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**STRATEGIC ISSUES IN HOUSING PRIVATIZATION:  
The Case of Mongolia**

*Final*

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## **1.0 The Problem**

In late October of 1994, the First Deputy Prime Minister of Mongolia, Mr. Enebish, looked out his window at Sukhbaatar Square, located in the center of the country's capital and largest city, Ulaanbaatar. Dominating the view was the towering statue of Sukhbaatar, who, along with Genghis Khan, was among Mongolia's greatest national heroes. At times Enebish felt that the problems faced by these two heroes were in many ways easier than the challenges facing him as director of the State Privatization Commission (SPC).

In 1992 the Prime Minister had charged him with the rapid development and implementation of a plan to privatize the country's state-owned and operated housing sector. For over a year, a team of foreign experts had worked closely with his staff to develop alternatives for transferring ownership of the housing stock. He and his staff also had the opportunity to learn about how other governments had privatized their housing stock. The Mongolian government had embarked on a public information campaign to educate the public about the privatization program in general and housing privatization in particular. But little actual progress had been made. Virtually all the housing stock remained in state-hands. He was under increasing pressure from Government and international donors to act.

The advisors had provided the SPC with several alternatives.<sup>1</sup> One was to simply give the housing away to those currently inhabiting the units. Another extreme would be to leave the stock publicly-owned but turn over management to a private company. In addition, they were considering several combinations of rents, with deep discounts and subsidies to encourage ownership and protect the less financially secure tenants. Which one of the alternatives presently before them was most feasible? Which course of action should he select? What type of expertise would he need to implement it?

Although he lacked the power to take unilateral action, Mr. Enebish knew that as Chairman of the SPC he was bound to take most of the blame if actions were not taken quickly. He glanced once again at the statue across the square. For Sukhbaatar things were certainly simpler; he could have drawn his sword and mobilized his followers to take action in defense of their homeland. For Enebish, the issues were less clear, the challenges more complicated, and the solutions far more elusive.

## **2.0 Background**

Many factors contributed to the slow progress with the Mongolian housing privatization program. The move toward a market economy had caused the economic situation of many people to

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<sup>1</sup> See Appendix 3 on the role of the advisors.

worsen dramatically. The withdrawal of Russian economic support in 1990-1991 removed one of the main pillars of the economy. The Soviet Union contributed between 17% and 55% of total government revenue during the 1980s, and financed more than 80% of all public investment. Not only did the collapse of the Soviet Union remove this direct economic support, it also caused Mongolia's exports, more than 90% of which went to CMEA (Council of Mutual Economic Assistance) countries, to plummet.

Naturally, this resulted in precipitous drops in output and investment; industrial production fell by 12% in 1991 alone, while investment fell by about 30%. Inflation and unemployment, meanwhile, had risen, with inflation exceeding 100% annually in 1991 and 1992, while unemployment exceeded 20%. The liberalization of prices in 1991 had contributed to accelerating inflation and had also caused the Government to introduce, for the first time, rationing of basic commodities such as meat, flour, sugar, cooking oil and rice. Many Mongolians attributed these conditions to the introduction of a market economy.

With incomes falling and the economic future growing ever more uncertain, few people could be expected to respond enthusiastically to proposals that they buy their apartments.

Moreover, the Government's inability to decide on critical elements of the program created skepticism over any housing privatization. Although the SPC was meant to take the lead on both policy and implementation aspects of the process, its position did not allow it to take unilateral action. Two years into the program, Mongolia's Government was no closer to deciding on the basic structure of the program than it had been at its inception. The SPC, in late 1991, retained an American consulting firm, with USAID funding, to help resolve these questions.

Throughout 1992, the technical assistance team and the staff of SPC debated how to implement the Government's goal to privatize state-owned housing. Most of the debate centered around two linked issues: 1) how quickly should the Government try to dispose of its stock; and, 2) what price should buyers be asked to pay. Worldwide experience had shown that fast privatization meant selling at a very low price, although low prices were themselves no guarantee of success.

These issues had been debated by experts on privatization throughout the world over the previous five years. Some advisors on privatization favored a very gradual approach (such as China's); more favored rapid privatization (such as Moscow's), although some recommended moving rents to market levels prior to attempting the mass sale of units. Other countries had decided to defer privatization of housing temporarily; the Czech Republic followed this approach, concentrating not on selling or giving away the housing stock but on managing it better through private management companies. In practice few countries had proven able to privatize their housing stock quickly, even by giving away houses and apartments outright to their occupants.

### **3.0 The Privatization Environment<sup>2</sup>**

Mongolia was one of the first countries to implement a voucher privatization program. Mongolia's first democratically elected government initiated a very aggressive privatization program immediately upon taking office in January 1991. The State Privatization Commission (SPC) announced plans to transfer 100 percent of its holdings in small enterprises and 80 percent of all state assets to the private sector by the end of 1993. In 1991, each member of the population was given three red<sup>3</sup> vouchers worth Tugrics 1,000 each (just a few \$US at the current rate of exchange) and one blue voucher worth T7,000. Almost all of Mongolia's 2,500 small enterprises were privatized within a year; most of which were bought by their staff. Only a small proportion of the 300 larger enterprises identified for privatization had actually been privatized by the end of 1994, although a substantial number had been valued. Agricultural assets were also being privatized, with most of the country's livestock already transferred into private ownership, using red vouchers.

Privatization policy was the responsibility of SPC, under the direction of its chairman, the First Deputy Prime Minister. Other members included Cabinet Ministers and other senior officials, such as the Governor of the Central Bank, the Chairman of the Stock Exchange, and the Mayor of Ulaanbaatar. There were no representatives of the private sector on the SPC, since there was almost no private sector before privatization began. The SPC had a small staff headed by the Executive Secretary (a former academic economist). While the SPC provided overall strategic guidance for the program, and exercised final authority over all privatization decisions, the local authorities largely implemented the privatization programs. For example, Ulaanbaatar, one of only three cities on Mongolia with significant portions of housing stock owned by the state, had its own Privatization Commission headed by the First Deputy Mayor.

### **4.0 The Structure of the Housing Sector**

In Ulaanbaatar, with 25% of the country's total population, overall management of state-owned housing rested with the Housing and Communal Services Company which reported to the city. The Housing Company<sup>4</sup> had a staff of 20 and supervised 13 Housing Authorities, each of which managed a group of apartment buildings. In Ulaanbaatar, 240,000 people lived in 48,500 flats in 707 buildings. Two thirds of these buildings were built since 1978. The Housing Authorities collected the rent and provided maintenance, repairs, heating, electrical supply, water, trash collection and cleaning. Although maintenance standards were low, the Housing Authorities were greatly overstaffed (15 to 25 units per employee) by western public and private housing

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<sup>2</sup>See Appendix 3: Technical Note for more detailed information on the impact of housing privatization not discussed in the main body of the case.

<sup>3</sup> These vouchers are referred to in the early promotion material as green. Unfortunately, when it came time to print them, no green ink could be found -- a typical Mongolian problem then and today.

<sup>4</sup>Like the SPC, the Housing Authority was chaired by an economist.

standards.

The Housing Authorities were not only supposed to be financially viable in terms of the cash flow from rents covering their operating costs, but they were also expected to generate a surplus. Part of this surplus was required to be handed over to the Housing Company and the Housing City.

Neither the Housing Company nor the Housing Authorities had the financial capacity to construct new buildings. No new construction had taken place for several years, and many partially constructed buildings stood idle, their construction halted for lack of funds. Although the Housing Authorities were responsible for capital repairs as well as routine maintenance, they lacked sufficient funding to undertake major repairs. Only 5 to 10 buildings could undergo repairs, although the normal schedule provided for 40 to 50 major renovations and repairs each year.

Part of the funding shortfall was attributable to the inability of the Housing Company or the Housing Authorities to increase rents, which only the national government had the power to do. Utility prices and rents did increase significantly in 1992 and subsequent years, but they continued to lag behind increases in operations and maintenance costs.<sup>5</sup>

It was clear to Enebish that market forces needed to be introduced into the housing sector if the existing housing stock was to be maintained, if new housing was to be constructed, and if an appropriate level of service was to be guaranteed.

## **5.0 Why Privatize Housing?**

The SPC believed that the principal reason for privatizing housing was to make a large sector of the economy market oriented. The investment and consumption decisions of current and future householders and other participants in the sector would respond to prices that reflected real costs. The members of the SPC developed the following objectives for the privatization program:

- to continue the transition to a market economy and reduce the role of the state;
- to provide opportunities and incentives for development of a Housing Bank and a market-oriented system of housing finance;
- to provide incentives for increased housing construction by the private sector;

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<sup>5</sup> Wholesale prices of coal and electricity and transportation charges were increased by between 40 and 300 percent in 1992. Ceiling prices for some "essential" goods were increased by two to four times. Wage decontrol began in the same year.

- to provide households with both increased control over their living environment and a valuable asset, the worth of which would increase over time;
- to reduce the fiscal demands of the state, cities, and provinces;
- to increase the value and use of the remaining small vouchers;
- to provide a fund for construction of additional housing;
- to help stop deterioration of buildings and units through increased maintenance and capital repair by private owners;
- to encourage labor mobility;
- to encourage private savings;
- to increase the range of choices in housing.

The SPC did not labor under the illusion that privatization of the state-owned housing stock would eliminate a state-owned asset. One of the reasons why housing privatization proceeded so slowly was that governments could not afford to forgo the lost revenue from the housing stock. The SPC clearly recognized the negative net worth of the housing from a public finance point of view.

## **6.0 How Quickly and at What Price?**

### **Key Decisions**

The principal issue was how quickly should, and could, this transfer of ownership be achieved. Most countries undertaking privatization of their state-owned housing had at least set out to do so rapidly. These included Russia, Hungary, Poland and Britain. Initially SPC believed that the transfer should be very rapid. A strong case, argued by some experts, could be made for rapid privatization through giving away the state-owned housing stock:

*Housing markets will not function properly until the transition to a free market is essentially complete; the go-slow approach perpetuates the current misallocation of capital and undermines the entire reform agenda of converting economies.<sup>6</sup>*

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<sup>6</sup> Buckley, Robert M., Patrick E. Hendershott, and Kevin E. Villani, Rapid Housing Privatization in Reforming Economics: Pay the Special Dividend Now, paper presented to the AREUEA Conference, October 1992.

Other experts, discussing overall privatization, argued that state enterprises should be distributed rather than sold: "The capital stock already belongs to the people, who have bought it earlier through previous savings."<sup>7</sup> A similar argument could be applied to housing: the people in the previously centrally planned economies had actually paid fully for the housing through being remunerated in kind rather than through money wages. While enormous subsidies were provided to renters in the previously centrally planned economies, the full cost of these subsidies was currently being paid by the existing population.<sup>8</sup>

## **7.0 Alternative Formulas**

### **7.1 Giving Away Housing**

It was clear to most experts that rapid privatization of housing could be accomplished only through giving it away. Only the very rich domestic residents and foreigners in the transitional economies could afford housing sold privately at free market prices.<sup>9</sup> If housing were sold at a market price (defined as the replacement cost, with no discounts), only a handful of people would be able to afford it, mainly the country's few newly rich. Efforts by foreign advisors had failed to devise a formula under which a significant proportion of Ulaanbaatar's households could afford to buy their housing even if most of the floor space were given away free.

Using a simple spreadsheet model, the USAID-funded advisors demonstrated that even the most liberal market-based formula, fully 50% of the population, could not afford to buy their units. If one assumed that the poorer families continued to spend the average 5 percent of their income on rent and the rich ones progressively up to 20 percent, that each household member received 4 square meters free, that financing for the balance of the space sold at full replacement cost were for 15 years at 8 percent (well below the rate of inflation), and that there were a 5 percent downpayment, only the top 50% of the population in income would be able to afford their apartments.

Thus members and staff of SPC began to adopt a more conservative approach as they became exposed to widespread opposition to the privatization from the tenants themselves, often expressed through their recently democratically elected representatives. In meetings with the foreign advisors, the President of Mongolia and the Chairman of the Parliament's Standing Committee dealing with housing policy had cast doubts on the feasibility of implementing the privatization program. They had expressed concerns over its potential impact on urban households suffering from falling real incomes. The Prime Minister instructed SPC that the program should proceed "gradually, step-by-step."

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<sup>7</sup> op cit page 38.

<sup>8</sup> Buckley et al, op cit, page 3.

<sup>9</sup> The booming property market in the Czech Republic has been largely fueled by foreign investment often associated with the mass privatization program.

The proposal to give away housing units also had other drawbacks. In Mongolia, as in other former centrally planned economies, only some households had received access to state-owned housing. Giving apartments to their occupants would thus involve a redistribution of wealth from all the people to some of the people. This was the same argument used in many countries against the transfer of full ownership of state-owned enterprises to their workers. Those fortunate enough to work for profitable firms or those industries able to attract foreign investment might become wealthy overnight, while others, who had suffered equally under communist rule, would receive nothing of value.

In economies such as Britain's, in which only the poorer households rented state-owned housing and the rich owned their dwelling units, a distribution of state-owned housing could at least be justified by liberal governments as benefitting those less well off. But this was not the case in Mongolia where those with lower incomes tended to live in tent-like "gers." Some Mongolian politicians feared that the ger dwellers, comprising over half the population, would not benefit from the privatization of the state-owned apartments. It counted for little that the ger dwellers would tend to benefit in the long run since they would be able to buy flats from the new owners. At present they would have to rely on highly politicized waiting lists. A counter-argument, however, was that they would at least be no worse off than under the existing system.

A significant problem with efforts to achieve rapid privatization of housing was that even if governments were prepared to give away the housing stock, few households seemed prepared to take the steps necessary to become owners. The experience of Russia's housing privatization program was instructive; it appeared likely that it would fail to privatize more than a small portion of the public housing stock. In Moscow, where housing units were offered free to their tenants, only 5 percent of the stock was transferred in the first few months of the program; two other cities in which apartments were transferred free or nearly so, managed to transfer only one percent of their housing stock.<sup>10</sup> Hungary, which deeply discounted housing prices achieved 20 percent privatization, and Poland, with a similar strategy, far less. In Britain, where discounts on the market value averaged 50 percent and sometimes went as high as 70 percent, more than half the tenants of council houses chose not to buy.

## **7.2 Level Playing Field**

The SPC had explored other formulas that used a combination of market mechanisms and subsidies, yet which involved selling apartments rather than giving them away. These included:

increasing rents to market levels (replacement costs),<sup>11</sup> giving housing

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<sup>10</sup> Kosereva, Nadezhda and Raymond Struyck, *Housing Privatization in the Russian Federation*, Housing Policy Debate, Volume 4, Issue 1, 1993.

<sup>11</sup> Establishing the "market value" of the apartments is a problem in an economy such as Mongolia's, which is only just emerging from socialism. See Appendix 2A on Apartment Privatization Appraisal Rules.

allowances to those unable to afford these higher rents, and, once the "level playing field" has been established, selling the units to those wishing to buy them;

increasing rents slowly as incomes rise, and gradually selling units at a price equivalent to the rent. This resembled China's program to introduce a market-oriented housing system over about 25 years by progressively increasing rents to full cost recovery levels, in step with wage increases.

Under the first option, a "level playing field" might never be achieved, whereas for the second option it could take a generation or more for rents to reach market levels.

### **7.3 Mongolian Compromise**

Another option also discussed was to:

- 1) distribute the housing units to the occupants wishing to become owners, with very high discounts on the market value (assumed to be the replacement cost); gradually increase rents up to market values;
- 2) introduce an income-based housing allowance program for those unable to afford the rising rents.

The relationship between the rent and the discount on the market value of the house was to be structured in such a way as to encourage households to choose ownership over rental tenancy. This made calculation of the housing allowances a critical problem. If the allowances were too high relative to the rent, then households would be better off continuing to rent, given that as owners they would have to take responsibility for maintenance, which might cost more than the rents (after allowances) they now paid. The difficulty was that the only way to determine the proper level of allowances was to test different rates in practice. By undertaking what would amount to a series of experiments, this approach could drastically delay privatization of most of the housing stock.

### **7.4 Privatizing the Management of Public Housing**

Given the limited scope for achieving widespread privatization of housing units themselves, privatization of the management of the housing stock could be seen as one way to make its provision, operations and maintenance more efficient and market-based. Experience in the West had shown that even under the most aggressive privatization program, many people would choose not to own their housing and would continue to rent. In Western countries, the high rate of home ownership was attributable mainly to tax subsidies. In West Germany, where home ownership was not heavily subsidized, the majority of the population rented their housing. In the U.S. and Britain, where the tax benefits from ownership were high, more than half the population owned their homes. It was likely that in Mongolia, as in other transitional economies, a large proportion

of households would choose to continue to rent housing. Since Mongolia lacked a private rental market, this meant that the state would remain the principal landlord.

## **8.0 The Enabling Environment for Privatization**

It was decided that the key to rapid privatization was not only to privatize with deep discounts but also to establish a legal, regulatory, financial and management framework that would make it possible for housing markets to flourish. These included:

**Winning Political Support:** Many misconceptions prevailed about the manner of privatization implementation. Many people feared that the units would simply be sold to the highest bidders, thus creating a class of anti-social landlords and resulting in widespread evictions of the very poor. Some politicians began to exploit these uncertainties. Although no polls had been conducted, probably the majority of the tenants opposed privatization of housing.

Problems were also anticipated from those who would not benefit in any direct way from the privatization, particularly the half of Ulaanbaatar's population (and much more than half the population of the country as a whole) currently living in gers. Some of the better off ger-dwellers would eventually benefit since they would have access to permanent structures once a second round of sales began; at present they had almost no hope of gaining access to state-owned flats. But the great majority would remain ger-dwellers. The SPC's answer to this problem was to plan on giving households who lived in gers that land on which their units were built as part of the future land privatization.

Some concrete steps had already been taken to win support within Government for the privatization of housing, with the expectation that this support would, ultimately, filter down to the population as a whole.

One of the first steps taken by USAID-funded technical support team to win political commitment to a privatization program was to articulate to the staff of SPC, the various privatization options and to outline the enabling environment that would have to be established. This "stakeholder" training was spread outward to the Ulaanbaatar Privatization Commission and Housing Company. The top management of all three were brought to the U.S. to study a market-oriented housing system and the private management of public housing. The mission was led by the Chairman of SPC, the First Deputy Prime Minister, who was at best agnostic towards the privatization of housing at the beginning of the process.<sup>12</sup>

Then the "training" spread to the top political leadership. Meetings were held with the

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<sup>12</sup> He came from the reconstituted Communist Party that won the national elections shortly before this program began.

President,<sup>13</sup> the Prime Minister and the Chairman of the Parliamentary Committee responsible for housing policy. All three expressed reluctance to accept the program unless it promised to leave no one worse off. They required enactment of guarantees for the large proportion of the tenants of the flats whose incomes were low and falling. The suggestion of a housing allowances program successfully addressed some of those concerns. SPC staff also held numerous meetings with parliamentarians.

**Public Information:** Experience showed that it was much easier for managers, as well as tenants, to understand the cost of ownership than the benefits. Mongolia had never had a modern, market-oriented economy. It became communist in the early 1920s when it was still a quite simple, pastoral economy. The principles of capitalist economics were for the most part unknown to, or poorly understood by, even those who have been trained as economists in Mongolia, Russia or East Germany. As a result, few Mongolians understood how homeowners in the West had benefitted so much in the long run from their freedom to choose and from the appreciation in the value of their housing stock asset. Flat dwellers earned so little discretionary income that they were frightened to take on new financial responsibilities. Condominium concepts, with which most Westerners were familiar, were particularly baffling to Mongolians; no one in Mongolia, including SPC, imagined that the privatization should include the stairwell, roof, heating system and land.

The State and Ulaanbaatar Privatization Commissions therefore undertook a public information campaign with the support of the USAID-funded advisors. The first step for these advisors was to train the managers of the Housing Authorities in the benefits and responsibilities of private ownership so that they in turn could educate groups of tenants. The slides used in this training (which had been translated into Mongolian) were shown on a weekly city affairs program on television. The managers of the program also appeared in a radio broadcast.

**Legal Framework:** For the privatization of housing to lead to the creation of a housing market, there needed to be a legal basis for carrying out transactions in real property. When the advisors first visited Mongolia in 1992, no legal framework existed for a market oriented housing system, except that the Constitution had established a right to own property. Although the general Privatization Law provided the basis for transferring ownership from the state to private individuals or organizations, there was, and remained, no legal basis for subsequent sales. SPC believed that it could issue a series of administrative orders under the general enabling Privatization Law to establish the legal framework without having to prepare new legislation. The Civil Code already contained provisions to cover landlord-tenant relations.

More troubling was the lack of any legal basis for a system of housing finance. Even if it were legally possible to transfer property, Mongolia had no cadastral system to facilitate sales and

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<sup>13</sup> The President too came from the reconstituted Communist Party. But in the 1992 elections he switched at the last minute to the party that won independence from Russia, and won. The Secretary of SPC came from the party that won independence but was kept on by the other party when it came to power following the first democratic elections.

purchases, although most of the city of Ulaanbaatar had been surveyed.

In preparing the necessary legal framework, SPC borrowed from other countries' laws. This included the Russian Housing Law, which was more a policy statement than a law.<sup>14</sup> SPC's legal advisors also began studying U.S. condominium laws and articles of association.

One of the problems with both drawing up and implementing the legal framework was that although there were thousands of lawyers in Mongolia, almost all worked for the Government and very few, if any, had received training in property law. No more than 10 Mongolian lawyers had studied in the West.

**Housing Finance:** There was little immediate prospect of introducing housing finance to the existing commercial banks since they had only just begun to learn the rudiments of commercial banking. Restructuring the financial sector had only recently started, with the State Bank acting as a central bank and a number of commercial banks being formed. Few bankers had any understanding of banking concepts in a free market, including the role of competition, the role of the central bank and the functions of the credit process. They had little understanding of how to appraise risks of loans or to pursue recovery in the case of defaults, while the legal system did not allow for easy collection of arrears or recovery of property pledged as collateral in the event of default.

SPC had proposed setting up a special housing fund, analogous to the privatization fund it had already established. This fund would be capitalized by the down payments made by those purchasing their flats (the difference between the discounted market price and the value of the free space plus the value of the vouchers). Financing would be offered in the form of deferred payments, with or without interest. State-owned units were already being privatized in Hungary in a similar fashion, using installment payments and large discounts.

If the units were given away, no such housing finance system would be required, at least for the first round of sales. Given the numerous gaps in the necessary legal framework for housing finance, together with an almost complete absence of basic financial know-how and technology, a giveaway program looked increasingly appealing.

**Housing Allowances:** A program using a combination of raising rents to market levels and establishing a system of housing allowances for those who could not afford the higher rents had already been launched in Hungary. This approach, which was pioneered in the town of Szolnok, with technical assistance from the U.S.-based Urban Institute, had helped to address the concerns of the political leaders who feared a backlash from constituents suddenly forced to pay substantially more for housing. This had also helped to establish a level playing field between owners and renters. Senior political leaders in Mongolia became somewhat more supportive of

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<sup>14</sup> The Privatization Law was passed in 1991. Oblasts and cities then drew up regional versions of that law. See Appendix 2, Law on Housing Privatization in Mongolia.

privatization of housing when this approach was explained to them. However, the Szolnok scheme did not win easy approval with the local council. The vote in favor of the scheme was a very narrow one and followed intensive lobbying by the mayor and his staff. A similar political struggle to introduce this approach took place in Bulgaria.

The choice to give away housing, moreover, would not necessarily do away with the need for housing allowances. The main source of public opposition to the privatization of housing in Mongolia had always been the fear that households would have to take on new responsibilities that they could not afford, or of which they were not even aware. This was even the case before the issue of joint ownership of common areas had been raised. People were well aware that the rents they paid could not defray the cost of proper maintenance, although few appreciated just how inefficiently that maintenance was being carried out. In the view of the U.S. advisors, a much smaller, well-managed and motivated staff could raise standards greatly.

## **9.0 Conclusion**

It was up to Enebish to come up with an appropriate solution to the problem. What to privatize, how to privatize, to go quickly or slowly? The choices seemed to multiply each time he pondered the problem, but the time available to act was rapidly shrinking. The Prime Minister reminded him of this each time they met, asking him if he had made any progress. The U.S. advisors were due to return to Mongolia in early 1995, to assist in implementing the program, but they awaited Enebish's formal invitation to do so. For Enebish, there was little point in using precious funds to bring them back until he had a clearer idea of which approach he wanted to implement. It was one of the problems with the new style of technical assistance. The advisors had laid out, in the clearest possible terms, the implications of each set of policy choices, but at the end of the day he, Enebish, had to make the decision.<sup>15</sup>

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<sup>15</sup> See Appendix 1 for the Housing Reform Strategy for Mongolia proposed to Mr. Enebish by his advisors.

**Strategic Issues in Housing Privatization:  
The Case of Mongolia**

**APPENDICES**

1. Housing Reform Strategy for Mongolia
2. Law on Housing Privatization of Mongolia
- 2A. Apartment Privatization Appraisal Rules
3. Technical Note on Housing Privatization in Mongolia

## APPENDIX 1 -- HOUSING REFORM STRATEGY FOR MONGOLIA

### STATE PRIVATIZATION COMMISSION

### HOUSING REFORM STRATEGY FOR MONGOLIA

1993-1995

#### 1. Goal

The overall goal was to establish a market oriented housing sector.<sup>16</sup> Once the goal had been achieved, all the people of Ulaanbaatar and other cities would live in housing that they could afford. Quantitative and qualitative shortages would only be temporary while the market oriented supply system adjusted to new demands.

#### 2. General Objective

The general objective of the 1993-1995 Housing Reform Strategy was to establish the initial conditions for a market oriented housing system in Ulaanbaatar by privatizing as much of the existing stock as market conditions made possible, progressively increase rents to market levels, and privatize the management of the state-owned rental stock.<sup>17</sup>

Once the objective had been achieved, between 10 and 20 per cent of households would have become the owners of the housing they now occupied, mainly through the condominium approach; the rest of the households would rent their housing, most from the state but an increasing proportion from private landlords. Rents would be market rents and houses would be sold at market prices. Housing allowances would be given to all households according to income, including ger dwellers. There would be private sector management of the state-owned housing. The most efficient of the current Housing Authorities would continue as private management companies; the rest of the stock would be managed by new private companies. The Housing Company would represent the state as owners of the housing, monitor the performance of the housing management companies and be responsible for bidding and rebidding contracts. The Company would sell off the state-owned stock in accordance with consumer demand.

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<sup>16</sup> A program contributes to the achievement of a goal but does not itself completely achieve the goal. Many other reforms outside the scope of this program will be required to achieve this goal: land use planning that is more sensitive to real demand, a more competitive building industry, market pricing of infrastructure and infrastructure standards that are realistic, better management of infrastructure provision, and so on.

<sup>17</sup> The general objective should be achievable through the program alone.

Owners could borrow from the Housing Fund to buy their homes and to upgrade them. Private sector construction companies would also have access to borrowing from the Fund.

### **3. Specific Objectives**

#### **Objective 1: Introduce market pricing of housing**

There was already market pricing for some housing: the gers, the small amount of newly constructed housing, and some privately rented property. Market pricing would be gradually extended to the existing stock of state-owned rental housing and to the state-owned housing that would be sold to tenants.

##### **Activity 1.1 Increase rents to market levels**

Rents would increase over a period of years until they covered all costs including capital costs. Rents would rise as soon as this strategy began implementation to cover all maintenance and management costs. This means that the Housing Authorities could be financially viable and could supply better maintenance services. It would be some time before "market" pricing would cover the replacement as well as maintenance costs. This was due to the depressed state of the economy and because many of the housing units had been constructed to standards that were unaffordable by the tenants.<sup>18</sup>

##### **Activity 1.2 Establish market sales prices**

The sales price would be equivalent to the rent; in other words there would be a level playing field between renters and potential owners. When the rent increased to cover all maintenance costs, the sales prices equivalent to that level would be established. This would create incentives to buy. As the rent increased to cover more costs, so the sales price would be increased. Some equity problems for the ger dwellers would remain, since they would pay full market costs, except in as much as their land and some other inputs were subsidized. The sooner prices could reach market prices, the sooner would the equity problems be overcome--and the more would be earned by the owners of the housing stock, the state.

#### **Objective 2: Establish legal framework for private ownership**

The legal framework would secure private ownership and facilitate transactions. The SPC had drafted a general housing law based on the one agreed by the Russian President and passed by the Supreme Soviet of the Russian Federation late in 1992. USAID provided technical assistance to the drafters of that law.

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<sup>18</sup> The market price is the price tenants are prepared to pay for the housing if tenants were able freely to bid for the housing. It is almost certain that in the depressed economy of today, tenants would not bid as much as the replacement cost of the housing, except for particularly rich families bidding for especially desirable properties.

### **Activity 2.1 Draft condominium law**

The State Privatization Commission already had a number of model condominium laws, notably the Russian law that was itself based upon a Czech law drafted with USAID technical assistance.

### **Activity 2.2 Draft law of transactions**

The fundamental purpose of such a law was to assure the parties to a transaction that their intentions could be carried out. Without that law, buyers had no remedy against defaulting sellers, and sellers no remedy against defaulting buyers. Only very general provisions were laid out in the draft Housing Law and the Civil Code.

### **Activity 2.3 Revise landlord tenant law**

Existing provisions in the Civil Code would have to be revised to take account of the new condominium form of ownership, partly since government-owner-tenant relations would change. The condominium would become the owner of the building originally owned by the state. The government would become a tenant in that building and would have to collect rents from its tenants in the building.

### **Activity 2.4 Establish land titling system**

With an efficient land titling system it would be administratively easy to identify owners of property and land and carry out transactions. The system should be easy to maintain, through computerization, readily accessible, and cheap to use. One of the more costly parts of setting up a cadastral system, establishing the basic survey reference points, had been carried out.

### **Objective 3: Privatize the management of the state owned housing**

Since so many households would chose to continue to rent their housing from the state for many years, it proved important to improve the efficiency of the management and maintenance carried out by the Housing Authorities. As seen in many countries, private management of public housing was much more efficient than public management of public housing. The quality of maintenance should increase and its costs fall to as little as half current costs. Eventually there should be fully free and competitive bidding for the management of the housing stock. An interim solution would be to privatize each the existing eleven Housing Authorities, give the two years to reach agreed performance standards, and, if they did not achieve those standards, have fully competitive bidding for the contracts concerned. It may be decided to have many more than the current eleven housing management companies and to contract out many of the services now provided by the management companies. These new companies could become "incubators" of private enterprise.

**Activity 3.1 Review management practices of Housing Authorities**

A more detailed review of the management practices of the Housing Authorities than had been possible under the USAID contract would be carried out. This would identify the character and magnitude of the improvements that could be undertaken. This review would be carried out by a small task force consisting of senior staff of the Housing Company and two or three Chairmen of Housing Authorities. They would submit their report to all the Housing Authorities, Ulaanbaatar City, and the SPC for review.

**Activity 3.2 Train cadre of Housing Company staff in effective management of public housing stock**

Three staff from the Housing Company would become interns with a private management company in the US for a period of three months. While in the US, they would gain experience of all aspects of housing management and prepare a training plan for their return.

**Activity 3.3 Train Housing Authority management**

The Housing Company trainers plus a manager from the US company would carry out a two-week training program for senior staff of the Housing Authorities. At the end of the training, each of the managers from the Housing Authorities would prepare a management improvement plan for his or her Housing Authority.

**Activity 3.4 Establish housing management and maintenance standards**

The Housing Company would establish the "objectively verifiable" performance standards to be achieved and maintained by the privatized Housing Authorities during the first two years. The Company would also set up procedures to monitor performance and carry out a general review after two years.

**Activity 3.5 Reorganize Housing Authorities as private companies**

The Housing Company, with assistance from the State Privatization Commission, would prepare a plan for the reorganization of the Housing Authorities into private companies. Once the plan had been reviewed and agreed by the Authorities and the Commission, articles would be drawn up and registered making the Authorities private companies.

**Activity 3.6 Reorganize Housing Company as owner of the housing stock and supervisory and regulatory agency for the Housing Authorities**

The Housing Company would be reconstituted as the representative of the State as the owner of the housing stock and the manager of the newly privatized Housing Authorities. It would also be responsible for carrying out sales of the rental stock--of buildings and units within buildings.

It would be the principle implementation agency for the housing reforms.

### **Activity 3.7 Review performance of the Housing Authorities**

The Housing Company would monitor the performance of the privatized Housing Authorities on a regular basis. They would set up a management information system with associated performance indicators. They would carry out periodic surveys on tenant opinions on the performance of the management companies. The Housing Company would undertake a major review of performance after the management companies' first two years.

### **Activity 3.8 Organize public tender for contracts of Housing Authorities not up to standard**

The Housing Company would organize public tenders for the management contracts if the Housing Authorities were found not to be up to standard.

### **Activity 3.9 Inform public of impact of privatized management**

The Housing Company and the Housing Authorities would jointly keep the public fully informed about the changes in the management of rental housing. The information campaign would stress the new responsibilities of tenants and management and make clear the benefits that would result from the new arrangements. The reasons for the increases in rent would be fully explained together with the allowance scheme. The Housing Authorities would work closely with tenants organizations.

## **Objective 4: Set up a housing finance system**

The objective of the fund was to increase the supply of finance to the sector, and facilitate home purchases and upgrading, without having to rely on Government budgetary support. Technical assistance would be required to design the fund and set up its operating procedures.

### **Activity 4.1 Design the fund**

Ideally, the banking system would provide housing finance. The Mongolian banking system had, however, little experience of ordinary commercial banking let alone a specialized activity such as housing finance. This entailed a much longer term lending activity than commercial banks were used to.

The State and City Privatization Commissions already had privatization funds that had been capitalized by the sales of the state-owned enterprises. The Housing Fund would be a separately operating part of the Privatization Fund. The Housing Fund would eventually be privatized. Its directors would be drawn from a wide range of public and private institutions, including the Central Bank, the Stock Exchange, the Ministry of Housing, one commercial bank, and the City of Ulaanbaatar. Management should have commercial experience and would be given training

in housing finance. Management should be rewarded by achieving the dual targets of growth and loan repayment.

#### **Activity 4.2 Capitalize the fund**

Funding would initially consist of the cash purchases received from the privatized flats. After some experience has been gained, additional sources would be pursued: sale of bonds backed by the bank and offering some protection from inflation; term deposits of 3 months or longer; and donor financing.

#### **Activity 4.3 Operate the fund**

Operations would begin once the first cash payments were made for the privatized apartments. The fund would then begin to collect repayments of the installment loans. The bank would make loans for first mortgages on privately owned housing, construction and interbank lending. None of its activities would be out of line with the rest of the financial sector. For example, interest rate would not be subsidized.

#### **Objective 5: Sell up to 20 per cent of units to buyers**

With the depressed economy and the low level of income in Mongolia, it was unlikely that many households would choose to buy their homes even at highly discounted prices. Informal surveys demonstrated that the great majority of households perceived the costs of ownership and the new maintenance responsibilities, outweighed the benefits, the pride of ownership and future growth in the value of the house. Few opted to buy their homes in other former socialist countries even when the discount was so high that the units had almost been given away free. In rich market economies most households chose not to own their homes where there were not strong tax incentives to do so. Only 40 per cent of households in what was West Germany owned their homes; 60 per cent did so in the US, where strong tax incentives favored ownership.

However Mongolians who had benefitted most from the early stages of the liberalization of the economy and had accumulated substantial savings, wanted to invest in home ownership. Many such people demanded that the privatization begin. As the economy recovered and the benefits of a market economy spread to a higher proportion of the populations, more and more people would want to own their homes.

The condominium approach to ownership was favored. Residents of the building choosing not to buy their flats would continue to rent from the state. The Housing Company would represent the tenants and the owners of those units, the City, on the condo management committee.

**Activity 5.1 Establish the Housing Company as the implementation agency for the private sales**

The Housing Company would be the implementation agency for both the new rental and sales policies. It would have the responsibility for all the key pricing components of market housing. It would maintain the level playing field between renters and owners by establishing prices for the housing that were discounted by an equivalent amount to the rents.

**Activity 5.2 Set up procedure to select buildings in which units to be offered for private ownership**

The following options were available: to allow anyone to purchase the unit they occupied; to sell units only in buildings in which the majority, or some other high proportion, wanted to own the homes they now occupied; to sell homes in buildings vacated by the Russians; or finish off partially completed buildings and sell the units to those who wished to buy. The third or the fourth options would prove most simple to administer although the fourth would be costly. Both would free up the units now occupied by the buyers for families on the waiting lists: either overcrowded families now in state housing or ger dwellers.

The most appropriate of the options listed above would be selected. The process would begin with one or two complete buildings.

**Activity 5.3 Set prices and other sales conditions for the initial privatization**

Prices would be set for the first round of sales at a price equivalent to rents that covered all maintenance costs except major rehabilitation. An alternative pricing policy for the first round of sales, which would probably go to the most wealthy families in Mongolia, would be to auction the units if one of the vacant building options was chosen. This would maximize revenue to the owners of the housing--money which would help to capitalize the housing fund--and help to establish what the market prices were, at least for the top of the market.

Discounts on the sales price would be given if the full cash price was paid. Otherwise a 20 per cent downpayment would be required with the balance paid over 20 years. Vouchers could be used as part of the payment required, at their face value. The interest paid on the balance would vary by changing individual and general economic conditions throughh using one of the "dual indexed" systems now popular for relatively unstable economies.

Sales of property by the new owners would be permitted. Transactions would help to establish efficient markets.

**Activity 5.4 Inform public of benefits and responsibilities of private ownership**

There was a widespread view that there were few or no benefits, but many costs associated with

private ownership. Most families felt that they would be paying out more for housing under private ownership than they did now and would receive nothing in return. To counter this, there had already been some publicity on radio, TV and in newspapers. Information dissemination would be intensified as the date for the first sales approached. Particular care would be taken to explain the benefits of the condominium approach to ownership.

**Activity 5.5 Inform public of procedures for privatization**

Guides would be prepared informing the public of the privatization procedures in detail. Once it had been decided that a certain building was to be privatized, meetings would be held with residents to discuss the procedures for forming a condominium and buying their units.

**Activity 5.6 Sell units in first buildings to be privatized**

The first sales would take place about three months after the initiation of this program and before November. Assistance would be given by the Housing Company to the buyers to form condominium associations. Residents would receive training in their obligation as members of a condominium and the benefits that membership would bring, and in the legal requirements. With legal help from the Ministry of Justice and the SPC, the Housing Company would draft the articles of association. For the first building to be sold in this way, a foreign expert on condominiums would provide technical assistance to the Housing Company.

**Activity 5.7 Review progress with selling units**

The Housing Company would carefully monitor the initial sales process. It would survey the first set of new owners to help to identify problems with the process. It would prepare a report on the impact of the pricing used in the first round of sales--were the prices too high or too low, were sales slower than expected or faster? The Housing Company would monitor free market sales prices.

**Activity 5.8 Adjust prices in accordance with market trends**

In accordance with the observed behavior of buyers in the market and trends in macroeconomic conditions, prices would be adjusted. Care would be taken not to create a pricing bias against home ownership. Although pricing may slightly favor private home ownership, as it did in most countries, the incentives should not be too strongly against renting.

**Objective 6: Implement housing allowances system for those who cannot afford market rents**

In the future the principle would be that households, not housing, would receive subsidies. The subsidies would be based upon household income and the difference between the rent for "minimum standard" apartments and what families could afford assuming that they allocated 10 to 15 per cent of income to rent and utilities. The rent for the standard apartment would rise over

time as progressively more of the cost elements were covered: routine maintenance at first, and eventually full capital replacement costs. Households paid up to 30 per cent of their incomes for rent and utilities in western market economies although in poorer countries the proportion was lower. In some former socialist countries, the proportion was as low as 1 or 2 per cent (Russia and China), and in Mongolia the proportion was about 5 per cent according to the 1992 Family Expenditure Survey. As real incomes begin to rise over the coming years, families would choose to spend higher proportions of their income on housing. The initial assumption under the housing allowance program would be that families would allocate 10 per cent of their income to rent and utilities.

### **Activity 6.1 Design the housing allowance system**

The objective of the system would be to make a minimal standard of housing affordable for the poor and disadvantaged as rents gradually increased to market levels over a period of years.

Since the Government did not have the resources to fund such a scheme from its budget, funding would have to come from the increased rents. Only part of the incremental rent revenue yielded by the rent increases would be available for improving maintenance standards. In effect, the allowances would be financed from the higher rents paid by those who could afford them. The Government may, however, as in other countries, decide to supplement this source of funds from the social security fund or the budget.

The allowance, which could take the form of a housing voucher, would be given to all poor and disadvantaged households, including those living in gers. Family Expenditure Survey data would be used to provide information on incomes and expenditures on rent and utilities.

A task force consisting of the State and Ulaanbaatar Privatization Commissions, the Ministry of Housing and Construction, and the Ministry of Social Security would design the system. The design would include the administrative procedures for revising and disbursing the allowances. The task force would be advised by an expert in housing allowances.

### **Activity 6.2 Implement housing allowances**

The housing allowance system would be implemented in Ulaanbaatar within 6 months of the initiation of the housing reform strategy. It would be extended to other locations within a year once a review had been carried out of its impact. The system would be revised periodically as the cost of living changed, incomes changed and the rents increased towards market levels.

DRAFT MAY 17

**APPENDIX 2 -- LAW ON HOUSING PRIVATIZATION OF MONGOLIA**

Article 1 -- Purpose of the Law

The purpose of the Housing Privatization Law is to privatize government-owned apartments, and to ensure that the financing of the apartments is sufficient to finance the services and maintenance connected with the same;

Article 2 -- Terminology

An "Apartment" is a unit of space built for living purposes, in which unit the owner shall be responsible for financing all future services and repairs.

Article 3 -- Housing Privatization

All government-owned apartments situated on Mongolian land can be privatized.

Article 4 -- Apartments Which Cannot be Privatized

The following apartments cannot be privatized:

1. Apartments which have historical and cultural affiliation;
2. Apartments in which officers of the army live;
3. Apartments belonging to cooperatives and communities;
4. Apartments built with foreign investment, or financed by international organizations;
5. Apartments related to the production and services by the State;
6. Apartments being used for government centers or government administration;
7. Apartments being used for student dormitories;
8. Apartments which do not meet the housing safety requirements;

Article 5 -- Citizen's Rights to Privatize Apartments

1. Citizens of Mongolia have the right to privatize apartments once lived in

by foreigners before the Housing Privatization Law became legal, i.e., foreign renters must submit their apartment to the state housing authority for housing privatization to occur, and must do so on demand by a prospective Mongolian buyer;

2. The apartment shall be deemed to be owned by all members of the family who live in the apartment;
3. Upon agreement by the family members, another party may be joined in the privatization of the respective apartment, excluding foreigners; however, before another person can be joined in the privatization of the apartment, said person must have lived in said apartment for at least one year;
4. The name of the added party to the privatization must be joined with the family names, in writing, and a payment contract must be in writing;
5. If there is more than one family living in the apartment, the apartment space would be deemed to be a collective possession;
6. If a member of the family, who participated in the privatization dies, that member's portion of the total payment shall be transferred equally to the remaining members of the family;
7. Pursuant to prior approval by the government, apartments which are owned by a government authority, may be privatized, after re valuation of the same;
8. Owners of an apartment must privatize the apartment on a voluntary basis.

## **PRIVATIZATION FACTORS**

### **Article 6 -- Reductions Relating to Privatization:**

1. 9 square meters would be exempt from valuation for each owner from each privatized apartment;
2. for every crippled member of a family, 6 square meters would be exempt from valuation; for each blind or deaf family member, 8 square meters would be exempt; for each child from birth to 14 years of age, 4 square meters would be exempt from valuation;
3. If all members of the family qualify for the exemptions related in this article, sections 1 and 2 above, the apartment would be transferred to the

owner without any fee;

4. The price of the apartment, after valuation, shall be reduced by 50%, if members of the family living in the apartment fit into the following categories: participants to two wars; family members who parents or children died as a result of industrial accident; families of victims of political destruction and partisans of the Mongolian People's Revolution;

**Article 7 -- Form of Payment**

1. Payment for housing may be made by: cash; loan or privatization voucher;
2. An apartment shall be deemed to be privatized commencing from the day when a payment contract has been signed;
3. An apartment owned by a foreign person or entity represents a conflict to the intent of the housing privatization program, and, as such, said apartment may be confiscated for privatization by the State Privatization Commission, to be purchased by a citizen family;

**ACCOUNTING AND APPRAISING APARTMENT FOOTAGE**

**Article 8 -- Standards and Criteria for Apartment Appraisals**

1. The floor space, from wall to wall, including living room, kitchen, corridor and bathroom shall constitute the total square footage for appraisal and valuation, and this footage shall constitute the total privatized square footage of the apartment;
2. 9 square meters, including exemptions enumerated in sections 1 and 2 of article 6, shall be initially exempted from valuation of the apartment. The remaining square footage shall constitute the "real" square footage for privatization and valuation purposes: the following shall also be exempt from the privatization price:
  - a) apartment deterioration
  - b) privatization vouchers (each voucher is worth T1000);
  - c) distance from schools, kindergartens, social services, key transportation centers;
  - d) lack of connection and/or distance from centralized transportation line network;
  - e) floor level of apartment in building (i.e., 1st floor, 5th floor, etc.)
  - f) location relative to an industrial area, polluted area, vicinity to natural light;

g) income of family whose income is lower than the "cost of living;"

(Items a. through g. would allow a maximum exemption of T7000 from purchase price, should a family qualify for the maximum exemption of each item).

3. The average price per square meter, and the percentage of reduction per exemption shall be determined by the government;
4. The purchase price of the respective apartment shall be determined one month prior to the purchase by the family, and the purchase price shall be submitted to the prospective purchase;
5. A second apartment appraisal shall be conducted by a selected committee from the privatization commission, also consisting of technical supervisors and construction experts;
6. Representatives from the "apartment owners rights" committee shall participate in the discussions and appraisals of the apartments and the organizational process of housing privatization.

## **ORGANIZATIONAL WORK IN THE PRIVATIZATION PROCESS**

### **Article 9 -- Preparation of the Organizational Work:**

1. The State Privatization Commission, the Ulaanbaatar "Housing Company" and the Ministry of Infrastructure shall formulate the implementation plan for housing privatization. The State Privatization Commission shall pass a resolution confirming the implementation plan;
2. The Ministry of Infrastructure, the Ulaanbaatar "Housing Company," the Apartment Owners Rights" Committee, technical supervisors and construction supervisors shall implement the plan;
3. The following documents shall be completed in connection with housing privatization:
  - a) contract of apartment ownership;
  - b) financial payment contract;
  - c) documents confirming family members living in each apartment, including : passport, birth certificate, pension books, etc;
  - d) construction and technical data relating to the respective apartment;
  - e) appraisal of total square footage of each apartment;
  - f) complete pricing of apartment must be in writing, including

- exemptions;
- g) number of people living in each apartment must be clarified;
- h) complete and explicit document of the individuals privatizing the apartment;
- i) all documents must be submitted to the local privatization commission for an "initial" decision;
- j) the local privatization commission shall submit the decision to the local "mayor's council" which would make the final decision;
- k) the local privatization commission, upon approval by the same, shall thereupon sign a contract with the new apartment owner and simultaneously hand the new owner the title to the apartment;
- l) each province shall organize its respective "housing authority" to service the apartments upon request of the owner.

## **APARTMENT PRIVATIZATION FUND**

### **Article 10 -- Apartment Privatization Fund, Financing**

1. The proposed privatization fund shall be used for the following purposes:
  - a) expenses which are related to apartment privatization, including financing, marketing, production and re-production of contract forms, etc.;
  - b) for construction, expansion repair of the existing electrical and utility lines, for reinforcement of apartment structures;
2. The fund shall consist of monies from rental income, state and city provinces, city project capital, apartment insurance, land tax, income from selling apartments;
3. The complete payment for the apartment shall be completed in the time period not to exceed 10 years from the signing of the purpose contract.

## **FULL RIGHTS OF APARTMENT OWNERS**

### **Article 11 -- Rights of Ownership**

1. Each apartment owner shall have the right to inherit, change ownership, rent and or sell the apartment after it is privatized;
2. Each apartment owners shall have the right to use and utilize the apartment for its intended purpose;

3. No apartment owners shall have their right to violate the purposes for which the apartment was intended, i.e., expand without permission, cause undue noise or violate the peace and tranquility of other tenants; should the tenant violate said rules, the apartment may be sold in auction;
4. The apartment owner shall have the right to execute necessary repairs to the apartment;
5. The owner shall be responsible for the payment of all utilities supplied to the apartment.

**Article 12 -- Rights of the Province, Local Housing Commission or Administrator**

1. The appropriate administrative authority shall have the right to confiscate the apartment and sell it if the owner violates the law;
2. The appropriate administrative authority has the right to establish an organization which shall provide for and account for the services provided to the apartment owner;
3. The appropriate administrative authority has the right for the responsibility to provide heating, electricity, water, and other utilities for each apartment;
4. The appropriate administrative authority has the responsibility to provide services to be rendered to the apartment owners in connection to the utilities.

**Article 13 -- Solving Complaints and Conflicts**

1. The local administrative authority shall have the responsibility to resolve complaints and conflicts from tenants in connection with appraisal of the apartment, payments, common areas, etc.;
2. The court shall resolve any conflicts relating to privatization which cannot be resolved through the local housing administration.

**Article 14 -- Other Items**

Housing Privatization Law shall be valid commencing from (Month), (Day), (Year).

**APPENDIX 2A -- RESOLUTION OF THE MONGOLIAN GOVERNMENT:  
"APARTMENT PRIVATIZATION APPRAISAL RULES"**

**A. COMMON BASIS**

1. Specific rules for privatizing and appraising apartments must be followed;
2. The intent of the appraisal is to establish a fair selling price for the apartment;
3. Specific conditions (set forth below) shall apply when determining the price of an apartment;
4. The Mongolian Government and the State Privatization Commission shall establish guidelines to be used in determining the price of an apartment;
5. All organizations shall be subject to the same guidelines which privatizing and appraising an apartment for selling price.

**B. DEFINING APARTMENT FLOOR SPACE**

6. Before pricing an apartment, the total floor space shall be determined.
7. Floor space quantity shall be defined by the sum of the space of the living room, kitchen, corridor, bathroom, and wall cabinet space;
8. The thickness of the walls shall not be included in determining the floor space;
9. The selling space shall be defined after reducing 5 square meters for "each" person living in the apartment.

**C. DEFINING THE PRICE OF THE APARTMENT**

10. The pricing of one (1) square meter of the apartment shall be defined after considering the following reductions by percentages:

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No.	Considered Categories for Pricing	Reduction by Percentages (%)
1.	Wall Materials:	10%
	a) prefabricated or iron concrete wall, or	5%
	b) wooden wall	
	c) block wall	3%
2.	Amortization since construction:	
	a) Prefabricated, iron concrete or brick buildings	.5%
	b) block buildings	.8%
	c) wooden buildings	1.5%
	d) brick buildings with wooden exteriors	1.0%
3.	Technical Condition:	
	a) Buildings not connected to heating or water supply system	30%
	b) Buildings with heating but not connected to the water supply system	15%
	c) Buildings with heating and water supply, but without hot water	10%
	d) Buildings without garbage collection services	3%
4.	Location:	
	a) Far from the center of the city, but close to a service center	3%
	b) Far from the center of the city and service center	5%
5.	Major Repairs not made:	
	Major scheduled repairs have not been made	15%
11.	Local authorities and commissions, responsible for pricing and valuation of apartments, must perform the appraisals for each apartment and submit the appraisals to the appropriate privatization body;	
12.	All appraisal, construction, repair and utility documents, and all building blueprints must be submitted to the local privatization commission for review;	

**D. DEFINING THE SELLING PRICE**

- 13. The local housing privatization authority shall ultimately determine the selling price of the apartment after considering the square footage, exemptions, reduction of percentages and the number of individuals in the family;
- 14. Reduction of percentages for one (1) square meter and considering the condition of the apartment:

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No.	Considered Categories for Pricing	Reduction by Percentages (%)
1.	Without a pavilion	5%
2.	Without a bathtub and shower	3%
3.	Bathroom and toilet in same room	3%
4.	With Hoar Frost	3%
5.	Apartment situated on the ground floor or higher than the 5th floor, and without an elevator in building	3%

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- 15. The local privatization office shall determine the selling price of an apartment based on the number of family members, the apartment floor space, conditions of the apartment and other documents, i.e., certificate of title, payment contract, passport, birth certificates, etc.
- 16. The selling price is determined by the price per square meter in the apartment, minus the reduction by percentages mentioned in section 14 above, multiplied by the space being sold;
- 17. A total of 30% of the price of the apartment shall be reduced from the total selling price if the entire payment is made in cash and privatization vouchers, together;

**OTHER ITEMS:**

- 18. Item 17, above, does not apply to buildings in whose apartments the use of "open fire" for heating is required.

**NOTE:** The reader would notice that specific common data in previous pages of the case do not reconcile with specific common data found in the proposed Housing Privatization law and the accompanying "Apartment Appraisal Rules." Inasmuch as the official translation for the Housing Privatization Law had not been published by the Central Government at the time of the writing of this case, the "official" accuracy of the translation of the Housing Privatization law and the Apartment Appraisal Rules cannot be confirmed.

## **APPENDIX 3 -- TECHNICAL NOTE ON HOUSING PRIVATIZATION IN MONGOLIA**

### **Background of Housing Privatization**

In early 1993, the Government of Mongolia began the privatization of at least 48,000 units of housing. This housing privatization project was funded by the United States Agency for International Development (USAID) under USAID's Privatization and Development Project. The primary contractor for this project was the U.S. firm of Price Waterhouse LLP (PW). PW contracted Abt Associates, a U.S. private consulting firm, as the subcontractor for this project.

In August of 1992, a seven-person team visited Mongolia and prepared a diagnostic report, and in November of 1992, a five-person team visited Mongolia and prepared "action plans" to help the Mongolian State Privatization Commission (SPC) implement the housing privatization project. Key agencies, in addition to the SPC (responsible for housing policy and implementation plan), were the City of Ulaanbaatar Privatization Commission (Mayor's office - responsible for implementing housing privatization locally), the Ulaanbaatar Housing Company (responsible for management of state housing stock in the city of Ulaanbaatar), the Housing Authorities (responsible for the part of the city housing stock in their respective area) and the Ministry of Infrastructure (responsible for establishing and carrying out urban planning policies and programs).

The studies and action plans developed by Abt Associates centered around policy issues and implementation decisions. Among others, the following issues required immediate resolution: establishing property values; ability to pay; renters vs. owners; establishing a legal framework to handle disputes of owners and renters, transfer of ownership, responsibility for "common areas," etc.; establishing a marketing campaign that would inform the citizens about the responsibilities and benefits of ownership; establishing an appropriate design of the housing privatization program that would clearly delineate management, administrative and implementation responsibilities; establishing a "housing fund" which would allow prospective buyers to obtain credit and financing, and; establishing a functional, comprehensive management information system.

Abt Associates established and implemented training programs related to home ownership options, housing privatization policy, valuation and computer management systems.

The housing privatization project was a "first time" privatization effort in the country of Mongolia. No member of the Mongolia housing privatization effort had heretofore had experience with housing privatization in a developing country. All housing was state-owned. Mongolians were prohibited by law from owning real property. Accordingly, there was naturally no legal infrastructure that would accommodate housing privatization, i.e., no land transaction law, no mortgage financing laws, and no landlord/tenant laws.

Impact of Housing Privatization

Additional problems existed which made the development and implementation of housing privatization even more exacting. Per capita income was very low, ca. \$25.00 (US) per month. In addition, inflation was still very high (though stabilized) and unemployment was high and rising. The consumer price index was rising monthly, while real income was falling due to inflation. Further, the government continued to subsidize housing. Existing housing units were debilitated and needed repairs and rehabilitation immediately.

Many citizens did not want housing to be privatized out of fear of increased costs and taxes to them. The citizens also feared that the privatization of housing would create unfair valuation of the unit for purchase.

There was a large shortage of housing coupled with a lack of adequate capital -- thus there was limited ability for construction companies to build new housing. The Central Government could neither afford to subsidize privatization, nor did it have capital to rehabilitate existing housing units prior to privatization. The government's housing subsidy and maintenance burden could not be alleviated unless or until the owners/renters of the individual housing units could pay for the housing rehabilitation and services themselves. Both the Central Government and the local governments were at financial risk until housing privatization could function in a self-subsidizing manner. It was clear that the Central and local governments would continue to subsidize low-income housing. It was due in part to the government subsidy issue, that the Central Government was moving ahead so rapidly with housing privatization, while unwittingly allowing the other economic, social and financial sectors to lag behind in development.

A lack of a credit market and available capital impeded prospective construction firms from obtaining capital to accomplish housing repair and new construction. There was a high demand for housing, but a shortage of available housing for citizens, and the housing situation for the poor was still somewhat tenuous.

In this environment, rent policies relating to housing privatization had to be coordinated with official agencies and personnel who were responsible for both economic reform policies and social welfare policies. However, housing privatization was moving ahead, by government mandate, much more rapidly than social welfare; consequently this disparity would not be resolved until some time after housing privatization had become a reality.

Inasmuch as there was no private housing market, there were no sample market prices for private housing. Abt Associates proposed to replicate a market price. Based on clear guidelines regarding an acceptable range of values (such as utilities, location, unit features, construction materials, age of unit, etc.), qualified inspectors would establish a "price" for any given unit based on its respective features. This proposal was accepted in principle and incorporated into "Apartment Privatization Appraisal Rules," ( see Appendix 2A of the case).

Due to a continually falling standard of living, and because real income was continuing to fall

for many households, the proposed and desired housing privatization process would not and could not be completed as rapidly as the government would have liked. The average family had little, if any, savings, and most could not currently assume the burden of repairing or maintaining their privately-owned apartment. Such fears led many to resist the privatization of housing.

#### Proposed Government Guidelines for Purchase of Privatized Housing

The government proposed a new Housing Privatization Law and Apartment Privatization Appraisal Guidelines (see Appendices 2 and 2A of the case). The proposed government guidelines, essentially those guidelines previously proposed by Abt Associates, would make it possible for most citizens in the city of Ulaanbaatar to purchase an apartment, assuming one was available. Very little cash would be required for the average family, and in many cases, only vouchers would be needed for the actual purchase or down payment. For those families who could not make a full payment for their apartment, after taking into consideration the many exemptions offered under the guidelines, most families would be able to meet the monthly payment for the purchase prices of the apartment. However, subsidies for the very poor was still needed.

#### Common Considerations Regarding Housing Privatization

A clear and defined legal, management and administrative infrastructure must first be in place to avoid chaos during and after the implementation of housing privatization. A feasible way to provide credit and financing for housing and housing construction had to be established. A housing market must be created and the market must have sufficient incentives for the purchaser of an apartment to create an on-going demand for housing. The fiscal demands on the Central and local governments could not be reduced until their housing subsidy burden was lifted and placed on the shoulders of those who own the apartments.

In addition, clear and distinct "landlord/tenant" rights and responsibilities must be established. Market rents must be fair and representative of market sales prices. The citizens must be properly informed about the housing privatization process and their responsibilities as owners and renters.

Reasonable payment policies must be established, including combinations of cash, vouchers, installments, discounts and affordability. In addition, owners must have the freedom and flexibility, as a matter of policy, to freely trade among residents and to carry out transactions, without constraints on future sales of the apartments they purchased.

The role of the state must be gradually decreased in order for the private housing market to be fully functional in a free market system, and the private sector must gradually assume the responsibility for the housing market. The citizens must be educated to the reality that supply and demand would ultimately lead to a fair and equitable private housing market in the country of Mongolia, but that the process would be only accomplished step-by-step.

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All parties involved in the housing privatization process must understand that housing represents an important share of national wealth and that housing is indeed a useful and important personal investment.