line item in the budgets. Generally speaking, the norm for maintenance was very low. However, the enterprises were successful in shifting a substantial amount of the maintenance expenditures into accounts for the enterprise's main activity, e.g., plumbers and carpenters were carried on the books as working for the main production unit when they were really maintaining housing.

Non self-financing entities (on-budget organizations), particularly Russian Federation government agencies, continue under this system. But they likely have difficulty hiding maintenance workers.

The *new system* was introduced as part of the liberation of enterprises from the control of the branch ministries, including giving them a clear profit incentive. The incentives for making expenditures on maintaining housing belonging to an enterprise are now fairly complex. The following factors are at work:

- (1) The enterprise can deduct from its income subject to the profits tax its expenditures for housing maintenance (net of tenant contributions). The tax rate in 1994 is 35 percent (up from 32 percent in previously). However, there

¹⁰⁹ Information in this section is based on interviews with Irina Minc and Igor Bychkovsky of the Institute for Housing and Municipal Economy and Ludmila Kuznetsova and Yelena Medvedeva of the Moscow Department of Communal Services, and on analysis of the law on the profits tax.

is a limit on these deductions that is set by local governments. In Moscow, for example, the maximum deduction was set at R22,000 per square meter of living space per year for the tax year of 1993. This cap applies to both routine maintenance and capital repairs.¹¹⁰

Obviously, expenditures above the norm cost the enterprise more and are thereby discouraged. Because the norm is locally determined, it may well be that governments in industrial centers set the limit at a high level even though it is the local government which loses the revenue.¹¹¹

- (2) Management of the enterprise enters into a "collective agreement" with the workers on the distribution of after-tax profits. These profits go into two funds: the Fund for Consumption and the Fund for Investment. Because the majority of workers often do not live in the enterprise's housing, they prefer a smaller expenditure on maintenance and a larger contribution to the Fund for Consumption, which makes payments to workers for vacations, etc. [Obviously, this procedure will become more complicated when the firm is privatized, because the agreement will also have to take distributions to share holders into account.]
- (3) Some enterprises are not making profits, and for them there is no possibility to deduct maintenance expenditures from taxable income; and they have an even lower incentive to maintain their housing.

Overall, it would appear that most enterprises have weak incentives to spend money on maintenance, since even profitable enterprises must pay for the majority of expenditures and the workers who control the allocation of after-tax profits are likely to want have more profits to distribute rather than sheltering some profits through maintenance expenditures.

We can use data from the Moscow survey on the comparative condition and location of municipal and departmental housing to develop a suggestive picture of comparative upkeep.¹¹² These data show conclusively that in Moscow the conditions in the municipal stock are better: municipal housing scored better on 17 of 19 indicators studied and 11 of 12 in which the differences were statistically significant. From the information cited earlier, it is clear that the conditions in

¹¹⁰ This figure was determined by the City's Department of Finance. We do not know the basis for the calculations.

¹¹¹ For a description of the allocation of tax bases see Wallich et al. (1992). While these allocations have been made in principle there is still a good deal of bargaining between the federation and lower levels of government over the distribution of taxes collected.

¹¹² Information from Daniell et al. (1993a).

general are not good; so the quality of residential living in the departmental stock must be quite bad. Unfortunately, we do not have a data set with full information on both housing conditions and expenditures for departmental and municipal units for any city, i.e., it may be that departmental expenditures in Moscow are low and thus the poorer quality would be expected.

Housing Allowances in the Department Stock. Residents of departmental housing are eligible to receive housing allowances. Two issues were prominent in designing the program. One was whether owners of departmental units (hereafter called "agencies") will be required to follow the same schedule of increases in maintenance fees and charges for communal services and use the same parameters as the municipality in computing their subsidy payments. Some agencies could argue that they are spending more than municipalities and therefore need a higher MSR, which would result for higher subsidy payments for their occupants compared with occupants of municipal housing with the same income.

The other issue is who pays for housing allowances. In the earlier discussion of housing allowances it was noted increases in rental revenues would nearly always exceed the housing allowance payments during the transition, i.e., until rents increased to be the same as operating costs. Hence, the typical enterprise would not lose money during the transition. But one can imagine agencies with low-income and underhoused (relative to the social norm upon which subsidy calculations are based) work forces; these agencies will lose money even during the transition.

The Council of Ministers' Regulation makes no special provisions for departmental housing and so it appears that enterprises should have the same programs as the localities in which they are located and fund allowance payments from their own resources. However, some argue that the lack of explicit directives for enterprises in the regulation leaves these issues unresolved. This is clearly an area requiring monitoring (and possibly clarifying regulations) if gross inequities are to be avoided.

Conclusion. Not surprisingly, the issues involved with departmental housing in the transition of the housing sector are complex. Perhaps most striking is the apparent desire of enterprises to retain their housing. The issues created in the transition are being addressed pragmatically as other reform actions require. Most prominent are the disposition of the housing belonging to firms being privatized and treatment of income eligible tenants in the housing allowance program. Nevertheless, more systematic attention should be given to improving the maintenance of this stock during the transition and to facilitating enterprises divesting themselves of their housing assets. The City of Moscow has made the sensible proposal to the Federation that the City would accept departmental housing in exchange for either direct budget support or a more favorable sharing rate for the corporate profit tax during the transition.

5. HOUSING FINANCE

Expanding long-term housing lending in Russia is a challenging task. The situation can be characterized simply. While there has been limited housing lending, lending in which the housing asset serves formally as collateral did not exist (before the passage of the Law on Collateral in 1992). The banking system is embryonic and the creation of over 1,500 new commercial banks in 1991 and 1992 alone has resulted in a poorly supervised and probably fragile system.¹¹³ High and volatile inflation rates imply potentially great interest rate risk for long-term lending, since the banking system's liabilities are heavily concentrated in short-term accounts. And, there is possibly grave credit risk associated with housing lending because the current confusion about the enforceability of foreclosure in case of default, notwithstanding existing legal provisions. While many of these problems are common to the entire banking system, some are special to housing lending.¹¹⁴

Despite these problems there has been a substantial amount of progress in initiating mortgage lending. The banks' interest in beginning such operations appears to be driven by two factors. First is the perception of an enormous future market for mortgage loans, with the present being the time to attain a good position for future market share. And the second is pressure from the federation and regional governments to support housing construction for both countercyclical economic reasons and as a way to help address the nation's severe housing problems.¹¹⁵ In effect, lenders have been finding ways, sometimes with the assistance of the government, to cope with the various risks and have actually begun lending operations.

This discussion is organized into four parts. We begin with a summary of the long-term lending being done on the eve of reforms. Next we review developments since early 1992, in the legal framework, banking practices, and long-term housing

¹¹³ International Monetary Fund et al. (1991), vol. 2, Chapter IV.5.

¹¹⁴ See World Bank (1993a) for a general discussion of the challenges facing the Russian banking system.

¹¹⁵ At the outset we should make a distinction between long-term mortgage lending as commonly practiced in most countries and traditional "mortgage" lending in Russia. Before the Russia revolution, mortgage lending was lending secured by real property, often the estates of aristocrats. These loans could be for long or short terms. Interestingly, these loans or securities based on them were frequently sold in a secondary market. In part of this reason, most "mortgage banks" in Russia today are engaged in short-term commercial lending in which the collateral for the loan is real estate, often the borrower's own home. A number of steps in the loan origination process are similar under these "commercial mortgage loans" and long-term mortgages. Hence, the experience banks are gaining from the short term loans will be valuable for future longer term lending. For a description of pre-revolutionary mortgage lending, see Tarankov (1992).

lending. The third section examines the developments to date from two perspectives: their implications for banks in ameliorating the risks they face in making mortgage loans and their impact on the ability of families to purchase a home, i.e. housing affordability.

Housing Lending Prior to Economic Reform

Traditional long-term housing lending in the Soviet Union was quite simple.

- (1) Loan volume each year was determined in the centrally-developed economic plan. Beginning in 1988 all long-term housing lending was done by the State Savings Bank, also known as Sberbank, which was changed into a joint stock bank in 1991.¹¹⁶
- (2) Lending was for individual construction and housing cooperatives.¹¹⁷ Since individual construction was forbidden since 1961 in cities of over 100,000 population, only cooperative loans occurred in these places; individual loans were concentrated in smaller cities and rural areas.¹¹⁸
- (3) Housing loans were not explicitly secured by the property as collateral and eviction in the case of default was questionable. In practice, lenders protected themselves by typically having loan payments deducted from wages by employers; where this was not possible, guarantors were sought and the bank could have wages garnished for non payment. Sberbank experienced low levels of delinquencies.¹¹⁹
- (4) The loan instrument was a fixed rate loan; interest rates were low and loan periods long.

¹¹⁶ Before this loans to individuals were made by Gosbank and Stroibank. Loans to members of cooperatives were made by Zhilsots Bank and Stroibank.

¹¹⁷ There are two types of cooperatives: housing building cooperative (HBC) and housing cooperatives (HC). For HBCs the borrower is the cooperative who on-lends to individual households. For HCs individual members obtain loans to purchase the units from a seller--municipal government or an enterprise. See Andrusz (1991) for a thorough discussion of housing cooperatives in the USSR.

¹¹⁸ In reality, housing cooperative were highly concentrated in Moscow and St. Petersburg.

¹¹⁹ As of the end of 1991, Sberbank's cumulative delinquent payments were rub 6.4 million on a housing loan volume of rub 10 billion. Source: interview with M.A. Gavrillin and A.K. Abramova, August 12, 1992.

Basic information on the lending of the past few years is given in Tables 5.1 and 5.2. We focus here on events through 1991; developments since are discussed in the next section. The data in Table 5.1 show that loans to individuals can be characterized as having extraordinarily long terms and carrying very low interest rates. These loans carried subsidies: the 2 percent interest rate charged until 1991 was less than the bank's cost of one-year time deposits and only 100 basis points above the official inflation rate. In 1991, the loan rate was 200 basis points below the one-year time deposit rate. Maximum loan amounts were reasonable compared with the cost of housing.

Lending for units constructed for Housing Building Cooperatives (HBC) carried deeper interest rate subsidies—the interest rate on these loans being only .5 percent. The loan term was shorter than on individual loans, but at 25 years still long enough to permit low monthly payments.

Even in 1990, loan interest rates were negative in real terms. By 1991 they were sharply negative, setting the stage for even worse conditions in 1992 and early 1993.

As shown in Table 5.2, the good news for Sberbank is that its volume of long term lending for housing has been small, and in recent years it has fallen in real terms. There are several ways to make the point about the small loan volume. In 1991, the number of loans to individuals was the equivalent to about 0.2 percent of the 1990 housing stock, and 0.8 percent of the 1990 single family housing stock.¹²⁰ Similarly, such lending constituted only 0.2 to 0.4 percent of gross domestic product.

There is no question that housing lending in the Russian Federation has been low compared with other countries. The figures in Table 5.3 document that among middle-income countries the Russian Federation had an extremely low ratio of mortgage loans to total housing investment. This, of course, is largely attributable to the enormous role played by direct state investment in the production of new rental housing. But even compared with Poland and Hungary the Russian figure is tiny.

¹²⁰ Data on the 1990 stock are from the State Committee on Statistics of the RSFSR (1991).

	1988	1989	1990	1991	1992	1993
Loans to individuals^c						
interest rate	2	2	2	3	8(+12) ^a	100 ^k
loan terms (years)	50	50	50	25	20	10 ^l
maximum LTV	75	75	75	75	75	70
maximum loan (th. rub.)	20	20	20	20	—	—
Loans to cooperatives (HBC)^d						
interest rate	.5	.5	.5	3	8(+12) ^a	100 ^k
loan terms (years)	.25	25	25	25	20	10 ^l
maximum LTV ^e	.70	70	70	70	70	79
GDP deflator, 1988=100 ^h	100	103	114	246	4084	41700
Interest on 1-year time deposit (%)	3	3	3	5	30 ⁱ	120 ^l

Notes:

- a. Beginning in April 1992 individual or cooperatives paid 8% and 12% was subsidized by the state budget. For the period January 10 to April 1, 1992 the interest rate on loans to individuals was 15%.
- b. LTV was determined through special decrees of the Soviet government. Some regions, e.g., Siberian coal areas, had and still have LTVs of 80%.
- c. Since August 1, 1992. For the period January 1 to August 1, 1992, the interest rate was 10%.
- d. House Building Cooperative.
- e. Loans for construction of individual houses.
- f. Beginning in January 1, 1993, the rate was 60%. By the end of the year higher rates were being paid on larger deposits. Rates on balances under R100,000 were 120 percent; the maximum rate of 180 percent on balances over R5 million. Beginning in January the interest paid on deposits was being compounded; previously no compounding had occurred.
- g. Beginning in April 1993, the interest rate was the same as the Central Bank discount rate.
- h. Source: Ministry of Economy, Center for Economic Forecasting.
- i. Beginning December 1, 1993.
- j. Sberbank only.

Source: Sberbank.

	1988	1989	1990	1991	1992	1992 ^d
Loans to individuals number (thousands)	73.4	53.1	124.4	94.8	120.1	c
volume ^a	661	438	1,296	2,127	21,611	200,200
average loan size ^b	8.9	8.2	10.4	22.4	179.9	c
Loans to cooperatives volume ^a	574	502	468	648	3,805	18,089
Total volume ^a current prices	1,235	940	1,763	2,775	25,416	18,909
1988 prices	1,235	912	1,546	1,128	622	525
ratio: loan volume to GDP (%)	.32	.16	.28	.23	.14	.13

Notes: a. millions of rubles, current prices
b. thousands of rubles, current prices
c. data not available
d. Sberbank only

Source: Sberbank

Eastern Europe		Other					
Poland	.33	Thailand	.66	Malaysia	.73	Jordan	.34
Hungary	.41	Morocco	.25	Mexico	.77	Philippines	.58
Russian Federation ^b	.07	Jamaica	.28	Turkey	.07	Tunisia	.20
		Korea	.62	Brazil	.21	Venezuela	.24
		Colombia	.60	Chile	.44		

Notes: a. Data are generally for 1990.
b. Long-term housing loans, not mortgages.

Source: World Bank Housing Indicators Project and authors' calculations for the Russian Federation.

Developments in Mortgage Lending

There have been numerous developments in the past few years. There have been several important actions by the Russian government in 1992 and 1993 to establish the legal foundation for real mortgage lending and to improve the efficiency of housing subsidies. Meanwhile, there were notable developments in the interest

rate structure. Lastly, there are developments in actual housing lending, by Sberbank and, more importantly, by other banks that have just begun mortgage lending operations.

Legal Developments. In Chapter 2 we described most of the major developments which effect the ability to make mortgage loans in Russia: the Law on Collateral, the Law on Mortgage, and the various enactments on land and property registration. One significant act merits further consideration. In December 1993, President Yeltsin signed a decree which established the basic institutional framework for mortgage lending.¹²¹

Up to this point no governmental body had clear responsibility for fostering and regulating mortgage lending. The decree creates the Agency for Mortgage Lending. Regulations being developed to establish the Agency as a stock company owned by the Ministry of Finance and give it two primary responsibilities: (a) to act as a liquidity facility for mortgage lenders and to have the power to issue mortgage-backed securities to generate funds, and (b) working with trade groups, such as the Association of Mortgage Banks, to develop the necessary training for bankers engaged in mortgage lending. In addition some propose the Agency serve as the industry's regulator, working closely with the Central Bank of Russia. If the Agency did not receive this role formally, it could still affect industry practices profoundly through the conditions it sets for purchasing mortgages.¹²² Regulation-through-mortgage-purchase-conditions is the established pattern for the enormous secondary operators in the United States, such as the Federal National Mortgage Association. It is planned that the Agency will begin operations sometime in 1994.

The same decree also includes two other notable features. It requires that the basic regulations for mortgage lending be prepared within three months and recommends that banks and finance companies launch real estate investment trusts to help families accumulate funds for home purchase. The investment trust are described below in the section on "housing debentures," as they are called in Russia.

From our perspective, the legal and regulatory structure for the Russian housing finance system has developed with remarkable rapidity. Still, a major problem for banks is the lack of clear foreclosure and registration procedures that

¹²¹ Presidential Decree, "On Development and Introduction of Non-Budget Forms of Investing into the Housing Sector," N.xxx, December 28, 1993.

¹²² If the Agency had all three responsibilities assigned to it, the Agency would resemble the U.S. Federal Home Loan Bank Board prior to the reforms and reorganizations provoked by the crisis in U.S. mortgage lending in the early 1980s.

would be provided by the Law on Mortgage. Passage of this law—in a responsible form—is by far the highest priority for the sector.¹²³

Interest Rates. At the end of 1993 interest rates became positive in real terms for the first time, certainly since January 1992 and perhaps for a much longer period depending on the extent of hidden inflation believed to have existed under the old regime.

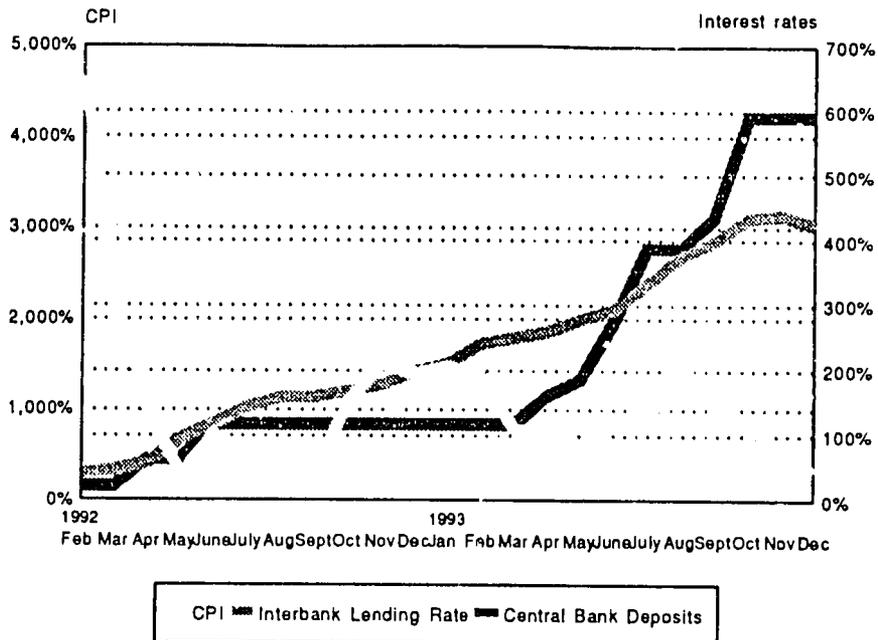
Many observers with limited knowledge of contemporary Russian banking practices have misunderstood the real structure of interest rates in Russia by looking only at the interest rates quoted on an annual basis in comparison with inflation. Hence, at the end of 1993, the interbank lending rate—a freely determined rate—was quoted at about 180 percent on an annual basis. When compared with inflation for the year of something like 850 percent, interest rates appeared to highly negative in real terms.

Banks, however, are applying this annual interest rate on a different basis. Monthly interest rates are computed by simply dividing the annual rate by 12, and borrowers pay the interest due using the monthly rate each month. Thus, each month the bank receives interest income which could then be invested in the next month. In effect, the 15 percent monthly rate corresponding to the 180 percent annual rate was being compounded on a monthly basis and the effective return to the bank was about 435 percent, i.e., 100 rubles lent at the beginning of the year yields about 435 rubles, if the interest income received each month is reinvested at the same rate. At low interest rates the impact of such compounding is minimal, but at the high rates prevailing in Russia, the effects are substantial indeed.

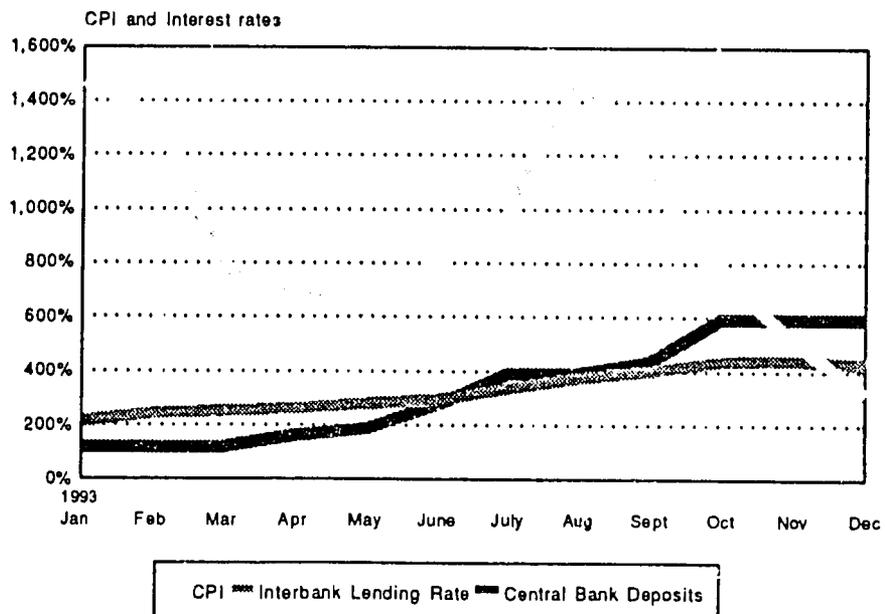
Figure 5.1 shows the relation between the effective interbank lending rate and monthly inflation—both expressed on an annual basis by compounding each on a monthly basis. The upper chart shows the steady climb in the interbank lending rate over the past two years relative to inflation. As illustrated in the lower chart, in December 1993 the rate actually exceeded inflation. The Central Bank discount rate, charged on a monthly basis, was also positive in real terms at this point. In this context it is important to understand that a significant share of commercial bank loans carry rates substantially above the interbank rates. We know of construction loans in December 1993 at a 260 percent annual rate. Other loans carry lower rates, typically because of deals with enterprises who keep large deposits which earn little

¹²³ Agricultural interests in particular have resisted the passage of a mortgage law which would make foreclosure a relatively simple and assured process for the banks. And it is quite possible that a version of the law could be passed by the Duma containing only weak provisions in this area and without provisions permitting the easy sale of mortgages in a secondary market.

FIGURE 5.1 A. ANNUAL INFLATION AND INTEREST RATES IN
RUSSIA, 1992 - 1993
(monthly compounding)



B. ANNUAL INFLATION AND INTEREST RATES IN
RUSSIA, 1993
(monthly compounding)



Note: Interbank rate compounded by IC rating.

or no interest or deals with equity holders. One expects that if inflation surges in 1994, interest rates will continue their upward trajectory and remain close to positive in real terms.

The importance of these developments for the present discussion is that lending for housing (or anything else) is not by definition unprofitable. Indeed, profit is determined by the risk-adjusted spread between the cost of funds and earnings on them. Russian banks are clearly profitable as verified by the constant founding of new banks.¹²⁴ The critical question for long-term housing lending is whether the risks of such loans can be adequately controlled—a topic addressed later in this chapter.

"Housing Debentures." While banks increased the interest rates on loans sharply during 1993, there was no corresponding movement on rates paid on deposits. A few small banks offered higher rates, but Sberbank, which continued to account for nearly 90 percent of all household deposits, at the end of 1993 was paying an annual rate of 100 percent with compounding only taking place on an annual basis. In this environment households energetically searched for higher paying options.

One response from the market was the creation of a kind of real estate investment trust. This scheme is operating in a least ten large Russian cities and more schemes are being created monthly.¹²⁵ As noted, the Presidential Decree on Non Budget Sources of Finance, issued in December 1993, encourages banks and finance-construction firms to offer such schemes. Below we describe the scheme of one firm, the Povolzhsky Financial and Building Company (PF&BC) of Samara. This is one of the oldest such schemes in this young industry. The schemes offered by other firms have similar structures.

The PF&BC Scheme. The company began by issuing "Series A" contracts and then developed and began issuing more general "Series B" contracts. As now designed the two schemes work together, as described below.

¹²⁴ Easterly and Vieira da Cunha (1994) estimate that enterprises paid the equivalent of 19 percent of GDP in an "inflation tax" in 1992 on no or low interest rate deposits in the banking system.

¹²⁵ In early 1994, an initiative was launched to create a Russia-wide debenture scheme under which people could purchase debentures in one city and redeem them in another city with a participating firm, with the appropriate adjustment being made for differences in prices. The seven likely founding firms are among the most experienced and they are located in Samara, Ryazan, Kirov, Tver, Novosibirsk, Ekaterinburg, and Yaroslavl. Interestingly, more than thirty firms have applied to participate in this association.

Under the Series A scheme:

- The "saver" purchases vouchers which are denominated in units of one-tenth of a square meter of housing. The price varies over time with the cost of construction. When the purchaser has amassed enough vouchers he can acquire a unit of the equivalent number of square meters. The firm charges a 0.5 percent registration fee for registering the vouchers.
- No interest is paid on the vouchers.
- The company is using the funds collected to finance the construction of a residential building. Savers who fulfill their contract will receive a unit in this building or another building constructed by the company.
- The vouchers are redeemable at any time and they can be freely traded. Redemptions use the current sales price as the basis for calculations. Redemptions are at a discount, however, the amount of which appears to be wholly at the discretion of the company. The discount is now 10-15 percent.
- The company sets the price of the voucher so that it covers all costs, including the cost in Samara of having to give 40 percent or more of the units in a building to the government. In fact, the price, although nominally supposed to be determined by construction costs, is close to auction prices.
- The company only sells vouchers to a number of savers equal to the number of units in the building. The vouchers have a term of 18 months.
- The saver has six months following the completion of "his" unit to purchase the required number of vouchers. If he does not purchase the unit, he can either sell his vouchers to the company or convert them to Series E vouchers with which he can purchase a unit in another building being constructed by the company. The company charges a 5 percent fee of the value of the newly purchased vouchers for this service. Units completed for which there are not voucher-buyers are sold at auction.
- The company has a contract with a major bank, AutoVAZbank, to supervise the company's use of the funds, i.e., to insure the funds are invested in the building being constructed, other real estate, or deposits. The latter two investments are only to be held until the funds are needed for construction.
- The company has also taken out an insurance policy which offers purchasers some degree of protection in the case the units purchases are not completed. Up to some limit the insurance proceeds will go to purchase alternate units for savers who have completed their contract.

- The company posts construction prices on a weekly basis. These are computed by its construction affiliate, MZK.
- The company expects that most of those purchasing units in the initial building with vouchers will be juridical persons rather than natural persons.

Series B differs from Series A in that it operates as a more general savings mechanisms. Many of the details of the two schemes are the same. Important differences include:

- The vouchers in Series B have a term until April 1, 2003, i.e., ten years from the first date of issue.
- The registration fee for purchased vouchers is .3 percent of the funds paid.
- The vouchers purchased are not tied to a specific building. Rather, when the saver has accumulated a sufficient number of vouchers, he then transfers his balance (the number of square meters valued at current construction prices) to Series A vouchers which are tied to a specific building. There is a 5 percent transfer fee.
- As in a general savings account (and the Series A vouchers), savers are able to cash-in their vouchers on demand.
- While supervision by AutoVAZbank continues for this series, the insurance provision is absent.

Discussion. On the face of it, this scheme appears to be reasonably safe and likely profitable for the company and advantageous for the saver compared with other savings instruments available in Russia even with quite high fees operating at various stages. A key point is that the funds raised be actually invested quickly in real estate whose value will move with the construction cost index.

If a firm offering such contracts relies solely on the funds generated in this way to finance the construction of the units and if it will only have the number of savers equal to the number of units in the building, then there is a good chance of the building's completion being greatly delayed. Obviously, other sources of funds are necessary—including commercial bank loans, bonds sales, and sales of vouchers like those of "Series B." Having to raise additional funds for the completion of the first Series A building was a major consideration in PF&BC launching the Series B vouchers.

It seems likely that families will have a difficult time actually using the voucher mechanism to purchase a unit. Using current prices, we could assume that actual

construction cost is at least R400,000/sq.m. in early 1994 prices, or R24 million for a 60 sq.m. unit. Even if the family bought R10 million worth of vouchers at the start of the building period, it would have to save about R778,000 monthly (in constant rubles) over a one year construction and six month grace period to purchase the unit.

There appears to be a natural complement between Series B vouchers and mortgage lending. The vouchers would preserve the value of the downpayment during the savings period, and the mortgage loan would permit the family to purchase its unit in a timely way. Note that if the family saved regularly for the downpayment (by purchasing vouchers), it would give the bank a good deal of confidence about the family's ability and willingness to make mortgage payments.

These schemes could be operated to the strong disadvantage of the savers and their regulation is essential. Drafts of regulations are being prepared by the federation government, under the leadership of the Ministry of Finance. One important principle incorporated in the draft regulations is that the schemes would have to purchase insurance to guarantee savers that they be paid the amount contracted for, i.e., the number of square meters purchased times the then current price per square meter. *If* the debenture issuer is investing the funds collected exclusively in residential real estate, then the insurer's exposure should not be large.¹²⁶

Subsidizing Home Purchase. In the first half of 1992, the Government addressed the problem of reduced purchasing power of would-be purchasers of new residential units through interest subsidies for fixed rate mortgage. The subsidies were believed necessary to offset increases in house prices and interest rates associated with inflation: subsidies were to help sustain housing affordability. As far as we can determine, limited, if any, analysis of the full cost of such subsidies was made prior to the decision to implement the programs. However, by the end of 1993, the government's approach to the affordability issue had changed markedly.

Subsidies in 1992. Two cases illustrate the government's early proclivity for deep subsidies. First, under Presidential Decree N.140 households purchasing a unit through a housing cooperative which began construction before January 1992 receive grants covering 70 percent of the increase in unit costs and interest rate increases. The subsidies are shared equally between the Federation and lower levels of government.

Second, under an agreement among the Ministry of Finance, the Central Bank, and Sberbank effective in April, 1992, Sberbank committed to lending 30 percent of incremental liabilities for farm development and individual and cooperative housing

¹²⁶ There has been some discussion of the national association of debenture schemes noted in the previous footnote being self-insuring, by establishing a reserve fund explicitly for this purpose.

at a 20 percent interest rate. Of the 20 percent, only 8 percent was paid by the borrower and 12 percent was paid from the Federation budget. While these loans were profitable to Sberbank in the spring and summer of 1992, before the end of the year the bank was already forecasting large losses for 1993 as the interest rates paid on deposits climbed to higher levels.

The subsidies in both of the programs just described are poorly targeted. There are no income, unit size or other restrictions on eligibility. Indeed, a rich Muscovite who had received a free-of-charge unit through privatization would qualify for the loans being made by Sberbank.

Developments in 1993. In April 1993 Sberbank concluded a new agreement with the Ministry of Finance about its mortgage interest rate.¹²⁷ Interest rates were set at 100 percent, the same as the Central Bank discount rate; and in the future the rate—on new as well as outstanding loans originated after April— will change with (and are the same as) the discount rate. At the end of 1993 the discount rate was 210 percent. For practical purposes subsidies have been eliminated¹²⁸ and Sberbank has shifted to an adjustable rate mortgage. A consequence of shifting to the high rates was a decline in the volume of mortgage lending done by Sberbank in the second-half of 1993 and an overall decline in real terms for the year concentrated in lending for cooperatives (Table 5.2).¹²⁹ In general, Sberbank lending was supported by it serving as the Government's agent for interest free loans to certain high priority groups, like victims of the Chernobyl accident. Subsidies for these loans amounted to about R55 billion in 1993, although these payments to Sberbank have been delayed.

In December 1993 the Russian Federation also made a sharp change in its policy for supporting unit purchase by replacing interest rate subsidies with down payment subsidies.¹³⁰ Federal subsidies can only go to those on the waiting list for

¹²⁷ Sberbank shifted to a mortgage contract for its long term housing lender after the passage of the Law on Collateral.

¹²⁸ Limited interest rate subsidies do remain. However, they have been assigned to several narrowly defined groups, such as the victims of the Chernobyl disaster, who through earlier legislation were given the right to interest free loans.

¹²⁹ In fact, this low volume of long-term mortgage lending appears to be exactly what Sberbank wants. The bank understands that its loan origination and servicing procedures are primitive and they are reluctant to make additional loans. However, rather than takes steps to modernize these procedures, the bank has decided to concentrate on being a direct investor in housing projects with some associated mortgage lending.

¹³⁰ Russian Federation Council of Ministers Order, "On Approval of the Regulations on Allocation of Allowances (subsidies) Free of Charge for Construction or Purchase of Housing to Citizens in Need to Improve Housing Conditions."

housing and will range from 5 to 70 percent of the price of the unit meeting the social norm (size) for the household, with larger subsidies going to families with lower incomes and more years on the waiting list. The objective of the subsidy is to assist moderate income families purchase a unit: the designers recognized that lower income groups would in general have to rely upon being allocated a municipal flat and that higher income households could fend for themselves.¹³¹

Table 5.4 illustrates the size of subsidies that would be received by various types of families.

parameter	case 1	case 2	case 3	case 4
monthly family income	rub 300,000	rub 300,000	rub 500,000	rub 500,000
persons in family	2	4	4	4
years on waiting list	5	5	3	10
subsidy as a percent of unit price ^a	50	70	50	64

a. This is the price of a unit of the social norm for a family of a given size.

The downpayment subsidies replace interest rate subsidies.¹³² The Order encourages regions and cities to use the same approach to subsidizing home purchase, but it leaves them free to determine the parameters of their programs.

The downpayment or "up front" subsidy has several strengths. First, the value of the subsidy is clear both to the government and to the recipient—something that

¹³¹ The regulation for this program, including the matrix showing the subsidies to households with different income and years-on-the waiting-list combinations, is Annex A.

¹³² There is one exception to this statement. Certain groups of households, such as victims of Chernobyl, who had been granted the right to interest free loans from Sberbank in principle now have the choice of taking an interest free loan or the up-front subsidy. However, in practice, Sberbank may stop making the no interest loans because the Federation is badly in arrears in making subsidy payments to the bank for these loans.

is not the case with interest rate subsidies or the various subsidies associated with a contract savings scheme. Second, if the up-front grant is standard for all borrowers with the same incomes and years on the waiting list, it is more equitable than other subsidies which tend to give bigger subsidies to families with higher incomes. Third, the subsidy is easy to administer, and the budget for the program can easily be adjusted each year—which is not true of the other subsidies under which the government promises to make payments for many years or must directly provide the funds to be lent. Fourth, it gives the home purchaser maximum freedom to choose how to finance his purchase—he is not tied to banks with contract savings schemes, for example. Finally, these subsidies are clearly "on budget" and the Federal Assembly will have to appropriate funds annually for the program.¹³³

Initiation of Mortgage Lending. Several banks began mortgage lending operations in 1993 and early 1994. As one would expect, each of these initial programs is characterized by the lender using various devices to cope with credit risk, interest rate risk, or funds mobilization issues.

Mortgage Standard Bank. In mid-1993, Mortgage Standard Bank (MSB) began long-term lending operations with a single large enterprise, Kamaz, the large truck manufacturer. MSB originates and services loans made to the enterprise's workers who are purchasing new units. Ten-year loans are made at a 210 percent interest rate using a fixed rate instrument, with the workers paying 10 percent. The bank sells the loans at par back to Kamaz or sister organization; Kamaz pays the interest differential, and it bears the credit risk. About 2,000 loans were originated in 1993, and a total of 12,000 are scheduled by the end of 1995. Thus, the bank obtains originating and servicing experience while avoiding most of the risks of mortgage lending.

Why is this arrangement of interest to Kamaz? First, the firm is able to produce additional housing for its workers at no greater cost than it did under the former arrangement of constructing rental housing. In this case, however, Kamaz has no responsibility for maintaining the units, as it would for rental housing. Second, by paying the large interest differential in effect to itself, Kamaz is able to maximize its tax deductions—deductions that are much larger than if it simply built rental housing or built workers' housing and gave it away.

The principle of working closely with an enterprise in providing owner-occupied housing to its workers is a sensible one, and one that banks in other countries have

¹³³ In Russia there are other reasons for banks to be worried. The practice is to budget interest rate subsidies one year at a time, making the banks especially vulnerable to a change of policy. Second, Sberbank has received little of the subsidies due to it, apparently because the Ministry of Finance believes its profits are generous and it can afford to absorb the subsidy costs—a worrisome precedent.

employed successfully.¹³⁴ This version is not as robust as it might be, however. Our understanding is that MSB is not underwriting the loans, but rather simply lending to the workers presented by Kamaz. Hence, the bank is gaining no practice in underwriting. Moreover, the bank's incentive to service delinquent loans aggressively is clearly not very great under these arrangements. On balance, it is possible that the bank may be developing poor lending habits rather than valuable experience.

Mosbusinessbank. In April 1994 Mosbusinessbank, the third largest commercial bank in Russia in terms of assets, will begin making long-term (10 year) mortgage loans on a commercial basis. For the first six months it will originate loans to its employees, but on a commercial basis: all loans will be rigorously underwritten and servicing is to be aggressive. During this period the bank will perfect its loan origination process. Then, economic conditions permitting, it will begin lending to other borrowers.

The most difficult twin problem faced by the bank was protecting the profitability of lending from severe interest rate risk (because of the decidedly short-term structure of its liabilities) while at the same time making loans affordable to borrowers. The result was the creation of the Deferred Adjustable Instrument for Russia—DAIR (Ravicz and Struyk, 1993). The DAIR is based on similar so-called "dual payment mortgages" being implemented in Hungary and is in concept similar to other indexed mortgage instruments designed for use in high inflation economies.¹³⁵ These instruments increase the size of the loan the borrower can take with a specified share of his income by lowering the interest rate initially paid to around 5-10 percent; the full interest rate payments are captured later because the loan principal is indexed to inflation or a cost-of-funds index. Thus, these instruments shift some of the increased interest payments required on the loan into the future when the borrower will better be able to pay them because his income will be higher. Equally important, these instruments shift most or all of the interest rate risk away from the lender to the borrower.

The DAIR employs two interest rates: (a) a "payment rate," i.e., the rate of interest used to compute what the borrower pays each month (typically in the range of 5-10 percent); and (b) a "contract rate," which is used to compute what the borrower owes. The contract rate for the DAIR could be, for example, the interbank lending rate plus additional charges for various risks, administration, and profit. The difference between the amount owed and the amount paid each month is added to the loan balance. Payments due are recalculated quarterly using the new loan

¹³⁴ The Housing Development Finance Corporation of Bombay, for example, has used this scheme very successfully.

¹³⁵ Such instruments include the price-level adjusted mortgage and the dual index mortgage. These instruments are described in Telgarsky and Mark (1991) and Ravicz (1992a).

balance, and the amortization period is reduced each quarter to force the loan to close on time.

The objective in designing the DAIR was to have the rate of return competitive with other opportunities available to the bank; operationally this was taken to be the interbank lending rate. Hence, the measure of profitability is relative to the bank making a series of short term loans (the whole period being equivalent to the mortgage loan period) in the interbank market. The DAIR, as designed, would yield about 140 percent of the interbank rate, and it appears to carry a quite acceptable credit risk.

Association of Russian Mortgage Banks. The Association held its organizational meeting on August 12, 1993. It is registered with the City of Moscow as a public, i.e., non profit, organization having education and other trade association objectives. The Association's creation came at the initiative of the Joint Stock Mortgage Bank and the St. Petersburg Mortgage Bank.

There are seventeen founding members, among them ten banks. The banks include eight commercial banks with "mortgage" in their name. These banks are located in Moscow (two), Ufa, St. Petersburg, Rostov on Don, Kuban, Saratov, and Novosibirsk.

The Association is an active participant in the legislative process. Perhaps most important is the development of its training function. After a two-day training seminar in November, the Association, in cooperation with USAID, held the initial offering of its basic, two week training course in February 1994. The course is to be repeated several times a year, and the Association plans to develop its own cadre of trainers. Given the lack of experience with mortgage lending in Russia, the availability of high quality training is essential to development of a sound industry.

Making Mortgage Lending Feasible: Reducing and Allocating Risk Efficiently

Many developments have been enumerated above. But the real question is what difference these make in reducing the risks faced by banks engaging in long-term mortgage lending and have they resulted in more families being in a position to borrow for a home, i.e., can they qualify for a loan *and* borrow enough funds to make a significant contribution to purchasing the unit? This section addresses this question.

Possible Actions to Reduce Risk. Making long-term mortgage loans involves several risks. In Russia, with its volatile economic conditions and the questions

surrounding eviction and foreclosure, some risks are higher than in the West for "structural" reasons. These risks can be reduced significantly—and often at low cost—by appropriate action by banks, or where appropriate, the national government. Additionally, lenders have the ability to mitigate some of these risks, particularly interest rate and credit risks, through adopting proper practices. This section discusses three principal types of risk, how banks and government could help address them, and what has actually been accomplished.

(1) *interest rate risk*—the risk that the cost of funds to the lender will rise relative to the interest rate on outstanding loans, thereby causing the lender to lose money on the loans. This risk increases as the difference in the duration of the mortgages and the liabilities funding them increases. Actions to mitigate this risk include the following:

- banks could develop and the Central Bank could grant affirmative permission and encourage use of indexed mortgage instruments that are suitable to inflation prone economies.
- the Central Bank and Ministry of Finance could make necessary changes in computation of tax liability and accounting procedures to accommodate the deferred receipt of interest income due.
- the Central Bank could develop reliable indexes for use with these instruments, indexes in which the public will have confidence.

Banks making mortgage loans are addressing interest rate risk through new loan instruments: Sberbank has shifted to a variable rate mortgage, with the interest rate defined as the Central Bank discount rate; Mosbusinessbank has adopted the DAIR, which uses the interbank lending rate as its measure of costs of funds; and, the Nizhni Novgorod Kredit Bank has implemented an instrument which indexes the loan principle with an index based on the minimum income. The use of indexed instruments has been facilitated by development of loan servicing software for the DAIR.

Thus far the government has not formally encouraged the use of such instruments. However, the Presidential Decree on "non budget sources of finance"¹³⁶ requires that regulations be prepared by the spring of 1994 on housing loans. Drafts of this document affirmatively permit the use of indexed and variable rate instruments for mortgage loans. In addition, it would require the Central Bank to publish a monthly report on the interbank lending rate. Lastly, with respect to

¹³⁶ Formally, the Presidential Decree, "On Development and Introduction of Non Budget Forms of Investing in the Housing Sector." This decree was discussed in Chapter 2.

accounting and taxation issues, banks have approached the Central Bank on these questions but no decision has yet been made by the CBR.

(2) *intermediation/liquidity risk*—intermediation risk is the risk that depositors will withdraw their funds at a time inconvenient for the bank. Liquidity risk is the risk that the bank will experience a comparatively small inflow of funds, including loan repayments, compared with the demands of depositors for funds, including interest payments due. Obviously, liquidity risk is greater for banks with their liabilities and assets concentrated in short-term accounts. Moreover, banks using the DAIR and other mortgage instruments have a heightened problem because the deferral of loan payments is the equivalent to the bank making larger loans to the same borrowers, and with no control over these "new" loans. During the years that these loans have negative amortization, the bank must continue to make interest payments to depositors while its interest income is reduced. Because of this feature of deferred payment mortgage instruments, banks are advised to hold only a small share of assets in such loans during the early years of a lending program; in later years, the liquidity problem is addressed by the high income flows from the older mortgages balancing the low flow from the freshly issued loans.

- One action by the government to assist banks with this problem would be to: encourage the State Pension Fund and other government funds to purchase mortgage-backed securities at market prices.

Pension funds and insurance companies typically have a large volume of investable funds. In addition, their needs for cash can be quite accurately predicted on a year-to-year basis. For this reason they have a comparative advantage in making long-term investments. Mortgages are clearly such an investment. At the same time, there are few good investment instruments in Russian financial markets. Interest rate-indexed bonds or other securities based on pools of mortgages should, therefore, be a highly attractive investment. One policy could be to give pension funds and insurance companies a target for their holding of mortgage investments, perhaps to reach 5 percent of investments over a several year period.¹³⁷

A second action possible for the government is to:

- establish a liquidity facility for purchase of a share of the negative amortization on indexed mortgage instruments (e.g., DAIRs) at market interest rates.

The Central Bank or Ministry of Finance could establish a facility that would consider requests from banks originating indexed mortgage loans for the facility to purchase the securities explicitly collateralized by these mortgages. Major mortgage lenders

¹³⁷ These funds should, however, be discouraged from becoming mortgage loan originators, either directly or through subsidiaries. Rather, they should invest in mortgage-backed securities.

would thus resolve their liquidity problem. The facility would base its decision to purchase the mortgage-backed securities on the strength of the bank, the quality of the loans (in terms of loan instrument structure, mortgage delinquency and default rates, etc.) and the share of all assets constituted by the indexed mortgages.¹³⁸

The facility should not purchase these funds exclusively with Central Bank or government funds for macroeconomic reasons. The expansion of the money supply could be controlled by the facility, in turn, selling securities to the public. The securities sold to the public could be based on pools of mortgages from several banks.

The President Decree on "non budget sources finance" creates the Agency for Mortgage Lending and requires that regulations for the new agency be prepared by spring 1994. Drafts of the concept for the Agency make it a closed joint stock company owned by the Ministry of Finance and the Central Bank of Russia. One of its primary functions, as described in the draft regulations, is to perform the liquidity operations described above for commercial banks making mortgage loans.

(3) *credit risk*—the risk that the borrower will not repay the loan and/or that the bank will not be permitted to foreclose on the loan. To control credit risk banks could:

- can adopt and implement conservative standards for underwriting mortgage loans and aggressive procedures for servicing them.

Early lenders have a mixed record on loan underwriting and servicing. As noted, Mortgage Standard Bank's arrangements with Kamaz embody incentives for it to be lax in these procedures. In contrast, other banks have, with U.S. technical assistance, determined the types of lending procedures that have been effective in other countries in which foreclosure is difficult or impossible but lenders have successfully dealt with credit risk. India offers a prominent example of a highly successful, high volume mortgage lender operating in a hostile legal environment by having excellent underwriting and loan servicing practices.¹³⁹ Mosbusinessbank has adopted these procedures and the same procedures are being promulgated in the training courses offered by the Association of Mortgage Banks.

For its part, the government should:

¹³⁸ It would be simpler for the facility to purchase mortgages or participations in full mortgages, rather than to purchase securities based only on the negative amortization (so-called "strips," i.e., stripping some of the income from the mortgage from the main part). The objective to the program--to provide increased liquidity--would be realized under either option. But investors would more easily understand investments based on full mortgages.

¹³⁹ A description of the procedures followed by the most successful Indian mortgage lender is in Buckley et al. (1985).

- pass legislation to strengthen the ability for the lender to foreclose; create an expedited system in the courts for hearing real estate cases including default on housing loans.

Clearly, foreclosure of a loan and eviction the borrower in default is fundamental to collateralized lending. Passage of the Law on Mortgage is critical. Once this law with its strengthened foreclosure procedures is passed, the Ministry of Justice could join in the first few foreclosure cases brought to the courts. It should monitor the execution of the courts orders by the bailiff to insure that a strong precedent is established. The special system of courts will help insure that foreclosure is a reality and that real estate cases are heard by judges knowledgeable in the field.¹⁴⁰

Increasing Affordability. In this context affordability is the amount of purchasing power a household can marshal for purchasing a dwelling unit. The goal of public policy is often to help households attain enough resources for the purchase of a modest unit. Thus, actions affecting affordability are of two types. First are those which help the household to obtain the maximum leverage of the funds it can generate itself. In general leverage is accomplished through a mortgage loan from a private bank which allows the purchaser to pay only part of the price of the unit at the time of purchase. Today in Russia the great majority of purchases have little leverage.¹⁴¹ The second type of action is government subsidies to help the would-be purchaser pay for the unit, either at the time of purchase or while the loan taken for purchase is being paid off.

Russia has made genuine progress in creating a mechanism to increase the ability of purchasers to leverage their own funds. The introduction of indexed mortgages, which defer some of the payments due in the early years of the loan to later in the loan's life (while preserving lender's profitability), have dramatically improved the size of the loan a borrower can take. Consider the following example. A family with a monthly income of R500,000 spending 30 percent of its income on its mortgage payment could borrow R.86 million at a 210 percent annual interest rate (17.5 monthly) rate charged at the end of 1993 by Sberbank. At a 10 percent annual rate (.83 monthly), the payment rate under the DAIR, the same family could borrow R15.3 million. Of course, until such instruments are made available, affordability remains low.

¹⁴⁰ Another important government action to reduce credit risk is for the government to establish a reliable registration system for land, property, and mortgage and other liens on land and property to reduce lenders' risk from clouded titles.

¹⁴¹ Purchasers might obtain a loan from family members or friends in addition to a bank. There are no data on the incidence of such borrowings.

Economists agree that subsidies are more efficient when they are well-targeted to their intended beneficiaries. Targeted subsidies permit households the maximum freedom in determining what to purchase. Their value can also be easily assessed by the legislatures granting them and the households receiving them. Russia's record regarding home purchase subsidies is mixed.

On the one hand, the targeting of a substantial share of housing purchase subsidies has been improved by the shift to downpayment subsidies under which the size of the subsidy depends on the beneficiary's income and number of years on the waiting list. The downpayment subsidies give unit purchasers great freedom in deciding which unit to purchase and the value of the subsidy is clear to everyone.

Two other federal subsidies have less attractive features. Construction subsidies continue for retired and demobilized military officers, victims of Chernobyl, and a few other well-defined groups. Such construction subsidies are likely to be inefficient compared with downpayment subsidies because (a) households qualify regardless of economic status and (b) beneficiaries have little choice over the unit they receive, thereby likely reducing their satisfaction with the unit compared with one that they could select themselves.

In addition, expenditures by households for the purchase of new or existing units are deductible from the income tax. Expenditures include payments to banks for loans taken for purchase. The revision to the tax law of December 1993 establishes a ceiling for such deductions at 500 minimum monthly wage, or about R8 million in early 1994. Deductions can be taken for expenditures only in the year in which expenditures are made, i.e., there is no "carry over" to later years. Marginal tax rates range from 12 percent for incomes of less than R3 million to 30 percent for incomes above R10 million.

The progressive tax rates mean that larger subsidies are enjoyed by higher income families. However, the ceiling is low compared with the typical purchase price. This pattern will likely change over time as the incidence of mortgage finance expands. The ceiling will permit larger cumulative deductions of mortgage payments year after year. Higher income families, who can afford to purchase more expensive homes and will more likely qualify for mortgage loans, will make larger deductions over the loan term.

We can illustrate the current affordability situation with data for Moscow from the December 1993 household survey.¹⁴² Several measures of effective demand

¹⁴² See Annex A for description.

were calculated. Effective demand was estimated based on combinations of several sources of funds:¹⁴³

- personal funds—reported self-assessments of the amount a household could collect from all sources, including family members, savings, sale of other assets, and credit, for purchase of a housing unit;
- personal funds plus the principal on a ten-year deferred, adjustable mortgage loan with a 12 percent payment interest rate, given monthly payments of 25 percent of the household income; and,
- personal funds, the principal on a mortgage loan and the equity in units privatized or purchased through secondary sales for only those in such units.

Finally, these three estimates of demand were recalculated for only those households on waiting lists, adding the up-front subsidy for purchase of housing for which each household qualifies, according to the Council of Ministers' Order of December 1993, described earlier.

Definitions of the various sources of funds for purchase are as follows:

Personal funds. All households were asked which sources they could use to improve their housing situation and were given a list of choices: credit, employer, relatives, savings, rent revenue, sale of assets or other. The most common sources of housing finance of those who responded to the question concerning sources of funds for housing were credit (14 percent), employer assistance (13 percent) and savings (11 percent). The household was then asked to estimate the amount of funds which could be collected.¹⁴⁴ This question was asked twice, once with reference to home purchase and the second time with specific reference to purchase or construction of a dacha; 15.5 percent of the sample responded to one or the other. The greater of the two responses was used in this analysis.

Housing Loan. The second measure of resources includes both personal funds and a mortgage loan for which a household would qualify assuming a ten-year mortgage at 12 percent annual interest. Mortgage payments would be 25 percent of the households monthly income. The size of the loan which the household can afford computed in this way is the same as under the Deferred Adjustable Instrument for Russia (DAIR), a dual rate mortgage which

¹⁴³ This section was prepared by J. Daniell.

¹⁴⁴ It is conceivable that these estimates could include revenue from the sale of their unit. However, for all cases, reported funds are insufficient to reflect the value of the household's unit.

Mosbusinessbank will soon begin using and other banks are considering. All households are considered eligible for the housing loan.

Equity. The equity a household has in a unit it owns is calculated for those living in privatized units (municipal, departmental and cooperative), those purchased in secondary sales, and other privately owned houses. There are 726 privatized, or privately owned units in the sample: 586 privatized municipal or departmental units; 118 privatized cooperative units, 14 secondary purchases, and 8 privately owned houses. As there is currently no long term lending and privatized units were obtained free of charge, equity here is defined as the value of the unit. Few households, however, actually know the current value of their unit. Therefore, a hedonic regression was used to estimate unit value.¹⁴⁵

The up-front subsidy has already been described. Note that if a household on the waiting list has privatized his unit, then when he takes the up-front subsidy and sells the unit privatized, he must return one-half of the sale proceeds to the government.

According to figures quoted by the Real Estate Section of the newspaper *Commerçant*, December 1993 auction prices of newly-constructed municipal units averaged R700,000 per square meter (\$583). Thus, for a 45 square meter unit, the price would be R31.5 million and a 60 square meter unit would be R42.0 million. Affordability of new units is presented in Table 5.5. The figures presented in each row represent the percentage of households who have less than the given amount of

¹⁴⁵ In the survey, households were asked several questions concerning their knowledge of the value of their unit, and the value itself. First, all households were asked if they knew the value of their unit, or another unit such as theirs which had been privatized or sold. The following question in the survey asked how much they appraise their unit for if the flat could be sold. The values given by households responding positively to the screening question were regressed on housing characteristics, including unit size, location, and amenities, and quality variables. Dummy variables were created for housing maintenance conditions which existed for more than one month: breakdown of hall lights, breakdown of the toilet, and the failure of the maintenance company to remove snow from the entrance. Other dummy variables identified unit characteristics: whether or not there was a telephone in the unit; a separate bath and toilet; central hot water; if the apartment was on the first or highest floor in the building; or if the building was located in the center of the city. The remaining independent variables describe other unit attributes: living space, kitchen space and the ratio of total space to living space. The coefficients produced by this regression were used to estimate the value of other privatized or privately owned units.

Some of the estimated values were negative, and were assigned a value of 10 million rubles. According to *Commerçant* (November 27, 1993, p. 12) the average cost per square meter of a unit in a Khrushchev-era building, the least desirable building type, was \$500/m². Given this as the average and a minimum total floor space of 30 m² for such a unit, R10 million seemed a reasonable estimate of the lower bound for unit values in Moscow. This value also corresponds to a break in the distribution of estimates obtained using the regression coefficients. The hedonic model, along with variable definitions, is provided in Annex C.

rubles, i.e., the percentage of households who could not afford a new unit of that value.

Using only personal funds (I), 98.4 percent of the households would not be able to accumulate the resources to purchase a new unit. Indeed, only 15.5 percent of the households could collect any funds to finance the purchase of a unit, the majority of which (73 percent) claim they could accumulate only one million rubles or less. A housing loan only slightly improves the affordability of a new unit for most households, since monthly household income is insufficient to qualify most families for a loan large enough to cover the cost of a new unit: less than two percent of households could afford to purchase a new unit, financed through a mortgage loan and personal funds.

Equity in a unit increases considerably effective demand for housing. Of those living in privatized municipal and departmental units, privatized cooperative units, or units purchased through secondary sales, 74 percent could afford to purchase a 45 square meter, newly-constructed unit if they used the revenue from the sale of their unit, a mortgage loan, and funds accumulated from other sources (III). A 60 square meter unit would be affordable for 60.7 percent of owners. As shown in Table 5.5, 26 percent would not have the resources to purchase a the smaller unit, and 39.3 would not be able to afford the larger unit. Thus, with the average estimated unit value of 51 million rubles, the majority of owners could easily afford a new unit, given the sale of their current unit.

For those on the waiting list, the up-front subsidy significantly improves the affordability of a new unit. Using only personal funds and the housing subsidy (IV), only 39.9 percent of households could not afford a 45 m² unit and 17.7 percent can afford a 60 m² unit. However, this scenario is very sensitive to the price of a new unit. With a housing loan (V), 35.6 percent of those on the waiting lists could not afford the smaller unit and 71.8 percent could not afford the larger.

New units are easily affordable for nearly all households who live in privatized or purchased housing and are on a waiting list for housing (VI). However, there are few such households in the sample; therefore, the results for this scenario are not statistically significant.

Table 5.5						
CUMULATIVE DISTRIBUTION OF HOUSING AFFORDABILITY¹						
SOURCES OF FUND FOR HOUSING ²						
Rubles (millions)	I	II	III	IV	V	VI
No funds	84.5	4.7	0.0	0.0	0.0	0.0
1 or less	95.8	14.0	0.0	0.0	0.0	0.0
1 - 6	97.6	81.8	0.0	0.5	0.0	0.0
6 - 12	98.1	96.3	4.1	1.6	0.0	0.0
12 - 18	98.2	97.6	10.2	3.2	1.6	0.0
18 - 24	98.4	98.1	16.1	18.1	16.5	0.0
24 - 30	98.4	98.1	23.8	39.4	25.5	0.0
30 - 32	98.4	98.1	26.0	39.9	35.6	6.3
32 - 34	98.4	98.2	29.6	40.4	38.3	6.3
34 - 36	98.4	98.2	32.8	71.3	42.6	12.5
36 - 38	98.4	98.3	35.0	71.8	53.2	12.5
38 - 40	98.4	98.3	37.2	71.8	67.0	12.5
40 - 42	98.4	98.4	39.3	72.3	71.8	12.5
42 - 48	98.4	98.4	49.6	93.1	81.0	18.8
48 - 54	98.5	98.5	59.0	94.1	92.0	43.8
54 - 60	98.5	98.5	68.9	95.7	95.23	56.3
60 - 66	98.5	98.5	76.4	96.8	95.7	56.3
66 - 72	98.6	98.5	81.8	96.8	96.3	68.8
72 or more	100.0	100.0	100.0	100.0	100.0	100.0

Notes:

1. The figures presented in each row represent the percentage of households who have less than the given amount of rubles, i.e., the percentage of households who could NOT afford a new unit of that value.

2. Sources of funds are as follows:

- I. Personal funds only
- II. Personal funds plus mortgage loan
- III. Personal funds plus mortgage loan plus equity in unit, for those who own their unit
- IV. I. plus subsidy for those on waiting list
- V. II. plus subsidy for those on the waiting list
- VI. III. plus subsidy for those on the waiting list

Overall, the figures just quoted show that more families could have the possibility of purchasing a new unit than generally believed. This results from primarily from two government policies: the housing privatization program which has endowed a large minority of families with substantial housing wealth and the up-front subsidy program which substantially augments the purchasing power of those on the waiting list. Indeed a third of families on the waiting list, who have not privatized their unit, could use the combination of the up-front subsidy and the a mortgage loan to purchase a new unit.

Conclusion

The primary conclusion of this review is that impressive progress has been made in the development of a mortgage finance system in Russia. The government has taken the initial steps to establish an institutional structure in which mortgage lending can be carried out on a commercially viable basis. Commercial banks pioneering mortgage lending for their part have displayed genuine ingenuity in coping with the substantial risks now involved with such lending. Similarly, non bank financial institutions have surpassed banks in developing and offering savings instruments geared to home purchase that protect savings from erosion by inflation during the period when funds for home purchase are being assembled.

Still, banks are well-advised to invest only a few percent of their assets in long-term residential mortgages under the handicaps of the current conditions, including negative amortizing loans that are essential in increasing the size of loan borrowers can support with current incomes. Economic stability is the most critical change required for an expansion of mortgage lending. Additionally, passage of a well-crafted Law on Mortgage is extremely important, particularly one that properly addresses foreclosure and (in the absence of other legislation) mortgage registration. Less urgent but also requiring near-term action is the activation of the Agency on Mortgage Lending and the issuance of regulations governing "housing debenture" schemes to protect the public from possible fraud. Action is underway on all the tasks just listed, and there is reason to believe that all could be accomplished in 1994.

6. CONCLUSIONS

Our general conclusions can be succinctly summarized. The Russian Federation has acted with dispatch to create much of the legal framework necessary for transformation of the housing sector to one operating under market principles. In the opening chapter we outlined a series of policy changes needed for the reorientation of the housing sector. These are summarized in Table 6.1 along with Russia's record on each. The accomplishments are impressive. While additional legislation in mortgage finance and land is needed, as well as the implementing codex for the Law on Fundamentals of Housing Policy in the Russian Federation, much can be done within the current legal foundation.

Equally important, progress is being made on the realization of the transition:

- Housing privatization is a clear success in terms of the volume of units being transferred to their occupants, although its momentum has significantly diminished since the peak in the first quarter of 1993. Additionally, the government took the critical step of creating the regulations on the formation of condominiums.
- Reform in the rental sector is well underway. Implementation of the program of raising rents to cover full operating costs combined with the simultaneous introduction of housing allowances has begun.

The most severe problem for the sector remains the improvement of housing maintenance. The additional revenues from higher rents are essential but so is a change in the incentives under which maintenance firms operate. The positive results of the experiments in Moscow and Novosibirsk with competitively selected private contractors are stimulating other jurisdictions to emulate them.

- Regarding housing construction, even over the past two years there has been a distinct shift away from the traditional panelized construction. Federal government policy is in favor of low-rise and cottage housing. Privatization of construction firms is well underway, although the largest firms appear to be resistant. At the same time small, new private firms have increased their market share significantly.
- Russia began the transition with a particularly undeveloped finance system and a limited number of capable bankers. Housing finance as known in market economies scarcely existed. Against this backdrop, there has been a surprising interest in long-term mortgage lending by both the government and the banks. The signing of the draft president decree in this area has set the stage for establishing much of the necessary infrastructure for such lending.

In addition, a mortgage instrument suitable for the Russian environment has been developed. A few banks have begun mortgage lending, using a variety of techniques to limit their risks. On the basis of this step-by-step progress, one expects a substantial volume of lending when economic conditions improve.

**Table 6.1
Summary of Russia's Record in Making
Policy Changes in the Housing Sector Needed at the
Beginning of the Transition**

Needed Policy Changes	Russia's Record
<p><u>rental housing</u></p> <ul style="list-style-type: none"> — increase rents gradually and at the same time introduce housing allowances to protect the poor — reduce the extraordinary rights of tenants living in social housing — prohibit rent controls — encourage housing adjustments by raising rents and removing restrictions on exchanges of municipal flats — privatize maintenance of municipal housing and introduce competitive selection 	<ul style="list-style-type: none"> — being implemented — Law on Fundamentals permits eviction to low quality unit for non payment of rent; regulations on housing allowances increase penalties for late payments; general implementation of both is pending — done — done — REUs are being privatized in 1994; competition only introduced on pilot basis
<p><u>encouraging privatization</u></p> <ul style="list-style-type: none"> — raise rents — pass condominium legislation — announce fixed time limit for free-of-charge privatization 	<ul style="list-style-type: none"> — done — done — not done and no action pending
<p><u>new construction</u></p> <ul style="list-style-type: none"> — remaining subsidies should be directed to purchasers who are on the waiting list for improve housing and be given at the time of purchase -- make mortgage finance widely available on commercial basis; shift to indexed mortgage instrument — demonopolize the residential construction industry 	<ul style="list-style-type: none"> — downpayment subsidy program created which partially replaces direct construction subsidies — an indexed instrument has been developed and some of the legal framework in place but the economic environment prohibits much lending — announced federal policy is for competition but little direct action taken

ANNEX A

MOSCOW HOUSEHOLD SURVEY

The objective of the Moscow Household Survey is to obtain information annually over a period of five years to track the changes in the housing sector in Moscow as it affects individual households. The first wave of the survey in December 1992 was designed to obtain a sample of 2000 units which were state rentals in January 1992. The original plan was to concentrate the monitoring on developments in the state sector which in 1990 accounted for 90 percent of housing units in Moscow. In the second wave of the survey conducted in December 1993 a sample of cooperative units was included at the request of the World Bank in order to obtain a sample representative of the entire distribution of housing stock in Moscow.

The primary sample was randomly drawn from a listing of residential telephone numbers provided by the Moscow Telephone Network. As of October 1992, 92 percent of apartments in Moscow (and 94 percent of urban families--the difference being attributable to communal flats) had telephones. The great majority of units without telephones is in areas of newly constructed buildings awaiting installation of this equipment. Samples were drawn of units in three of these large, new residential sites from listings of units in each. Including these areas, 95 percent of all units in Moscow were included in the population from which the sample was drawn.

The original 1992 sample was restricted to state rentals by interviewer screening. Occupants were asked whether the unit met the definition for inclusion, i.e. was a state rental unit in January 1992. Several attempts to contact the residents were made. If the occupant refused to be interviewed or could not be contacted, the interviewer followed instructions for selecting a similar unit in the same building, usually a unit above or below the one originally selected through the telephone listing. Refusals by occupants on the first or last floor of a building, or in buildings with no elevators, were substituted with flats of similar characteristics in another entrance of the same building. If an appropriate substitution could not be made the address was replaced by another from the list of extra, randomly selected units. Vacant units were recorded as such and selected information on the condition of the unit was gathered.

A total of 2,002 in-person interviews were completed in December 1992. The same households were contacted in the second wave of the survey conducted in December 1993. Of the original households, 1900 were successfully interviewed. In addition, 250 randomly selected households in cooperative units were interviewed in 1993. The cooperative units were selected from the original list of residential telephone numbers and were identified as cooperative units by interviewer screening in 1992.

The sample appears to be representative of the Moscow population and is relatively consistent with other data collected by the Russian State Statistical Bureau (Goskomstat). Of particular interest is the distribution of income. A comparison of the income distribution from December 1992 data to that of the March 1992 Moscow Family Budget Survey conducted by Goskomstat (ratio-adjusted to compensate for a sampling bias) reveal their similarity: households in each income decile have approximately the same percentage of total income in each sample. A similar comparison between the November 1993 Moscow Family Budget Survey and the 1993 wave of the Moscow household survey yielded similar income distributions, as shown in the table below. However, the mean income reported in the December sample was 29 percent lower than anticipated, given the monthly inflation of 12.5 percent and the data for November. Mean household income in November was R197,510, while in the December survey households reported a mean of R168,847. We believe the relative underreporting of

income in the panel survey results primarily from the more thorough and detailed reporting of incomes required in the budget survey. The budget survey itself, however, is not without problems.¹⁴⁶

COMPARISON OF INCOME DISTRIBUTIONS OF MOSCOW HOUSEHOLD SURVEYS AND MOSCOW FAMILY BUDGET SURVEYS				
Percentage of total income by income decile				
Decile	March 92	Dec 92	Nov 93	Dec 93
1	1.7	2.0	2.1	2.3
2	3.7	3.6	3.8	3.2
3	5.2	5.1	5.1	4.7
4	6.6	6.4	6.3	6.0
5	7.9	7.5	7.8	7.5
6	9.3	8.9	9.4	8.8
7	10.7	10.6	11.1	12.1
8	12.7	12.8	13.3	11.7
9	15.7	16.0	16.0	16.2
10	26.5	27.0	25.0	27.6

For the purpose of estimating effective demand for housing, household income in the sample was increased by 29 percent.

The survey included questions on housing quality of both the flat and public spaces in the building, household characteristics including family size, occupations, income, and wealth, household intentions with regard to future housing, and attitudes towards privatization and quality of housing maintenance. This survey provides data which enable a thorough analysis of the housing sector in Moscow.

¹⁴⁶ For discussion of the Family Budget Survey, see Annex A in Struyk et al. Implementing Housing Allowances in Russia. Washington, DC: Urban Institute Press, 1993.

ANNEX B

**RUSSIAN FEDERATION REGULATION ON
DOWNPAYMENT SUBSIDIES**

**REGULATIONS ON ALLOCATION OF
ALLOWANCES (SUBSIDIES) FREE OF CHARGE FOR CONSTRUCTION OR
PURCHASE OF HOUSING TO CITIZENS IN NEED TO IMPROVE HOUSING
CONDITION**

1. The present Regulations specify the procedure to be followed in allocation of free allowances (subsidies) to citizens in need to improve housing conditions for construction or purchase of housing units, including construction or purchase through the use of bank credit.

2. Subsidies shall be given at will of citizens who are on a housing condition improvement waiting list in local executive power bodies, at enterprises, and organizations, as well as persons who are eligible, in compliance with the effective legislation, for benefits in financing of housing construction or purchase.

3. Subsidies shall be allocated:

by local executive bodies according to the present Regulations; and by decision of governments of the Russian Federation republics, territories, regions, autonomous regions, autonomous districts, and the cities of Moscow and St. Petersburg;

by enterprises and organizations.

4. Citizens qualify for allocation of subsidies under the condition that their monthly income per a family member does not exceed the limit established by the bodies financing the allocation of these subsidies.

In case subsidies are allocated from the republican budget of the Russian Federation the above mentioned maximum income level is established by the Council of Ministers - Government of the Russian Federation in the draft annual budget separately for different territories and regions.

5. The subsidies are allocated from the republican budget of the Russian Federation within the limit determined in this budget for the appropriate year on the basis of the requests of the Russian Federation republics, territories, regions, autonomous regions, autonomous districts, and the cities of Moscow and St. Petersburg and the interested ministries and departments of the Russian Federation to the following groups of citizens:

- servicemen, persons retired from the military service, and officers of the Ministry of Internal Affairs bodies;
- refugees and forced migrants;
- persons who worked in the Far North regions and the regions equated to the Far North regions for at least 10 years;
- persons who suffered from the Chernobyl accident as well as from other accidents and natural calamities;
- other persons eligible for receiving benefits in financing of housing construction or purchase according to the current legislation.

Subsidies to servicemen, persons retired from the military service, refugees and forced migrants, persons who worked in the Far North regions and the regions equated to the Far North regions for at least 10 years, are allocated in places of their new residence chosen by these persons in accordance with the effective legislation.

6. Citizens of other categories that are not specified under Item 5 of the present Regulations but who need to improve housing condition shall be given subsidies by the local executive bodies from the local budgets in the amount established by the decision of local executive bodies of the Russian Federation republics, territories, regions, autonomous region, autonomous districts, and the cities of Moscow and St. Petersburg.

Employees of the enterprises and organizations (excluding the enterprises and organizations financed from the budget) receive subsidies by the decision of these enterprises and organizations at their own expense as well as from other sources of financing.

7. A subsidy shall be allocated to a family only once. In this case, a family who received a subsidy shall be removed from a housing condition improvement waiting list. The members of the family that received a subsidy at the age of 18 and more and not separating from the family, lose the right to benefits related to construction and purchase of housing future.

8. Subsidies are allocated for construction and purchase of single-family houses and flats in multifamily houses.

For existing housing units purchase subsidies are allocated on the same conditions as for construction or purchase of newly built housing.

9. Subsidies are allocated in form of payments transferred by banks by the decision of the body funding the allocation of the subsidies and in accordance with the direction of the recipient of the subsidy: for housing construction -- to the developer, for housing purchase -- to the seller.

In some cases, at the request of the recipient the subsidy may be allocated in the form of a land lot, construction materials, or some other form identified by the effective legislation.

10. The subsidies for the owners of privatized flats in need to improve their housing conditions and eligible for subsidies according to the items 2 and 4 of the present Regulations, in case these owners sell previously occupied housing units, are reduced by 50 per cent of the sum received from the sale.

11. The amount of a subsidy granted to a person may be of 5 to 70 per cent of an average cost (for the moment of subsidy allocation) of construction or purchase of a house or flat (in a particular region) the living floor space of which is within the social norm for the family receiving a subsidy and is in compliance with the standard consumer quality requirements for a housing unit.

The above mentioned amount depends on the income per a family member and the years on the waiting list in accordance with the attached Table.

If the figures of income and years on the waiting list do not coincide with the values in the Table, the amount of the subsidy is calculated on the basis of interpolation or by the following formula:

$$80 - 4 D + 4 B \text{ (but not less than 5\% and not more than 70\%),}$$

where :

D - the monthly income per a family member/minimum wage level ratio;
B - years on the waiting list

The monthly income level per a family member is determined as an average value for the last three months.

The bodies allocating subsidies according to the local conditions may specify size of subsidies shown in the table within the limit of +/- 10% of housing construction or purchase cost.

November 21, 1993

TABLE: Calculation of subsidy amount

(As a share of a housing unit building of purchase cost, percentage)

Monthly income per one member of a family/ minimum wage level ratio	Number of full years on the waiting list															
	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15 and over
4 and less	64	68	70	70	70	70	70	70	70	70	70	70	70	70	70	70
5	60	64	68	70	70	70	70	70	70	70	70	70	70	70	70	70
6	56	60	64	68	70	70	70	70	70	70	70	70	70	70	70	70
7	52	56	60	64	68	70	70	70	70	70	70	70	70	70	70	70
8	48	52	56	60	64	68	70	70	70	70	70	70	70	70	70	70
9	44	48	52	56	60	64	68	70	70	70	70	70	70	70	70	70
10	40	44	48	52	56	60	64	68	70	70	70	70	70	70	70	70
11	36	40	44	48	52	56	60	64	68	70	70	70	70	70	70	70
12	32	36	40	44	48	52	56	60	64	68	70	70	70	70	70	70
13	28	32	36	40	44	48	52	56	60	64	68	70	70	70	70	70
14	24	28	32	36	40	44	48	52	56	60	64	68	70	70	70	70
15	20	24	28	32	36	40	44	48	52	56	60	64	68	70	70	70
16	16	20	24	28	32	36	40	44	48	52	56	60	64	68	70	70
17	12	16	20	24	28	32	36	40	44	48	52	56	60	64	68	70
18	8	12	16	20	24	28	32	36	40	44	48	52	56	60	64	68
19	5	8	12	16	20	24	28	32	36	40	44	48	52	56	60	64
20 and more*	5	5	8	12	16	20	24	28	32	36	40	44	48	52	56	60

* Within the limits specified in the Item 4 of the Regulations.

Reference

on the Draft Resolution of the Council of Ministers -- Government of the Russian Federation
"On approval of the Regulations on allocation of free allowances (subsidies) for construction or
purchase of housing to citizens in need to improve housing conditions"

The Draft Resolution was elaborated in accordance with the article 25 of the Russian Federation Law of December 24, 1992 "On Fundamentals of Federal Housing Policy" and the State Targeted Program "Housing" approved by the Resolution of the Council of Ministers - Government of the Russian Federation of June 20, 1993 # 595.

Introduction of subsidies will not require additional funding from the republican budget of the Russian Federation, because part of the funds, formerly allocated for housing construction for the groups of citizens receiving housing units at the expense of the republican budget, will be now allocated for these purposes.

Amount of subsidies will vary from 5% to 70%, and in average will make 1/3 of the housing construction or purchase cost, and the rest expenses will be covered by bank loan, citizens own means and other funding sources. This will allow to extend the effect of housing improvement process on the larger number of families.

In 1993, for example, with respect of summer indexing by 1.9 minus 15%, total expenses of the republican budget for housing construction will make about 1178 billions of rubles.

Maintaining the given volume of funding for 1994 and use of only 20% of it for allocation of subsidies to families for housing construction or purchase will allow, by expert estimations, to increase the number of families that will be able to improve their housing conditions by 45%.

11.2.1993

ANNEX C

SUPPLEMENTAL DATA

C.1 ESTIMATE OF EQUITY IN HOUSING

A hedonic regression model was used to estimate unit value for privatized or purchased units using the sample described in the text. The regression equation is the following:

$$\begin{aligned} \text{equity} = & -27.62 + 21.57*\text{totliv} + .85*\text{a12} + 2.03*\text{a14} + 9.97*\text{bath} \\ & (0.558) \quad (0.407) \quad (0.047) \quad (0.452) \quad (0.432) \\ & - 26.57*\text{hotwater} + 82.79*\text{center} - 13.39*\text{badfloor} \\ & (0.225) \quad (0.000) \quad (0.198) \\ & - 9.76*\text{nolight} - 19.02*\text{snow} - 26.73*\text{nocommod} + 20.14*\text{telefon}. \\ & (0.411) \quad (0.252) \quad (0.182) \quad (0.113) \end{aligned}$$

where:

totliv = ratio of total space to living space;

a12 = square meters of living space;

bath = 1 if there is the bath and toilet are in separate room(if not, 0);

hotwater = 1 if there is central hot water (if not, 0);

center = 1 if the units is in the city center (if not, 0);

badfloor = 1 if the unit is on the first or highest floor (if not, 0);

nolight=1 if hall lights were out for more than one month (if not, 0)

snow=1 if snow was not removed for more than one month (if not, 0)

nocommod=1 if the toilet was out of use for more than one month (if not, 0); and,

telefon=1 if the unit has a telephone (if not, 0).

Significance for the coefficients are in parentheses.

The R-square for the regression is 0.432, with an adjusted R-square of 0.379.

Table C.1
Family Groups: Mean Incomes and
Percentage Distribution Among All Households:
Moscow, December 1993

family group	mean household income	percentage of all households
pensioners — poor	37,761.5	8.9
pensioners — higher income	116,721.1	10.5
singles — poor	57,015.1	6.1
singles — higher income	234,803.4	5.4
adults with kids — poor	86,606.6	17.6
adults with kids — higher income	276,714.4	17.4
adult with parent — lower income	87,976.8	8.6
adult with parent — higher income	286,467.2	5.8
complex family — lower income	95,180.2	8.3
complex family — higher income	288,854.5	11.3

- a. The population of households in table C.1 and C.2 are persons living in units that were state rentals as of January 1992, some of which have been privatized over the period.

Source: Data from 1993 Moscow housing panel survey.

Table C.2
Percentage Distribution of Households by
Most Prestigious Occupation of Family Member:
Moscow, December 1993

occupation	percent of households
directors ^a	6.6
intelligentsia ^b	13.3
military	3.6
white collar workers	12.7
skilled workers	18.5
blue collar workers	19.5
pensioners	23.7
other	2.0

- a. directors and managers of firms or state enterprises
b. skilled employees in non production industries, e.g., education, culture, science and administration.

Source: Data from 1993 Moscow housing panel survey.

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