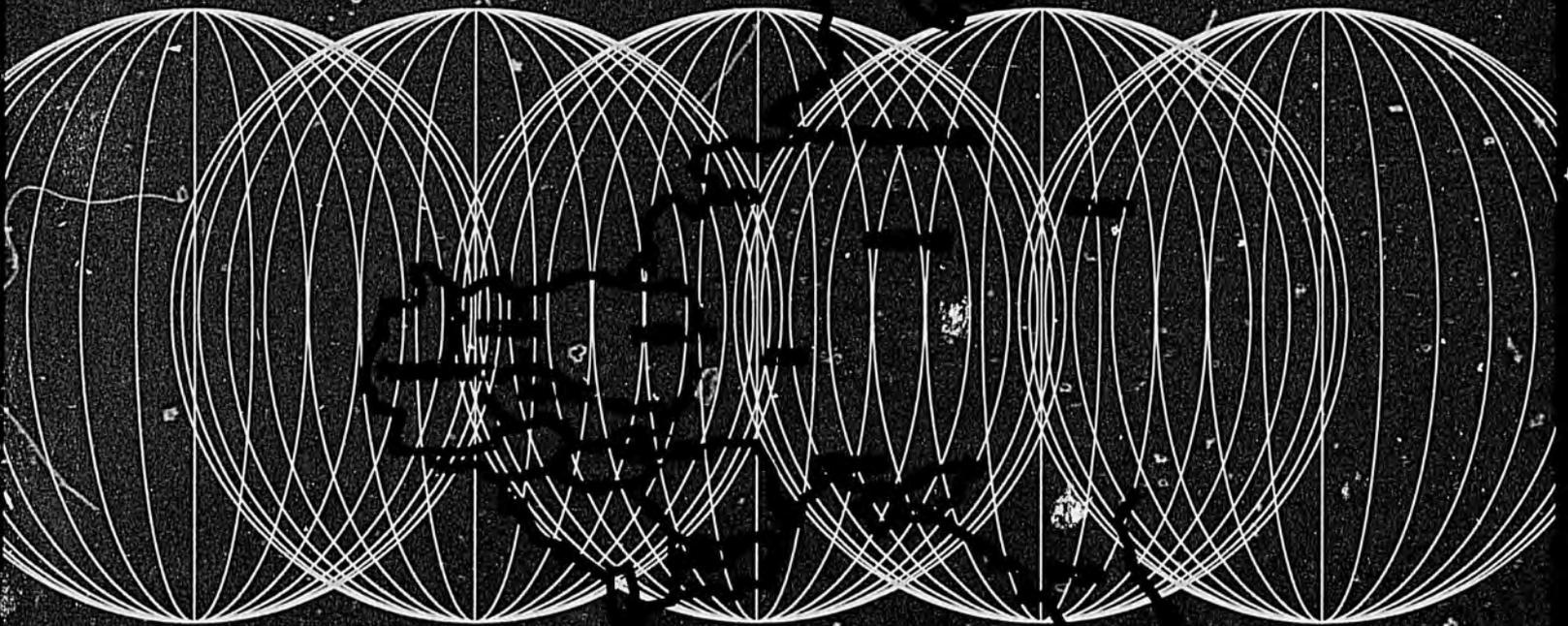


**FROM PLANNING TO MARKETS  
HOUSING IN EASTERN EUROPE**



**THE URBAN INSTITUTE**  
Prepared for the Office of Housing and Urban Programs (USAID)

PD-ABG-674  
12N 84 224

**LEGAL ASSISTANCE TO THE RUSSIAN FEDERATION  
FOR THE HOUSING SECTOR**

**TRIP REPORT**

**APRIL 9, 1993 -- APRIL 24, 1993**

Prepared by

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## **ABSTRACT**

This report summarizes the activities of Urban Institute consultant Steve Butler during his trip to Russia from April 9, 1993 through April 24, 1993. Butler provided legal consultation to the Russian Federation government and Moscow city officials in several key areas during this trip: mortgage finance, condominium ownership, land allocation, regulation and registration.

In the area of mortgage finance Butler continued his work at the federal level assisting representatives of the Supreme Soviet, Gosstroi and the Ministry of the Economy to formulate the legal framework for secured lending. Significantly, many of Butler's comments and suggestions on the draft Mortgage Law (the most fundamental piece of legislation in this area) were incorporated into the final version which is expected to pass in June.

This trip Butler met with a number of Federation and Moscow city officials involved in the process of establishing condominium ownership in Russia. While there remain major legal and regulatory problem areas which Butler discusses in this report, Moscow did pass condominium legislation in April and a federal condominium law is in the drafting stage. One of the major flaws in the Moscow condominium law, which will be eliminated in the Federation law, is the provision in the Moscow law which makes compliance with the condominium rules voluntary for owners of privatized units.

Included as an appendix to this trip report are Butler's comments on the 1993 Fundamental Land Legislation of the Russian Federation ("Land Code"). The Land Code is currently in the revision stage after a first reading in the Supreme Soviet and is expected to pass in final form this summer. The Land Code is the basic legislation governing land allocation and ownership in the Federation. Butler's comments highlight potential problem areas of the law, conflicts with existing legislation and offers suggestions for clarification. Butler's report also discusses the existing problems of Russia's inefficient land registration system and efforts to modernize titling procedures.

## **EXECUTIVE SUMMARY**

This report summarizes the activities of the legal advisor to the Urban Institute/USAID Russian Shelter Sector Reform Project in the field from April 9, 1993 to April 24, 1993.

### ***Mortgage Law:***

The team is involved at all levels with preparation of the new Mortgage Law and other legal infrastructure for private sector mortgage lending. Butler was invited to meet with the Chairman of the Supreme Soviet committee preparing the new Law, at which it was suggested that an official Supreme Soviet invitation to provide comments on the work be issued.

Butler assisted several government agencies, including the Ministry of the Economy and the State Property Committee to prepare their own comments on the draft Mortgage Law. This aid consisted of working with these agencies to mark up the draft law with proposed changes.

Long term advisor Ray Struyk, Institute for Housing Economy economist Nadezhda Kosareva and Butler were invited to meet with the City of Moscow Committee on Economics to discuss with them what steps the City could be taking to promote private sector mortgage lending.

### ***Land:***

Land issues are among the most difficult in Russia today. The issue of use and ownership of agricultural land, for example, is causing delays in consideration of the proposed Mortgage Law. The land issue is considered a bellwether of the progress of reform by many progressive bureaucrats.

Butler met with representatives of the Ministry of the Economy, State Property Committee and the State Committee on Land Resources and Utilization (Roskomzem) to discuss various land issues, including the issues of the pending revision of the 1991 Land Code and the progress on land registration issues. Butler prepared an analysis of the pending Land Law, with emphasis on issues pertinent to private sector housing development.

The land registration task seems to be moving ahead at a brisk pace, all things considered. In addition to a World Bank team, there are five or six other national technical assistance teams presently at work with Roskomzem to implement cadastral systems. Demonstration programs are planned or actually in implementation for various jurisdictions.

**Condominiums:**

The Moscow Condominium Regulation was enacted in mid-April. While it leaves much to be desired, it is an improvement.

The federal government, Gostroi in particular, is preparing its own law of basic principles for condominiums, which will correct some of the flaws in the Moscow ordinance. In particular, it will make common management organizations mandatory for buildings of three or more privatized units.

Butler met with the officers of a private sector association of housing communities, which claims to represent over a million persons in over 500 buildings in Moscow alone. The association's basic agenda - more rapid formation of condominium associations with real management power - is similar to many of the proposals the Urban Institute team has advanced in recent months.

Butler has been invited by the Moscow Housing Department to assist in the preparation of model organizational documents to accompany the Moscow regulation.

**Housing Codex:**

The politics of the Housing Codex has become complicated, with two legislative drafting groups sponsored by the Supreme Soviet working independently. Butler's earlier work outlining the Housing Code has been provided to both groups and some of the basic ideas have been adopted by at least one group.



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This report summarizes the activities of my trip to Russia from April 9, 1993 through April 24, 1993 working on behalf of The Urban Institute and the United States Agency for International Development. During this trip I again provided legal consultation to various Ministries and legislative bodies of the Russian Federation and the City of Moscow with regard to creating a legal framework for the housing sector, with particular emphasis on the laws of mortgage finance and condominium ownership. This past trip also involved a significant amount of discussion on issues of land allocation, regulation and registration.

## **I. MORTGAGE LAW**

There is a great deal of activity on the concept of private mortgage lending. Apparently the private banks are putting pressure on lawmakers for better laws, as we have expected them to do. My February 15, 1993 report on the existing laws of secured lending has been widely circulated and is generally well received. It appears that we are playing a helpful role in the formulation of this area of the law, as reflected in the many invitations extended to us to discuss the issues.

### ***Supreme Soviet***

One of the key meetings of this trip was with George Zadonski, Chairman of the Supreme Soviet Committee on Budget, Taxes and Prices. Mr. Zadonski was accompanied to the meeting by Alexander Makovsky, the Committee's chief legal advisor and someone with whom we have been working for several months. Zadonski's Committee is the sponsor of the draft Law of Real Estate Mortgage dated February 15 that is under consideration by the Supreme Soviet and the Government.

While the meeting was intended as a courtesy call, as I have been working with the Chairman's staff on technical issues, it resulted in two significant proposals. First, Zadonski suggested that the Supreme Soviet issue a formal letter to the team requesting our comments on the law being developed. This would give our work the status of an outside expert advisor to the Supreme Soviet and would provide somewhat greater circulation of our views among the deputies. Clearly, as we are in general accord on the law, this is a strategic move that would advance Zadonski's own agenda.

The second proposal from Zadonski was that we broker a meeting between his working group and the working group at Gostroi. He has become aware of the Special Program Housing recently published by Gostroi, and the significant emphasis that program places on private mortgage finance. As a result of that document, the Gostroi staff and the Supreme Soviet Committee on Architecture, Construction and Housing, apparently have taken up the mortgage finance issue. Zadonski is concerned, rightfully, that the recent entry of Gostroi and its legislative committee into the field may upset the work of his own committee completed over the past year. He claims to know Minister Basin a bit, but none of the other Gostroi staff members.

I advised the Chairman that his concerns were probably well founded and that if we could be instrumental in coordinating such a meeting we would be glad to do so. We will await the results of his further investigation of the matter.

Zadonski attributed the current delay in the mortgage law to the efforts of the Agricultural Committee to protect its turf. The Agricultural Committee is extremely conservative, and is attempting to remove agricultural land from Zadonski's draft mortgage law by writing its own mortgage law which applies only to agricultural land and follows the National Land Bank scheme proposed by Vice President Rutskoi and his supporters.

The Agricultural Committee's proposal would allow mortgage of agricultural land only to a national land bank, which would be a publicly chartered corporation. As discussed further below, many people in government see the national land bank as a prime opportunity for corruption.

The Chairman does not expect this issue to be resolved until both bills are submitted to the Presidium for a reading date later in May.

### **Gostroi**

In a later meeting with Mr. Khodayaev of Gostroi (formerly of the Ministry of the Economy, where we have been working with him for the past year), he acknowledged that both Gostroi and its legislative committee were looking at the mortgage laws as a result of the Special Housing Program document, and that they were aware of Zadonski's work. He agreed that a meeting between the groups could be productive.

Khodayaev, who is essentially the senior deputy to Anvar Shamuzaev on housing policy formulation in Gostroi, provided me with the outline of a program on which he was working which emphasized private mortgage finance. The program would rely on a combination of direct downpayment assistance grants, first mortgage loans from the private sector, and soft second loans from enterprises and other employers. The relative amounts of each would be based on an income test.

The proposal for several types or levels of mortgage loans to the same borrower resembles to a certain extent the existing German practice. However, in the face of expanding privatization, whether it is reasonable to rely on the enterprises for housing lending or housing production as anything more than a transitional step is, in my view, an open question.

### **Federal Government**

The draft of the Mortgage Law has been circulated under Kasbulatov's cover to the Government Ministries for comments. I was asked by Andre Lazerevsky to assist the Ministry of the Economy to prepare its comments, which I did in a long conference as well as by providing them with all of the written material produced to date.

The Government's comments on the law were to be collected and coordinated by the State Committee on Property, which is the lead Committee in privatization matters under the direction of Mr. Chubais. The afternoon before the coordinating meeting arranged by the Committee I was asked not just for comments, but to mark up the law with usable legislative language. This was accomplished in time for the meeting at 9 the next morning.

I was subsequently invited to a meeting with the responsible staff members of the Committee on Property who expressed their appreciation for the comments and advised that most of them were included in the Government's recommendations to the Supreme Soviet.

### **Moscow Committee on Economics**

The Moscow Committee on Economics, a subcommittee of which appears to be a policy shop under the direction of Mr. Klimov, has been requested by various Moscow banks to become involved in the issue of residential mortgage lending. They are casting about for an appropriate role and provided us with a two page outline of the areas in which they thought they could become involved through appropriate law or regulation.

Struyk, Butler and Kosereva reviewed the outline with Klimov and his staff in a good meeting in which we were able to convince Mr. Klimov that many of the items on the outline (e.g., the form of mortgage documents) were actually private sector responsibilities that did not need normative guidance, but perhaps policy and financial support from the City for trade associations such as the proposed Russian Center for Mortgage Finance.

We were able, however, to focus attention on certain areas in which City action could have a beneficial impact on mortgage finance generally, including issues of consumer protection and disclosure; organization and training of the municipal judiciary in mortgage issues; and attention to the planning and zoning issues affecting single and multifamily/ownership issues. Most of the issues we raised were put on the agenda.

The City will convene a working group under Mr. Klimov's direction to explore these issues, and we have been requested to participate in its activities.

### **Future Work**

Even given the disputes over agricultural land, there will probably be a mortgage law in June. Before then, I will be responding to the official letter from the Supreme Soviet requesting our views. Most of those views have been expressed informally in the comments provided thus far; the most recent work is attached under Exhibit A.

Upon completion of the law I intend to do a final wrap up, including identification of those areas that may need further attention in the longer run.

Once the new law is enacted, we should put into final form the documents and procedures for mortgage loan underwriting on which we have been working with Mosbusbank.

## **II. LAND**

As noted above with respect to the Mortgage Law, land is at the root of many privatization issues in Russia today.

### **The Land Code**

The 1991 Land Code of the RSFSR, a Perestroika era law, presently governs land relationships in the Federation. However, a new Land Code is considered necessary because of the rapid pace of change and may be enacted as early as May, 1993; the proposed revision may have already had its second reading. My initial comments on the Land Code, which will be provided to staff at the Ministry of the Economy and the State property Committee at their request, are attached as Exhibit B.

Clearly, this will be a gradual process of reform. The hallmarks of the proposed law are:

(1) The law essentially leaves it up to the local jurisdictions ("subjects of the Federation," which include republics and autonomous territories and regions) to choose the allowable form of land tenure from a list of three: ownership, lease, or "permanent right of use." This is a political compromise of significant proportion, catering to the profoundly conservative leadership of the hinterlands.

If this provision is adopted, and if a market economy is in fact created, it will be interesting to see if the differences between these different forms of tenure are as a practical matter broken down over time by market forces.

(2) After creating on paper an elaborate system of power sharing among the various levels of government with respect to land issues, the law essentially wipes it away by placing ultimate power in the hands of the State Committee on Land Resources and Management ("Roskomzem"), a federal agency. How much control Roskomzem ends up having on crucial land issues will, in my opinion, be a significant issue in the near future.

(3) Of concern to our mission, the rights of land allocation for entrepreneurial housing development are still vague. However, since we all know that such development is actually being done at this time in the areas surrounding the major cities, this may be yet another instance in which the difference between the law and reality is overlooked.

(4) The law retains two of the basic concepts of Soviet land policy: (1) the right to own or possess land is conditioned on its efficient use for the designated purpose; and (2) taking or condemnation of land by the state is simply another planning tool -- a mechanism for allocating land among competing economic interests in the private sector -- and not an extraordinary exception to private property rights.

### ***The Issue of Agricultural Land***

Agricultural land, as mentioned above, is presently interfering with progress of the Mortgage Law, and figures prominently in the Land Code as well, which is heavy with special provisions for agricultural land.

The issue of agricultural land is considered relevant to issues of housing and urban development because, by definitions in the current proposals, it includes most of the land available for development surrounding the major cities and towns. Control over use and allocation of that land can therefore be of crucial importance to the concept of suburbanization and new town development that is still a major part of the long term Russian housing program.

To one extent, the focus on agricultural land is a reflection of the political power of the rural and regional deputies in the current legislature and the predominantly conservative leadership of the rural and agricultural areas of the country. However, there seems to be a remarkable commonality of opinion on this issue among the reform minded bureaucrats with whom I work: it is setting the country up for massive corruption through the "National Land Bank" concept being promoted by Vice President Rutskoi and his supporters in the legislature.

According to most versions of the "National Land Bank" presently circulating, it would be a private corporation holding a charter from the government as a monopolist in the purchase and sale of agricultural land. It would be the only institution in the country licensed to grant mortgages on agricultural land or to which land users could transfer land for subsequent resale in the market.

It appears that the transfer of land to the bank would be subject to restrictions on prices ("normative prices") and profits, while the bank's subsequent resale would be at market prices. Many involved in the issue believe that there are many members of the legislature, federal and local governments licking their chops over the potential for personal profit in this scheme. (In some ways it may perhaps be viewed as balancing the prerogatives of the urban politicians, who through their control of urban land opportunities are widely suspected, whether true or not, of significant amounts of self dealing.)

In a meeting with representatives of the Ministry of the Economy, State Property Committee, and one of the chief legal advisors to Roskomzem, none were willing to concede the agricultural land issue to the conservatives, thinking this was a very bad precedent and a key test in the progress of reform.

### ***Land Allocation***

In my view, there is a potential conflict building between Roskomzem and the other levels of government over the control and allocation of land. At present, the law arguably puts land control and allocation in the hands of local governments. The draft Land Code continues to give authority to local government for land decisions, but at the same time establishes a contradictory role for Roskomzem as the final arbiter of all land decisions in the Federation.

I had the opportunity to discuss this apparent conflict in a meeting with Petre Loika, Deputy Chairman of Roskomzem, and Mr. Tretnikoff, the head of Roskomzem's Urban Land Division. They conceded that the law was vague right now, but they were working on the additional law and regulations needed to clarify the relative powers of the various land bureaucracies.

Roskomzem is organized pyramidally, like many other Russian federal bureaucracies. Under the Federal Committee, which is the supervisory body, it has republican, regional and territorial committees (87), city and town committees (700) and raion/district committees (about 1,800). In effect, each political jurisdiction has a branch of Roskomzem. Also, like other federal bureaucracies, local Roskomzem committees purport to have two masters -- the higher Roskomzem Committees and the government of the local jurisdiction. Accordingly, Roskomzem claims to be a servant to the decisions of local governments, by providing technical assistance on cadastral and planning matters, and also an equal authority, representing the interests of the federal government.

In the final analysis, the role of Roskomzem and all of the federal bureaucracies will probably depend on how the intergovernmental relations in the Federation develop. It seems clear now that many local jurisdictions are taking an independent course.

With respect to issues of land allocation and control, this arrangement will probably work only to the extent that the interests of Roskomzem and the local political authorities are congruent. Several of those with whom I spoke allege that Roskomzem is quite conservative and will fight a rear guard action on land privatization. Giving the benefit of the doubt that Roskomzem is in fact a middle of the road agency, its policies will likely be far too conservative for places like Moscow or St. Petersburg and far too progressive for some of the satrapies in the hinterlands.

### ***Land Registration***

While Roskomzem's future role in land use and allocation decisions may still remain to be seen, their preeminence in technical issues of land classification and registration does not seem open to question. In these matters they seem to be working hard and making progress.

My meeting with Messrs. Loika and Tretnikov at Roskomzem revolve mostly around issues of land registration. Contrary to my understanding prior to the meeting, there is a great deal of ongoing work on these issues.

Roskomzem has been working with teams from Germany, Holland, Denmark, Sweden, Australia and Switzerland on implementation of demonstration programs of the land registration systems used in those countries. Several teams have been given local jurisdictions in which to begin their program (Sweden-Novgorod; Australia-the Moscow Oblast; Denmark-a district of St. Petersburg) and have begun work. The demonstration programs will continue for about 18 months, at which time the programs will be compared and a decision made on choice of system.

Once a system is chosen, it appears that the countries involved would also provide training and technical assistance in implementation.

All of the programs are variations of the title registration systems that are generally used in Europe. The Australians are implementing their Torrens system, which has been used in some jurisdictions in the USA. The title registration system of course differs fundamentally from the document recordation system used predominantly in the United States. However, there are many reasons why title registration is probably the best system to use in Russia now, and a competition between the two approaches would not be very productive.

In addition to the above missions, the World Bank has just completed a month-long mission which is expected to produce by June, 1993 a major document on proposals for land registration in Russia. Roskomzem has requested a loan from the Bank for assistance in designing and purchasing cadastral hardware and software. (Apparently Roskomzem has just issued a letter of intent for hardware and software systems to an American firm, Ashtec.)

The greatest challenge they face now is in the urban areas, where land records are in the worst condition. The inventory process, for which they have recently completed a procedure manual, is expected to take 3 to 5 years. Part of the problem is that they cannot find trained personnel, particularly in surveying work. They see training assistance as one of their most pressing needs in the coming years.

The objective of Roskomzem is to create a parcel-based, multi-purpose cadastre, which would include all physical and juridical information relating to individual parcels of land. The cadastre would be managed by Roskomzem and its local branches, and would be the designated registry for land transactions such as transfers, leases and mortgages.

The unified cadastre is obviously a great step forward for Russia. Under present conditions there are a half dozen or more agencies that have responsibility for some aspect of collecting and registering land information. For example, in Moscow, matters relating to land are covered by Moskomzem (the local branch of Roskomzem), matters relating to commercial property by the Property Committee and matters relating to residential property by the Housing Department.

To protect the existing political interests, Roskomzem is willing to allow the existing bureaucracies to retain responsibility for collecting and registering land matters within their competence, but subject to the requirement that all such information be kept in the unified cadastre. For example, they have agreed that Gostroi would supervise the collection of information on structures, as opposed to land. While the efficiency of this may be argued, it is not necessarily an unusual arrangement in cadastral systems.

We have been extended an open invitation to comment on the laws and regulations developed by Roskomzem as they become available, which we should do. However, with the basic direction of the land registration issues having been set, and the obvious expertise and familiarity with the issues demonstrated by the people with whom I met, it is clear that legal or legislative advice is not the highest priority in this area. Moreover, in addition to the major mission of the World Bank, we have identified active technical assistance missions from 6 other countries.

While Roskomzem would probably be glad to designate a jurisdiction for an American technical assistance demonstration program, the needs in this area, as identified by Roskomzem, are technical and financial assistance in identifying, evaluating and purchasing hardware and software for the cadastral system, and training programs for persons involved in cadastral work. (It should perhaps be noted that there are some, including a World Bank team that looked at the issue in 1992, that are of the opinion that Roskomzem is overemphasizing the issue of technology, and that more useful progress could be made on a simpler system.)

## ***Planning***

There is still no apparent rush to work on the Town Planning Codex, though apparently some local jurisdictions are moving forward with their own ideas.

I met with Michael Berezin of St. Petersburg, who after years with a research institute associated with Minstroy has opened his own planning and urban consulting office. He has just received a commission from the St. Petersburg government to write a local law of zoning and zoning procedure. I was able to provide Michael with several hours of questions and answers as well as all of the earlier work on American land use practice that I provided to Minstroy in connection with the Town Planning Codex.

## **III. CONDOMINIUMS**

The issues of common ownership of the the newly privatized apartments is also one on which slow but sure progress is being made.

### ***Moscow Regulation***

The Moscow condominium regulation was promulgated in April. Its major flaw is that it still considers condominiums to be voluntary organizations. This is a position the city's lawyers have held from the start with respect to existing buildings, and it has been unshakeable. Among other flaws, the regulation also fails to provide a strong enforcement mechanism for collection of financial obligations from condominium members. Overall, however, it offers a useful outline to the many housing associations that have been beseeching the City for some guidance.

I was asked by Mrs. Terokina of the Privatization Office to assist with the development of forms of organizational documents to accompany the regulation, and will complete the drafts by the middle of May.

Moscow is embarking on a program of "licensing" housing associations before agreeing to turn over management control. The grounds for the licensing are basically that (1) the appropriate organizational documents have been executed; (2) there is a sound financial management plan; and (2) an unspecified number of the housing association's members have participated in training courses to be offered by the Office of Privatization.

The licensing program raises mixed feelings. There is no apparent legal authority for the licensing, and good arguments that it violates the Law of Privatization. It could be another reflection of the foot dragging that the City has shown in relinquishing control of the buildings. At the same time, some amount of training would probably be advisable before the City simply walks away from some

of the privatized buildings. We will be following the development of the licensing program in the coming months.

### ***Federal Law***

Gostroi is preparing its own condominium law of general principles, apparently spurred to action by the initiative of Moscow. The law will cure the major defect of the Moscow regulation by making the condominium rules mandatory with respect to all owners of apartments in buildings having 3 or more privatized units.

We were not given a timetable for this law, but presumably will have an opportunity to look at it before enactment. Mr. Krameninikov, the new legal advisor for the Gostroi Housing Division, with whom I met, will be drafting the law. Apparently, his first draft was unacceptable to Mr. Shamuzafov.

### ***New Buildings***

It was brought to my attention in a meeting with the Office of Privatization of the Moscow Housing Department that even the City's regulation on mandatory creation of condominium organizations for newly completed buildings is not being enforced.

That Regulation ("On Provisions for Maintenance of Housing Sold in the Duly Authorized Way at Auction Sale," November, 1992) requires that housing associations be established for all new buildings, but allows the units to be turned over for occupancy prior to creation of the association and obtaining the agreement of the new purchaser to join the association. In addition, it allows the new purchaser to enter into an individual management contract with the government property management organizations prior to the time that the housing association is created.

In practice, when the new owners have been approached regarding creation of an association, many have refused or the apartment has been found to be rented by an absentee owner who cannot be located.

We have provided the Department of Communal Services with a memorandum (Exhibit D) outlining the flaws in this process and suggesting how it can be corrected. It is a simple matter for the City to create the association prior to signing contracts for the new units and conditioning such contracts on participation in the association. It is a simple matter also to require that only the association is entitled to contract for management of the building on behalf of all new owners. We were advised that the city is considering changes to the regulations that would accomplish these objectives.

### **Owner's Association**

I was invited to meet with the association formed to represent owners of apartments privatized under the new laws. The rather complex official name of the group is the "All Russia Fund for Promotion of Individual Flats." The group is headed by Mr. Anatoly Basargin, President, and I met with him and his chief legal advisor, who is also a member of the Moscow State University law faculty.

The group is registered as a public association. It claims to have nearly a million members, representing over 500 buildings in Moscow alone, and has recently begun operations in St. Petersburg and Nizhny-Novgorod. Its role is to represent the interests of the new owners and to provide financial assistance for building maintenance and rehabilitation. They have started their own bank.

These men are committed free-marketeers by Russian standards, believing strongly in the privatization program and the creation of a private housing market. On behalf of their membership they are beginning to assert their influence with elected representatives and claim to have access to many government officials.

The main issues on which we were in agreement included:

- (1) the need to require universal membership in the housing associations;
- (2) the need to turn real management authority from the cities over to the new owners;
- (3) the need to deal with the ownership of the land appurtenant to privatized buildings.

The issues on which we failed to agree were the right of the new owner's associations to ownership of all vacant and commercial space in the buildings, and the need for more economic exclusivity in the privatized buildings.

I agreed on my next trip to conduct a technical seminar for the leadership of some of the member associations.

## **IV. HOUSING CODE**

The politics of the Housing Code have become complicated, with two rival working groups sponsored by the Supreme Soviet preparing different drafts. Apparently the only common member of both groups are Messrs. Shamuzafarov and Khodayaev of Gostroi.

My draft of the outline of the Housing Code has been presented to both groups, and I have been advised by Mr. Khodayaev that the basic premise of dividing the law cleanly between social housing issues and private sector housing issues was adopted. Khodayaev thinks that many of my suggestions on issues relating to the private sector will be of help to them, though several, such as the landlord-tenant code or federal law of condominiums, may be enacted as separate laws. It appears to be acknowledged that the thinking of the working groups has not yet approached the level of detail provided in my draft outline of the Housing Code.

Gostroi has apparently brought onto its staff from the Supreme Soviet Mr. Krameninikov, a young lawyer with some experience in housing issues, with whom I met. He is a protege of, and has enlisted the assistance of, a lawyer from the Yekaterinburg Institute of Civil Law who is reputed to be one of Russia's leading housing experts. They will together be working on the Housing Code.

Khodayaev has provided me with the legislative agenda of Gostroi and issued an open invitation to provide whatever comments or material I think may be of use in considering the various items on the agenda.

Considering the political situation between the two working groups, the projected completion date of June for the Housing Code may be delayed.

## **V. PROPERTY TAXES**

At the request of the Moscow Tax Inspectorate, I provided a seminar to the senior staff on legal issues in the collection and enforcement of real property taxes. My outline of the seminar is attached as Exhibit C.

The Tax Inspectorate is the only tax agency in the Federation. It is organized pyramidally as described above for Roskomzem, and is also an agency of both the federal and local governments.

These people need a great deal of assistance, far beyond what a few seminars from our team can provide. They have been given the responsibility to devise the real property tax system, entirely new to them, and are wrestling with basic concepts of property inventory, appraisal, enforcement and collection. They have no trained assessment staff, and rely on three separate agencies for basic cadastral information. They presently rely on BTI (Bureau of Technical Inventory), a group of engineers interested mainly in hard construction costs, for all property evaluations.

They have little, if any, appropriate hardware or software of their own.

The Chief of the Income Tax Bureau, who attended my seminar, showed me that they have just translated the IRS Form 1040 into Russian, of which he was proud but which any American would surely recognize as a desperate cry for help.

Perhaps the best aspect of this situation is that there is no existing Russian system or attitudes that have to be overturned before progress can be made. This is probably an area in which municipal tax experts could have real impact.

I will be preparing another short outline for them describing the institutional structure of the local property tax system.

## **VI. SCHEDULE OF MEETINGS**

### **1. *Gostroi***

Mr. Shamuzafarov, Director of Housing Division  
Mr. Khodayaev, Senior Advisor  
Mr. Krameninikov, Legal Advisor

### **2. *Ministry of the Economy***

Mr. Andrei Lazerevsky, Deputy Director of the  
Committee on De-Monopolization

### **3. *Moscow Housing Department***

Mrs. Terokina, Office of Privatization

### **4. *Moscow Tax Inspectorate***

Mrs. Prisyagina, Chief Tax Inspector  
Mr. Glinkin, Chief Dept. of Methodology  
Mr. Leshko, Chief of MIS  
Mr. Alexeev, Chief Legal Counsel  
Mr. Voronkov, Chief of Income Tax Bureau

5. **State Property Committee**

Mrs. Vulkova

6. **State Committee on Land Resources and Utilization  
("Roskomzem")**

Mr. Petre Loika, Deputy Chairman  
Mr. Tretnikov, Director of Urban Land  
Mrs. Vitt, Chief Legal Advisor

7. **All Russia Fund for Promotion of Individual Flats**

Mr. Anatoly Basargin, President  
Mr. Valerian Vesjely, Legal Advisor

8. **Supreme Soviet**

Mr. George Zadonski, Chairman of the Committee on  
Budget, Prices and Taxes  
Mr. Alexander Makovsky, Chief Legal Advisor to the  
Committee

**EXHIBIT A**

**MEMORANDUM**

**TO:** Ray Struyk  
**FROM:** Steve Butler  
**RE:** Mortgage Legislation in the Russian Federation  
**DATE:** March 24, 1993

This memo outlines the extent to which our comments and advice have been incorporated into the proposed Law of Mortgage of the Russian Federation pending as of this writing. As you know, we provided recent comments (March 10, 1993) after the first reading of the Law of Mortgage; the impact of those comments remains to be seen.

**Suggestions Adopted**

Many of the issues we raised with respect to the Law on Pledge (Memo to Shamuzafarov, August 14, 1992) and suggestions we made with respect to the first draft of the Law on Mortgage (Memos to Chairman Zordonsky, November 10, 1992 and December 22, 1992) have been accepted and are reflected in the pending Law on Mortgage. Changes or additions that can be traced to our work include:

1. In structure, the law has been simplified somewhat to deal with real estate mortgages generically, and there is not so much emphasis on the differences between the "objects" of real estate mortgages.
2. The law deleted earlier references to foreclosure of land mortgages by sale to the "land bank"; my argument was that the land bank was destined to be a transitional phenomenon and that the law therefore should not include specific procedures but only general references to the possible applicability of other laws.
3. There are new provisions dealing with the assignability of mortgage security, and clarification that assignment is only valid in connection with assignment of the underlying debt; the prior draft prohibited assignment of real estate mortgages.

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4. The law now provides for a non-judicial process of mortgage foreclosure as well as for a negotiated deed-in-lieu of foreclosure.
5. Variable rate and negative amortization loans appear to have been dealt with by allowing attachment of a mortgage schedule setting out formulas for calculation of the interest rate, outstanding debt and other variable sums. (I believe, however, that this provision may still be somewhat ambiguous in face of the contradiction with the Law on Pledge.)
6. Issuance of bank securities or bonds secured by mortgages, the beginnings of a secondary market, is now specifically addressed.
7. The law adopts its own rules for foreclosure auction sales. While they follow closely the provisions of the existing Law of Civil Procedure, there was previously some question whether the Civil Procedure provisions were meant to be applied to real estate foreclosures. The question is at least resolved.
8. It has been acknowledged that a defective mortgage instrument may still be binding on the parties, but may not be binding on third parties harmed by technical defects in registration. Previously, the entire transaction was nullified for technical defects, a draconian result.
9. It is clarified that the statutory requirements are minimum requirements and that mortgage documents may go beyond the statute to express the agreements of the parties.
10. The law designates a specific registry for mortgage registration -- the local Committee on Land Resources and Land Management.
11. Provisions for challenging registered documents have been added.
12. Mortgagees have been given priority liens on condemnation proceeds.
13. The law now calls for a technical property description (i.e. survey or metes and bounds).
14. Other secured creditors are specifically required to be joined in any foreclosure action.

15. The law requires issuance of a foreclosure deed by the court.

16. The law now addresses the rights of lessees in foreclosed property, as suggested; but, while the issue is resolved, it does the opposite of what I recommended. I don't know whether this is misunderstanding or a conscious policy decision.

17. They have clarified the concept of the "contents" of a property subject to a mortgage, so it now resembles our concept of "fixtures."

18. The status of mortgages on apartments in commonly owned buildings as "real estate" mortgages is clarified.

19. With respect to enterprise mortgages, the law now allows disaggregation of real estate assets for foreclosure sale, as recommended; previously, real estate assets of an enterprise could only be foreclosed if the enterprise was sold as an entity.

As noteworthy are the deletions made from the original draft of the law in response to our comments. As you know, our clients have had a tendency to throw a great deal of unrelated or overlapping material into the laws, which I have been trying to discourage. For example, the original draft included general provisions on title registration which were more than was needed in a mortgage law but not enough for a general law of title registration. I suggested that these issues be left to a broader based law of title registration and the provisions were deleted.

The original draft suggested that appraisal of land was a public function and the amount of loans on land was governed by the law. I suggested that these were both market functions, and the provisions were deleted. Similarly, the original draft gave a mortgagee an automatic right to call the loan if the value of the land decreased, which was deleted at my suggestion; call rights are a matter of private negotiation.

### **Open Issues**

The advice that has not been adopted, and issues still not addressed, can be found generally in my memo of March 10, 1992 on the pending Law of Mortgage and my paper of February 15 entitled "The Legal Basis for Residential

Mortgage Lending in the Russian Federation." The most important of those issues include the following:

1. While there is now a broader range of procedures for enforcing mortgage security, the right of non-judicial sale is made dependent upon the creditor and debtor reaching agreement after the loan is in default. This is not the most likely scenario. Rights of non-judicial sale should be specified in the mortgage contract and should be enforceable after default without the further agreement of the debtor. As drafted, in my view, the Law on Mortgage significantly compromises the utility of this procedure.

2. As drafted, the non-judicial foreclosure process also depends upon an agreement between the creditor and debtor as to the value of the property. Again, this is not likely to happen too often. Needless to say, if there is no agreement as to the value of the property, there will be no agreement allowing non-judicial foreclosure. It would be better if all foreclosure sales could proceed on the basis of an independent appraisal or other price approved by a court.

3. The mortgagee's rights to obtain possession of the property after the nullification of a foreclosure auction sale need further consideration. If the first sale fails, due to lack of interest or prices failing to meet the official valuation, the mortgagee may take the property only if he has the consent of the mortgagor and an agreement on the price. Again, not likely to happen.

In the second and final sale, the starting price for the auction is set by an independent auction agency designated under the law, and if the second sale fails the mortgagee is required to take possession of the property at the established starting price.

This entire procedure deserves further consideration. We have suggested that the law give some further protection to mortgagees, either by setting minimum bid prices equal to the debt or by allowing mortgagees to bid on the property at auction sales.

(Note: I have had recently the opportunity to review the corresponding Bulgarian laws. The Bulgarian law allows the mortgagee to take the property at 80% of

the appraised value if the auction sale fails. This is a good provision.)

4. There is still some ambiguity regarding the circumstances under which a mortgage is terminated. They have incorporated some of the Civil Code provisions on termination of obligations into the pending Law on Mortgage, and in my view those provisions may be frequently susceptible to broad interpretations that adversely affect the rights of creditors.

5. Some basic issues about priorities of liens are not yet resolved. There is still a need for a basic law of title registration. (In that regard, the Bulgarian law of title registration is very simple and right on point; we should consider using it as a basis for discussions with our clients.) In particular, the issues of construction loans and other loans disbursed in installments are not addressed.

6. The registration process is, in my opinion, overly complex. It is a hybrid system taking some elements from the European land registration system and the American document recordation system. There are still many ambiguities about the logistics of the process that may not be resolved until it is actually put into effect. The law does allow for enactment of further regulations concerning the format of the registration logs, the rules for keeping the logs and the rules of mortgage registration.

7. The law still gives broad discretion to courts to defer satisfaction of the debt or restructure the loan if there is a land parcel involved in the transaction. I recommended earlier that this provision be deleted or that the circumstances under which a court can order mandatory forbearance be better defined. Significantly, the provision has now been limited to where there is a land lot involved, and does not apply to other residential foreclosures. However, I'm not sure what this distinction will amount to in practical terms.

8. I have recommended that the law further clarify and limit the conditions under which a court may stay execution of a mortgage foreclosure. However, this is essentially a procedural issue and it may take an amendment to the Code of Civil Procedure.

9. I have recommended that the law clarify the consequences of foreclosure with respect to interested third parties; essentially, under what circumstances will their rights not be terminated by the foreclosure process?

10. The full consequences of nullification of a foreclosure sale have not been addressed. For example, what are the rights of a bona fide purchaser if a sale is challenged and overturned 2 years after completion? Also, there is still a three year period in which sales can be overturned, which I have suggested is far too long. (Note: By comparison, the Bulgarian law specifically spells out the rights of bona fide purchasers and all property rights obtained in foreclosure auctions are incontestable 6 months after acquisition.)

11. The pending Law on Mortgage places a mortgagee that obtains title in foreclosure in the shoes of the mortgagor with respect to obligations to existing tenants, including, apparently, preexisting financial obligations. This is inadvisable and greatly increases the risks of the creditor. Creditors should have no liability to tenants except by contractual agreement.

12. The law on acceleration of debts in default is still ambiguous; this could be a significant practical problem in the enforcement of mortgage loans. The law still allows borrowers to suspend enforcement proceedings any number of times simply by paying the amounts of the overdue installments. (Note: The Bulgarian law deals with this by allowing the debtor to suspend the proceedings by payment of the overdue installment and agreeing to accelerated retirement of the loan. Moreover, under the Bulgarian law the debtor may take advantage of the provision only once over the term of the loan. I have recommended a similar approach for the Russian law.)

13. The ambiguous priorities for unsecured debts found in the Code of Civil Procedure still come into play. These provisions need review and clarification. There are still too many question about what sort of subsequent obligations of a debtor can prime a mortgagee's lien.

14. I have recommended that statutory notice requirements and cure periods be put in the law for the benefit of residential mortgagors.

15. There is still no requirement for consumer protection disclosure, similar to our RESPA or Truth in Lending laws. I have recommended that a simple version of such laws be considered.

16. In my view, there is still too much emphasis being placed on distinctions between land mortgages and mortgages of buildings and structures. This is, I think, a conceptual relic of the Soviet past that we may have to work with; I understand that the same issues are arising in all transforming socialist economies. One practical consideration underlying this distinction is that in the short run there will be a large amount of land remaining in public control, and the drafters of the law want people to know that they can mortgage structures alone. They will just have to work out the legal principles in the context of actual transactions.

## MEMORANDUM

TO: Mr. Raymond Struyk, The Urban Institute  
FROM: Mr. Stephen Butler  
RE: The RSFSR Law on Real Estate Mortgage  
DATE: March 10, 1993

The following are my comments on the recent Russian federation Law on Mortgage passed on first reading in early March. I'm uncertain of the quality of the translation with which I am working, so my comments must be taken in that context.

### SECTION 1

#### Article 4

(2) Why is the distinction between mortgages of land lots and mortgages of buildings, structure, homes, apartments, etc. necessary? As a practical matter, the mortgage of a land lot without the structure, or vice versa, makes little sense, particularly in residential transactions. The concept of mortgage security is not the mere right to own the property, but to sell it. How can a piece of land be sold if someone has the right to occupy the dwelling rent free? How can the dwelling be sold if someone else owns the land and can prevent access to the dwelling? If a mortgagor retains rights to the land, can he build another house right next to the one he lost through foreclosure?

Perhaps I don't understand the policy objectives, but in my opinion there is too much being made about the distinctions between land and other forms of real estate, and it may lead to illogical results.

(3) This is confusing the difference between mortgages of lease rights and mortgages on leased property. A mortgage on leased property implies an actual mortgage on the real estate. But a holder of a lease has no right to put a mortgage on the real estate because he does not have the right of alienation; he is not an owner. On the other hand, a mortgage on a lease is a mortgage on a right to occupy and use real estate for a term of years. In certain contexts different legal conclusions may arise from this distinction.

Paragraph 3 is simply too vague, and all that really needs to be said is that mortgage of lease rights or rights of operational management are subject to the provisions of this law.

Article 5

(1) Why does the law specifically require mortgagee approval for lease but not sale of the property? This could give rise to an argument that sale is permitted without the consent of the mortgagee. I don't think this is the intention.

Article 6

Generally, shouldn't all matters in Article 6 be subject to agreement between the parties to the mortgage?

(1) Prohibited encroachments should include matters affecting rights of ownership or title; for example a mortgagor can be required to bring necessary court actions to resolve adverse claims to title.

Article 7

(5) The extent of a mortgagor's right to substitute a new underlying mortgage in place of a terminated underlying mortgage is unclear. It may be unfair to an overlying mortgagee to allow a mortgagor to place a new underlying mortgage ahead of the overlying mortgage, particularly if the new underlying mortgage has a different interest rate, amount, term or other material provisions. All of these changes would increase the risk of the overlying mortgagee, and were probably not be within his contemplation when he made his bargain.

I would recommend that second mortgages automatically become first mortgages upon retirement of a prior first mortgage, or that overlying mortgagees can declare their loans immediately payable if the terms of the underlying mortgage are materially changed to increase his risk.

Article 8

My translation seems to say that a mortgagee can pledge its interests in mortgages to secure bonds or other securities issued by it, if the right to do so is reserved in the mortgage contract. If so, I think this is a good provision.

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Article 9

(1) It is inappropriate to speak of "loss of the mortgaged property" as terminating a mortgage. Land cannot be lost, only taken. Therefore, with any mortgage covering structures and land, this provision would make no sense. Additionally, in the event of confiscation or destruction of structures, the mortgage actually remains in effect as a lien on confiscation or insurance proceeds. This provision may need more thought to determine how it relates to modern mortgage practice.

With respect to Article 228 through 236 of the Civil Code, I have the following comments:

(a) under Article 229, the right of set-off to terminate a mortgage obligation should only be made by order of a court;

(b) under Article 231, if you allow a right of set off against transferees of mortgage obligations, you may be undermining concepts of negotiability that may be enacted at some point in the future; an exception should be taken for any laws of negotiable instruments now or hereafter enacted.

(c) Article 234 is irrelevant to market mortgage systems, and in any event is covered under Section 5 of the Law on Pledge. If this provision is retained it should be made subject to the obligation to compensate the mortgagee for any losses from government interference with the security of the contract.

(d) under Article 235, impossibility of performance is generally irrelevant to mortgage transactions. For example, if a debtor became unemployed and could not find other employment, would payment of his debt be impossible? This provision may give courts too much discretion to favor the debtor's position. Generally, the concept of fault as described in Article 222 of the Civil Code is also irrelevant to enforcement of a mortgage debt.

(e) under Article 236, is it appropriate to say that liquidation of a corporate entity of itself terminates a mortgage in the absence of resolution of the debt through bankruptcy proceedings? A bankruptcy court may award the property to a creditor or another purchaser and all parties may want to leave the mortgage in effect.

Generally, the provisions of Article 228-236 of the Civil Code should be more finely adjusted to new developments in the mortgage law and commercial practice.

**SECTION 2**

Article 11

(1) Are the Contract of Mortgage and the Mortgage Deed the same document? Can they be the same document? If so, this should perhaps be stated in the law.

Article 12

(10) Both the interest and the principal balance should be subject to determination as described in the annex to the mortgage; there may be loans on which interest is accrued and added to the outstanding principal balance.

(13) If the Mortgage Deed must contain the registration number, this implies that (1) the notary will certify the deed before it is presented for registration, or (2) that the notary will accompany the registrant to the registry and certify the document simultaneously with issuance of a registration number. Has this process been given adequate consideration? What the law might want to say is that the deed will contain a space for the entry of registration information upon completion of the registration process.

Article 13

(2) A residential mortgage loan is generally paid monthly over about 20 or 25 years -- that is, about 240 to 300 separate payments. To require that notations be made on the mortgage deed itself, even on a schedule to the mortgage deed, and then to give the presumption of validity to the creditor's notations, is perhaps inviting administrative problems and complex legal disputes. It might be better simply to say that the creditor is obligated to provide the debtor from time to time, but not more often than every 6 months, with a record or acknowledgement of payments made to date and the outstanding balance of the loan.

**SECTION 3**

Article 15

If it is at all feasible, if the registration system is to work more effectively for the protection of all interested parties, a copy of the entire mortgage document should be registered. This of course would also serve to diminish the liability of the registry.

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Article 16

(3) Who is this 15 day registration period applied to -- the parties or the registry? If to the registry, the mortgage should take effect as to priority over subsequent interests as of the date the mortgage is presented for registration. If the registry is not prepared to issue a registration number at that time, it should be willing to stamp the Mortgage Deed and a duplicate copy as to the date and time the mortgage is received in the registry and to keep a separate log with minimal information on mortgages received but not yet registered. The reasons for this should be obvious.

I'm sure that everyone understands that under this law there could a 15 day delay between the time loan documents are signed and the actual disbursement of loan proceeds, as in the absence of title insurance no creditor could be advised to disburse a loan until registration was completed.

Article 18

(1) Again, it is best if a copy of the entire document is included in the records.

Article 21

(2) I believe this provision is meant to say that the extension of the mortgage is granted at the request of the mortgagee, not the mortgagor, upon presentation of the original document.

I think a provision for automatic mortgage termination is inadvisable; as the volume of mortgage transactions increases and records become more complex it will probably cause many legal disputes. It will also increase creditor's risk and costs, which will in turn cause higher borrowing costs. I believe the law already provides an adequate approach elsewhere, which is to give mortgagors the right to demand return of the original mortgage document and to enforce the demand in a court. As a practical matter, it will probably be rare for a creditor to return the mortgage upon receipt of a legitimate demand. Some American jurisdictions have similar laws, but the grace period following maturity of the mortgage is far longer than one or two years.

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Article 22

(1) Is it appropriate to impose a tax for merely inspecting and making copies of the mortgage records; under a fully developed mortgage registration system thousands of people may be inspecting the records daily, including title insurers and attorneys. Imposition of such taxes simply increases transaction costs and raises the cost of housing.

It is reasonable, on the other hand, to charge for certified copies.

**SECTION 4**

Article 25

(1) Presumably, the mortgage contract can prohibit sale or other transfer of the property without the permission of the mortgagee, as provide in Article 20 of the Law on Pledge.

This provision confuses the debt and the mortgage. A distinction should be made between the two. A successor to the mortgagor should take the property subject to the mortgage, but does not necessarily assume the obligations under the debt except by express agreement with the mortgagee. The distinction here is, for example, that if the debt is not paid the property would be still be subject to foreclosure while owned by the successor, but the successor would not be responsible for a deficiency judgement or subject to an action simply for collection of the debt.

Article 26

(2) Again, a distinction should be made between liability for the debt and operation of the mortgage. Liability for the debt should not be imposed automatically on the beneficiaries of an estate; the mortgage debt is in fact an obligation of the estate, not the individual beneficiaries. Accordingly, the mortgage should be paid from the estate assets, or by sale of the property. If the beneficiaries of the estate want to specifically assume the debt obligation, they should be permitted to do so, in which case it is between them and the bank whether liability is apportioned or common.

Again, if the debt is not paid, the lender may foreclose even while the property is owned by the beneficiaries.

The issue is that in many cases it may be unfair to saddle children or other devisees with the debts of their parents, when it would be more in their interests to simply give up the property.

An automatic transfer of liability on debt is appropriate, however, in most corporate reorganizations.

## SECTION 5

### Article 30

The purpose of this article is unclear. The law provides that Mortgage Deeds are not assignable without assignment of the underlying debt. Therefore, this Article is addressing the pledge of rights under loan contracts, along with the pledge of rights under the accompanying mortgage security. Isn't this already covered in detail under the Law on Pledge? I would need more information on what this article seeks to accomplish.

## SECTION 6

### Article 31

(3) The court should require notification of all persons with a known interest in the property, not just other mortgagees. Notification of all known interested persons should also be required when the property is sold without court procedure.

### Article 32

(1) The right to sell property without court action should be a matter for agreement in the mortgage contract. To require that the mortgagor consent to such a procedure after a default will, in my opinion, significantly decrease the value of this procedure because in most instances mortgagors will refuse to cooperate with mortgagees. It will generally be difficult for mortgagors and mortgagees to reach agreement on the starting sales price for the home at auction, and without that agreement the mortgagor will simply not agree to the procedure.

The mortgagee should be able to sell the property at a reasonable price without court action on the basis of the mortgagor's consent in the mortgage contract. There should be no requirement that the mortgagor and mortgagee agree on the sale price prior to auction. The price should be

subject to confirmation by the court, at which time either party could submit evidence of reasonableness.

Remember, auction sales are imperfect market transactions and involve considerable risk to purchasers. The real value of the property is unlikely to be obtained, which is a risk the mortgagor assumes when he takes the mortgage loan. The test should be reasonableness under all of the circumstances.

Article 34

(1) The two month time period is too long. Interest is accruing during this time which may be lost because of the borrower's deteriorating financial condition. The long time period also risks deterioration and vandalism.

(3) The notice should be published in a newspaper of substantial circulation; the government regulations or the court should be authorized to designate acceptable circulation levels for newspapers in which legal notices may be published. Publication in some obscure journal or newspaper is by definition unreasonable.

(4) The property is sold to the highest bid in excess of the starting sale price.

Article 35

As a general matter, the auction procedure deserves more attention. It has several flaws.

(2) If upon failure of the first auction the mortgagee's purchase of the property is subject to an agreement with the mortgagor, this will rarely happen as they will have different views of the value of the property.

Article 404 of the Code of Civil procedure allows the mortgagee to take the property for the amount of the original valuation included in the mortgage, against which the mortgagee can set off the amount of its mortgage. Article 404 is a better provision because it does not depend on the agreement of the mortgagee and mortgagor at a time when they may not be in a cooperative frame of mind. Alternatively, the mortgagee might be permitted to purchase the property at the current appraised value. Finally, the mortgagee could purchase at a price proposed to and approved by the court. All of these alternatives are better than requiring agreement of the mortgagor and mortgagee on price.

(3) The interests of the auction agency are to complete auctions and take commissions or fees, and therefor they have an interest in setting the starting sales price as low as possible. This may conflict with the interests of the mortgagee. If the auction agency is permitted to set the starting price in a second auction, the law should provide that the price will not be lower than the outstanding balance of the mortgage, or the mortgagee should be allowed to bid at a second auction and set off its mortgage against its bid price. Otherwise, the mortgagee has no means of protecting its interests if the debtor is insolvent and cannot pay a deficiency judgement.

The Code of Civil Procedure provides that there will be no starting price in a second auction sale, and the comments in the foregoing paragraph apply to that provision as well.

#### Article 36

(1) The court should be able to overturn the auction procedure only if there is a breach of a significant rule that resulted in real and demonstrable harm to the debtor or some other party. Auction proceedings should not be nullified on grounds that could have been raised by a party with notice during the foreclosure or auction proceeding.

The provision allowing three years for challenging an action is not as good as the existing provision under Article 428 of the Code of Civil Procedure. Article 428 at least makes clear that a challenge must be brought within 10 days of the offending action or of the time that a party without notice becomes aware of the offending action. Challenges not brought in that 10 day period are disallowed. The provision of the proposed Law on Mortgage allows a flat 3 year period for bringing a challenge, without reference to when the challenger became aware of the offending action, which is quite simply unworkable in modern mortgage practice.

In any event, a 3 year statute of limitations for nullifying and unwinding auction sales is too long, and should be decreased.

A major problem with this entire area of the law is the rights of mortgagees and bona fide purchasers in the event that the auction procedure is nullified. Can they bring another foreclosure proceeding? Is the debt reinstated? Does the bona fide purchaser become the mortgagee or is he entitled to complete reimbursement from the mortgagee or the

debtor? What is included in his reimbursement? The cost of his improvements to the property?

SECTION 7

Article 38

I think this provision is meant to say that such parcels of land may not be separately mortgaged, but that they may be part of the mortgage affecting the entire property. Even restricted land may add value to a larger parcel in terms of aesthetic value or increases in allowable density on the unrestricted portions.

Article 39

(2) This is probably too much to ask of mortgagees and limits the incentive for mortgagors to pay their debts; the result may be that owners of land subject to moratorium will not get mortgage loans.

A better approach would be to allow the mortgagee to eject the mortgagor, take possession of the land in trust and collect rents or products until expiration of the moratorium, after which they could complete the sale. This could be achieved by excluding the mortgagee's possession of the land from the definition of a "sale" of the land. (Article 12 of the Constitution prohibits only "sale" of the land for the period of the moratorium.) This is a reasonable interpretation because the moratorium is intended to prevent short-term, speculative profit taking, and not the legitimate security interests of creditors.

Article 40

(1) This concept should be turned around. The presumption should be that the mortgage of a parcel of land includes a mortgage on the structures unless otherwise provided in the document.

(2) Paragraph 2 is reasonable so long as it is permissive, and not mandatory.

(3) This paragraph addresses leases and other rights to use the property deriving from the mortgagor. It raises many serious questions.

Generally, the mortgagee may prohibit lease of the property without his consent. At the time consent is requested, the mortgagee may condition his consent on an

agreement with the tenant that the mortgagee will have no liability to the tenant and the tenant's lease will terminate, at the option of the mortgagee, on foreclosure of the mortgage. This situation should not pose a problem. Other situations include the following, however:

(a) What happens if the mortgagor gives a lease without the permission of the mortgagee? Shouldn't such a lease be declared terminated upon foreclosure of the mortgage?

(b) What happens if a mortgagor and mortgagee want to agree that the mortgagee has no right to approve leases, and that the mortgagee therefore has no opportunity to obtain a separate agreement with the proposed tenant? (This is not an unusual agreement in commercial real estate.) The proposed article 40 of the Law on Mortgage virtually requires the mortgagee to reserve the right to approve tenants in order to protect its own interests in a foreclosure.

(c) What happens if the mortgagee and a proposed tenant cannot agree on the terms of the lease or separate agreement? Either the mortgagor will be prevented from leasing the property or will seek a court judgement holding that the mortgagee has acted unreasonably and that the lease may proceed. If a court does grant such a judgement it is imposing a significant potential liability on the mortgagee, and is in effect creating a contract between the tenant and the mortgagee. Should a court be permitted to do this?

(d) What happens if the mortgagor has substantial outstanding financial obligations to the tenant at the time of foreclosure? Does the mortgagee assume these obligations as a condition of foreclosing on the property? Clearly, in some instances it would be more in the interests of the mortgagee to forgo its interest in the property rather than to assume new obligations.

(e) What happens if the mortgagee subsequently sells the property, or it is sold in a foreclosure auction sale? Does the bona fide purchaser assume the mortgagor's preexisting obligations to the tenant? Clearly, this would discourage sales and have a serious impact on the auction price.

This provision places too much risk on lenders and not enough on tenants and mortgagors, and it raises more issues than it answers. A simpler and probably more equitable system would be as follows::

(1) leases or other rights of use and occupancy entered into before the mortgage is made and which the mortgagor discloses to the creditor may not be terminated by foreclosure in the absence of a contrary agreement between the mortgagee and tenant;

(2) all leases or other rights of occupancy entered into after the mortgage is made may be terminated in foreclosure in the absence of an agreement between the mortgagee and tenant;

(3) under no circumstances does a mortgagee or bona fide purchaser in possession of the property through foreclosure assume any obligations of a mortgagor to a tenant arising prior to the date of the mortgagee's possession, unless it specifically agrees to do so in an agreement with the tenant; such a mortgagee or bona-fide purchaser would be required, however, to satisfy obligations under a valid lease arising after the date of his possession.

#### Article 41

(1) My translation suggests that this provision applies to a typical residential mortgage transaction as well as to agricultural land. I have no comment on agricultural land, but this sort of provision is strongly discouraged in residential transactions as it adds great uncertainty to mortgage enforcement and is a serious disincentive to lending. It could have the effect of increasing interest rates and costs of all borrowers. As written it is too vague and would allow the court to base its judgement on just about anything. If it is to be retained, which I would strongly discourage, the conditions for deferral and the terms of deferral should be made more specific.

Land is real estate, just like the structures on it. As a general principle, it deserves no more special consideration than any other piece of real estate. For example, it is curious that this provision does not apply to a foreclosure of a persons home or apartment when a land lot is not mortgaged, but only when the land lot is specifically mortgaged. As I stated earlier, the concept of a mortgage of land and not structures, or vice versa, makes little sense in most transactions. (It is seen sometimes in complex real estate transactions in highly developed commercial systems and is generally intended to take advantage of certain tax concessions; it is never done in the absence of a long term lease on the portion of the real estate that is not mortgaged.) So it is likely that in practice this provision of the law may apply to all

mortgages of cottage style housing. But why doesn't it, then, apply to the foreclosure of a condominium apartment in an urban area, in which the land is not mortgaged? As mentioned earlier, the distinction between land and other types of real estate seems to lead to some illogical results.

7/11

## SECTION 1.

### Article 2.

Modify (2) as follows:

2. Mortgage may be established to secure any pecuniary obligation, whether presently existing or to be created at some future time, including those resulting from loan, purchase and sale, lease, contract, any other agreement, inflicted damage.

### Article 4.

2. Delete (2) in its entirety.

3. Replace the present paragraph 3 with the following:

Mortgage of lease rights to real estate property are permitted and are governed by the provisions of this law.

### Article 5.

1. Modify the third paragraph of (1) as follows:

Unless otherwise stipulated by the present law or the Contract of Mortgage the mortgagee's consent is required to transfer the property to a third party by sale or under property rental or lease contracts.

2. Delete the entire first paragraph of (2).

### Article 6.

Add a new (1) to this paragraph as follows:

(1) The provisions of this Article 6 shall apply in any contract of mortgage unless otherwise agreed between the mortgagor and mortgagee in the contract.

Add a new sentence to (5) as follows:

5. Upon violation of the liabilities by a mortgagor stipulated by Para 3(points 1 and 2) and 4 of the present Article the mortgagee has a right to demand pre-scheduled discharge of the mortgage-secured liability. This provision is not meant to limit the mortgagees right to demand a pre-scheduled discharge in the event of any other default under

the mortgage agreement to the extent such right is included in the mortgage contract.

**Article 7.**

Modify (5) as follows:

5. When the senior mortgage is terminated without settlement of the mortgagee's claim at the expense of the mortgaged property value, the mortgagee under the overlying Contract of Mortgage takes position of the mortgagee under the senior Contract of Mortgage. (Delete everything after this.)

**Article 9.**

Article 9 should be revised to include only the following:

Besides general reasons for liability termination (Articles 228 through 236 of the Russian Federation Civil Code), mortgage shall be terminated in the following cases:

- discharge or satisfaction of the mortgage-secured liability in accordance with this law or other applicable laws;

- by agreement of the parties to the contract;

- by order of a court or arbitration tribunal in the case of legal invalidity of the mortgage;

- in connection with completion of an action to foreclose the mortgage; or

- in cases stipulated by Articles 28 and Item 5 Of Article 35 of the present Law.

**SECTION 2.**

**Article 11.**

Revise (3) as follows:

3. The Contract of Mortgage meeting the requirements of this Article shall be effective between the parties from the time of its execution and as to all third parties since the time of the Mortgage Deed registration.

**Article 12.**

Revise (13) as follows:

(13) The Mortgage Deed shall contain a place for insertion of the name of the agency which registered the Mortgage Deed, with the Mortgage Deed Reg. No., date and place of registration indicated (Item 2 Article 18), which information shall be inserted upon completion of registration..

### **Article 13.**

Revise (2) to read as follows:

2. Upon discharge of the liability secured by the Mortgage Deed, the mortgagee shall be required to return the original Mortgage Deed to the mortgagor, together with a statement of the mortgagee acknowledging satisfaction of the debt, within 30 days of the final payment under the debt.

With respect to any mortgage debt paid in installments, at least once every quarter the mortgagee shall provide to the mortgagor with a statement of the amounts paid to date on the debt and the outstanding balance of the debt. In the event that the mortgagee fails to provide such statement there shall be a presumption that the debt has been paid by the mortgagee in accordance with the agreed upon schedule.

The Mortgage Deed original being with the mortgagor is indicative, unless proven otherwise, that the Mortgage Deed secured liability has been discharged.

### **SECTION 3.**

#### **Article 15. Mortgage Registration Agencies**

1. Mortgage is subject to registration by Committee for Land Resources and Land Management of an area (city, city district) where the mortgaged real estate property is located.

2. Mortgage is registered by making a registration entry in the Real Estate Registry (in the Land Cadastral Log). A note certifying registration on the Mortgage Deed is made pursuant Item 2 Article 18 of the present Law and copies of the documents submitted pursuant to paragraph (2) of Article 16, certified by the parties to be true and correct copies of the originals, shall be entered into the permanent records of the registry.

#### **Article 16. Mortgage Registration Procedure**

Revise (2) as follows:

2. Along with the mortgagor's and mortgagee's application, the following instruments are to be presented for mortgage registration:

- The original Mortgage Deed and one copy certified by the parties as required under Article 15;

- the originals and certified copies of the instruments mentioned in the Mortgage Deed as its Appendices;

- evidence of payment of the State Duty charged for registration.

Revise (3) as follows:

**3. Registration of the Mortgage Deed is to be completed no more than fifteen days since delivery of the instruments required for its registration to the Committee for Land Resources and Land Management.**

#### **Article 18.**

Add a new (3) as follows:

3. The certified copies of the Mortgage Deed and accompanying appendices shall be kept by the registry in accessible form and location and shall be available for inspection by those persons using the registry in accordance with the provisions of this law.

#### **Article 21.**

Revise Article 21 by deleting the present (2) and adding the following new paragraphs:

2. In the event that the mortgagee fails to return the original Mortgage Deed to the mortgagor as required under paragraph (2) of Article 13, upon the expiration of a thirty day period from the date of the mortgagor's written demand on the mortgagee for return of the original Mortgage Deed, the mortgagor may file in the registry a notarized affidavit stating the satisfaction or other discharge of the debt and the termination of the mortgage contract.

3. The mortgagor shall have the right to demand return of the original Mortgage Deed in a court of law, and in the event that the Mortgagee is determined to have negligently or willfully failed to return the Mortgage Deed the mortgagee shall be liable for all costs of the mortgagor in bringing the claim and for any other damages directly incurred by the mortgagor.

4. There shall be a legal presumption, which may be rebutted by evidence presented by a mortgagee, that the mortgagees' rights under any mortgage have terminated 2 years after the maturity date stated in the Mortgage Deed or in any subsequent amendment or modification to the Mortgage Deed duly registered under this law.

5. The registration entry may be liquidated for reasons other than those stipulated by Para 1 and 2 of the present Article as well as its extension for longer periods in compliance with a court judgement, arbitration court award.

6. A note on liquidation of the registration entry or its extension is made in the Real Estate Registry ( the Land Cadastral Log) and on the Mortgage Deed original.

#### **Article 22.**

Revise (2) as follows:

2. A payment at a rate fixed by the Russian Federation Ministry of Finance upon agreement with the Russian Federation Committee for Land Resources and Land Management is collected for the issuance of certified copies of registry documents.

### **SECTION 4.**

#### **Article 25.**

Revise (1) by deleting the entire second paragraph and revising the first paragraph as follows:

1. In case of the mortgagor's alienation of the mortgaged property by its sale, device, exchange, or another way, for payment or on a gratis basis, in compliance with the Contract of Mortgage, in the absence of a contrary agreement between the mortgagee and the new owner the mortgage remains in force for the party coming in possession of the said property and may be enforced in accordance with its terms without regard to the ownership of the property. Notwithstanding the forgoing, in the absence of a contrary agreement between the mortgagee and the new owner, the new owner shall not be liable for the debt of prior mortgagor.

#### **Article 26.**

Revise by deleting (2) entirely and modifying (1) as follows:

1. When rights in the mortgagor's mortgaged property are transferred to another party by way of universal succession (as a result of inheritance or reorganization of the mortgagor legal entity), in the absence of a contrary agreement between the mortgagee and the new owner the mortgage remains in force for the mortgagor's successor and may be enforced in accordance with its terms without regard to the ownership of the property. Notwithstanding the forgoing, in the absence of a contrary agreement between the mortgagee and the new owner, the new owner taking the property by any legal succession other than corporate reorganization shall not be liable for the debt of prior mortgagor.

**Article 28.**

Revise this section as follows:

When mortgaged property is taken from the mortgagor according to court judgement, arbitration court award for the reason that another party is a true owner of this property (vindication), the property mortgage is terminated. In these cases the mortgagee has a right to demand a pre-scheduled discharge of a commitment secured by a Mortgage Deed. Notwithstanding any other provision of law, no confiscation of the mortgaged property by the state for any purpose, including commission of a crime, shall result in termination of the mortgage until such time as the mortgagee has been repaid the entire outstanding principal balance and interest of the underlying debt.

**SECTION 6.**

**Article 31.**

Revise (3) as follows:

3. The court or arbitration court into which the claim on taking recourse against the mortgaged property was brought shall, before considering the case, check whether the property in question is mortgaged under other Mortgage Deeds, and notify about the claim all other parties having an interest in the property that is reflected in the public records or otherwise known to the court, and give them a chance to participate in this case with a third-person status.

4. Delete (4) entirely.

## Article 32.

Revise (1) as follows:

1. The mortgage-secured mortgagee's claims (Article 3) can be settled from the mortgaged property value without applying to court or arbitration court provided that the mortgagee's right to do so is reserved in the Mortgage Deed.

The mortgaged property is sold by the mortgagee through the organizations specified in Para 2, Article 33 of the present Law at the price at the price deemed reasonable for sale of the appropriate property. Unfavorable effects of selling the mortgaged property at an unreasonably low price shall be to the mortgagee's account. Notwithstanding the foregoing, any price that is at least 80% of the value of the property as stated in the Mortgage Deed shall be deemed reasonable as a matter of law.

Surplus proceeds from the sale of the property over and above the amounts due to the mortgagee shall be returned to the mortgagor after deducting all costs and commissions of the sale.

## Article 34.

Revise the first paragraph of (2) as follows:

2. Except as otherwise provided in this law, officials of State power and administration bodies, judicial structures and Attorney's office, as well as the mortgagee and the specialized organizations holding the auction have no right to participate as bidders in such public auctions, either directly or through other persons.

Revise (3) as follows:

3. A notice about a future public auction shall appear in the in a local newspaper of substantial general circulation at least ten days before the auction, with its time and place, nature of the property to be sold, and its starting sale price specified. **Such published notices shall be placed in the areas reserved for other public notices and shall be clearly and conspicuously marked in bold type as a notice of real property foreclosure sale.**

Revise (4) as follows:

4. The mortgaged property starting sale price at the auction shall be determined upon agreement of the mortgagor with the mortgagee , and in the absence of such agreement at a starting sale price fixed by the court judgement on taking recourse against this property. Unless agreed by the

mortgagee, in no event shall the starting sales price be lower than the outstanding amounts owed to the mortgagee at the time of the sale.

**Article 35.**

Revise (2) as follows:

2. Within ten days since the auction was declared Upheld, the mortgagee has a right to purchase the mortgaged property at a price agreed to between the mortgagor and mortgagee, and in the absence of such agreement at price set by the court upon application of the mortgagee. The mortgagee may credit against the purchase price any amounts owed under the terms of the Mortgage Deed.

Revise (3) as follows:

3. Unless the mortgagee uses the right granted by Para 2 of the present Article, a second public auction shall be held not later than a month since the first auction, in compliance with the procedure specified in Article 34 of the present Law.

The second auction uses as a starting price the one which is set out by the organization which holds the auction. In the event that the final bid for the property at auction is less than the outstanding amount owed to the mortgagee, prior to completion of the sale the mortgagee shall have the right to enter a bid for the property equal to the amount owed under the mortgage and to credit against such bid the mortgage obligation.

**Article 36.**

Revise (1) as follows:

1. The court superior to the court which had passed a judgement/award on taking recourse against the mortgaged property may declare the public auction held with violations of existing procedure which damaged interests of the mortgagor, mortgagee, or third parties having rights in the property on sale, null and void. A claim for declaring the auction null and void may be brought by any of these parties only in accordance with the provisions of the Code of Civil Procedure of the Russian Federation governing procedures for the execution sale of property.

Add new (3) and (4) as follows:

(3) An auction sale shall be deemed invalid only on account of fraud or if the alleged defect is shown by convincing evidence to have caused substantial harm to the mortgagor. In no event shall the auction sale be declared null and void on the basis of claims that the mortgagor, or any person claiming rights through the mortgagor, had knowledge of and an opportunity to raise prior to completion of the auction sale.

(4) If an auction sale is declared null and void for reasons other than the fraud of the purchaser at the auction sale, the purchaser at the auction sale shall have the right to be reimbursed from either party to the mortgage contract for the full amount of the purchase price and any reasonable expenditures for maintenance and improvement of the property made since the date of his acquisition, and until such time as he receives such reimbursement shall have a lien on the property enforceable in a court of law.

## **SECTION 7**

### **Article 37**

1. Delete (1) entirely.

### **Article 38**

Revise as follows:

1. Land on which construction is prohibited under applicable planning, environmental or other applicable laws may not be mortgaged as a separate parcel of land.

### **Article 39**

2. Delete (2) entirely. Insert a new (2) as follows:

(2) If land is restricted by law as to sale or alienation for any period of time, it is hereby declared that the acquisition of land by a mortgagee, or any bona fide purchaser, in a mortgage foreclosure conducted under this law is not a prohibited sale or alienation of the land and may proceed in accordance with the provisions of this law.

3. Delete (3) entirely.

### **Article 40 Mortgage of land lot structures located there**

Revise (1) as follows:

1. All buildings and structure which are located or will be erected on the mortgaged land lot are deemed to be mortgaged simultaneously with the land lot unless otherwise provided in the Mortgage Deed.

Revise (3) as follows:

3. In case the building located on the land lot is not in possession of a mortgagor but of a third party pursuant to lease or other claim of occupancy, and the rights of occupancy claimed by such third party arose or were created after the effective date of the Mortgage Deed and without the consent of the mortgagee, then in the absence of a contrary agreement between the mortgagee and such third party all the rights of such third party to occupancy of the property shall terminate upon completion of the foreclosure.

**Article 41.**

**Delete (1) entirely.**

#### **SECTION 8**

Delete the entire Section 8.

#### **SECTION 9**

**Article 46**

**Delete Article 46 entirely.**

**Article 49**

**Delete Article 49 entirely.**

**EXHIBIT B**

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**MEMORANDUM**

**TO: MR. LAZEREVSKY**

**FROM: MR. BUTLER, THE URBAN INSTITUTE**

**RE: FUNDAMENTAL LAND LEGISLATION OF THE RUSSIAN  
FEDERATION**

**DATE: APRIL 16, 1993**

As we discussed, enclosed are my comments on the referenced legislation.

You should note that I am working with a translated version of the legislation, which may at times lead to inaccuracies in my understanding.

Please also be aware that we are concerned with the legislation primarily insofar as it affects issues of housing and urban development, and therefore do not address some of the broader issues of land policy. We approach the law from the perspective of: Will land be available on such terms and through such procedures as to encourage the creation of a private sector housing development industry?

Finally, I have assumed that it is intended to make land an object of market economics and relationships, and that assumption is reflected in my comments. That assumption may frequently conflict with the actual policies expressed in the proposed law.

**General Comments**

My general comments about the proposed law are summarized as follows:

(1) The organization of the law could be improved if the drafters distinguished conceptually in their own minds between the present stage of privatization, when land is transferred by sale or lease from the state to the private sector, and a second stage when land is largely under private ownership or control. In a true market system, the role of government in the second stage would be considerably smaller than proposed in this law.

For example, in the initial stages of privatization, the state may seek to implement certain development

objectives in its land allocation decisions, but as the private market develops market forces should be substituted for state involvement in allocation, ownership and use decisions.

(2) Similarly, the law ties rights to land allocation, ownership or possession to the use made of the land. As you know, in a true market system the rights to possess or own land are separate from the use that is made of it and, within the constraints imposed by town planning laws, the owner is free to choose the land use in accordance with market principles. In my view, the conceptual tie between property rights and land use should be dissolved to a greater extent.

An example of how this might affect the law is that sale or lease of land by the state might be subject to use restrictions for only a limited period of years, in order to achieve designated development objectives, and thereafter use of the land would be determined solely by market forces and the usual town planning processes.

Similarly, the administrative bodies with responsibility for land allocation should be encouraged to transfer land solely on the basis of price, without becoming involved in or restricting use decisions. Finally, the concept of "efficient use" of the land, as determined by the state, as the basis of ownership rights simply has no place in a market system.

(3) The relationship between town planning and the land allocation measures set out in this law are sometimes vague. For example, it seems that the bodies charged with allocating land can make such allocations solely on the basis of their evaluation of the proposed use, without regard to more comprehensive plans or use regulations.

Good urban planning cannot be done parcel by parcel. Accordingly, this law should clearly make all land allocation processes subordinate to town planning norms and procedures. Such norms and procedures should not be modified or overruled in the process of land allocation ("the tail wagging the dog"), but only through the established procedures of town planning.

(4) Better distinctions may also be made between land transactions in which the government has a continuing interest, such as leases of state owned land, and transactions between private parties with respect to privately owned or controlled land. Private land transactions should be governed by freely negotiated

agreements between the parties, and not the detailed legal requirements frequently included in this law.

For example, the state should have no involvement in transactions in privately owned land, other than to serve as the register of the transaction. Such transactions are subject to the civil law of contracts and to the town planning laws with respect to use.. Similarly, elements of private lease transactions should be left to the agreement of the parties, and need only minimal treatment in the law.

While the terms of state and municipal lease transactions may be more extensively defined in the law, it is my opinion that even those leases should be subject to market principles, and that public land owners should be encouraged to act creatively and entrepreneurially with respect to their lease transactions; they should not be hampered by rigid legal requirements.

(5) The allocation of authority for land regulation among the different levels of government is often ambiguous and overlapping, which may lead to several administrative bodies claiming conflicting rights to regulate the same land.

(6) Perhaps too much control over land use decisions remains in the hands of the federal government and its administrative bodies, primarily "Roskomzem". While the relationship between Roskomzem and local authorities with respect to land use decisions has not been fully set out in the law and regulations, such decisions should perhaps be more responsive to local development concerns and therefore to local control.

(7) Too many of the "general principles" regarding land use are in fact related to the issues of agricultural land. It is frequently unclear which restrictions apply only to agricultural land and which are meant to apply to all land. It might be better to consolidate all legal principles affecting agricultural land in a single section of the law.

(8) The concept of "withdrawal," "redemption" or confiscation of land seems to be treated as a usual and ordinary part of the system. In fact, such actions appear to be viewed as just another means of land allocation. This is a striking departure from market systems, in which confiscation of land by the government is viewed as an extraordinary action having nothing to do with land allocation issues.

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In the initial stages of land reform, it may be necessary for the government to take an active role in land reallocation. Again, however, that stage should be transitional, and at a later stage state "withdrawal" or "redemption" of land should be treated as an extraordinary action intended to serve the most vital needs of the public, and its use limited accordingly. At a later stage of development use of "withdrawal" as a method of land allocation will likely be highly inefficient as compared to market mechanisms.

### Specific Comments

#### Chapter 1

##### Article 3

Can the authority of the different levels of government for land categorization be more clearly stated? Under Section 12 of the proposed law and the recently enacted (February 2, 1993) Regulation on the Committee on Land Resources and Utilization (Roskomzem), Roskomzem appears to be responsible for categorizing and changing the category of land. How does this relate to the powers of local government as described in chapters 2 and 3 of this law?? Or to the Laws of Town Planning, Kray and Oblast Administration, the Federal Agreement and the Law of Local Government.

As a general planning principle, the categorization of land, and changes in categorization, may be most efficiently performed by territorial and local governments. The interest of the federal government in the categorization of land should be primarily for the protection and management of land that is a vital national resource and in public ownership, which would include some of the land included in categories 4 through 7 of paragraph (1).

##### Article 4

There appears to be a contradiction between paragraph (1) of this article, which maintains that land is a "national" property, and paragraph (2), which states that land can be in private ownership. These words reflect a conflict that is apparent throughout the entire law.

The law already states the principle that land can be either privately or publicly owned. Instead of characterizing land a "national property," it might be more

appropriate to state the intention that all land relationships are to be subject to market principles, subject to such reasonable regulation as is necessary to protect a national asset.

Paragraph 2 also allows Republic and territorial governments to individually elect whether they will allow private ownership of land. The right to own land is a fundamental right of citizenship; shouldn't there be a uniform national policy? Is Russia truly one nation? Why should the fundamental rights of citizens in one part of the Federation differ from those in another part? What will this mean if there is a constitution that grants the right to own land?

Aside from the questions of equal treatment of citizens of the same nation, there are potentially serious economic consequences of this policy. Significant differences in property rights among the different areas could distort the allocation of private investment among areas or regions. Investment decisions may be made on the basis of legal rights rather than the economic efficiency of investment.

#### Article 5

One of the most important points for the housing sector is that individual citizens have the right to own land for the purpose of constructing housing for rent or sale, including multifamily apartment buildings and cottage style housing complexes. Much of the housing development in a market economy will likely be the work of individual or corporate entrepreneurs. Perhaps this right is covered in item (8) of paragraph (1) (land for "entrepreneurs activities"), but it is unclear.

#### Article 6

Land may also be transferred to joint ownership with undetermined shares in the case of condominium housing developments; in fact, this possibility is recognized under Article 38 (3) of this law. Should this be acknowledged in this section, which seems to imply that joint ownership is limited to agricultural or enterprise land? This is a good example of a "general provision" becoming unclear by reference to the specific issues of agricultural land.

Article 8

This Article seems to imply in paragraph (2) that it applies only to legal persons engaged in agriculture. Do other legal persons have the right to own land? Again, the specific reference to agricultural land in paragraph (2), among the "general principles," results in ambiguity; it should perhaps be moved to the later chapter on agricultural land.

Article 10

Under paragraph (1), why does a foreign citizen or legal person have to be a "sole owner" of the enterprise? Why can't they hold interests in land as joint venturers? This seems to contradict later provisions of the law that allow Russian citizens to contribute land to joint ventures with foreign persons.

The approach presently taken in several other transitional economies in Eastern Europe is to say that only foreign citizens or legal persons registered in Russia as entrepreneurs or corporations, or holding interests in duly registered Russian corporations or joint ventures, can own land.

Article 11

Are items 4, 8 and 9 of paragraph (3) broad enough to include development and sale of housing by a citizen as an entrepreneurial activity?

You might consider that governments having jurisdiction over land should be permitted to dispose of the land for housing construction at no charge if they determine that such housing is not constructed for profit, serves an important social purpose, and is necessary to keep the housing affordable to a wide range of citizens.

Article 12

If land is acquired from the state at a fair market price, there should be no restriction on the subsequent right of the owner to sell the land.

If land is acquired for free or at less than market value, there may be better ways to prevent speculative profits on land than absolute prohibition on sale. Such

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provisions could include, for example, sales contracts that allow the state to share in profits from the sale if the land is resold within 5 years of acquisition. Such a provision allows market forces to work without allowing unfair profits.

In any event, there should be a special exception to restrictions for sale of land appurtenant to housing developed as an entrepreneurial activity. Entrepreneurs who develop housing for sale, either cottage style homes or apartments, should be able to sell the land with the housing at any time after completion of construction.

With respect to paragraph (5), once the land has been sold or leased by the state, shouldn't a change of use of urban land be subject only to the town planning laws and the terms of the lease? Why should the local Soviet be involved, other than through enactment of the usual procedures for town planning? This adds yet one more level of bureaucracy and expense to the land use process, and increases transaction time and expense.

If land purchased from the state is to be subject to use restrictions, those restrictions should be limited to a reasonable period of time, and not remove the land from market forces indefinitely.

### Article 13

As a general principle, this law should incorporate by reference the provisions of the Law on Collateral and the pending Law on Mortgage. By setting out its own principles of mortgage finance it invites conflicting interpretation of the laws.

(1) All citizens or legal persons should have the right to mortgage land which they own. Mortgage of privately owned land by a lessee should be with the consent of the owner, and is a matter for private negotiation. Mortgage of state or municipal land by a lessee should be granted as a legal right subject to reasonable regulations enacted for protection of the public interest in the land.

(2) Estimation of the prices of land is a market function, not a normative function. Normative prices generally distort markets. However, I acknowledge that in the transitional period market prices may be difficult to determine.

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(3) The right of owners of mortgaged land to lease or sell the land should be a matter for agreement between the owner and the mortgagee. These matters should not be dictated in the law. The right of a leaseholder to assign the lease and mortgage debt should be a matter between the leaseholder and the mortgagee. These are all issues bearing on risk and the costs of lending and borrowing and should be left to market forces.

(4) What is the intention of this paragraph? The term of the mortgage has no relationship to the period of limitation of sale if the mortgagee can foreclose his mortgage as stated in paragraph (5).

(6) Land of certain types of jointly owned housing ("condominiums") will be considered to be in joint ownership without designated shares. Laws governing condominiums and other jointly owned housing generally allow a mortgage with the consent of less than 100% (usually 70%-80%), or else one member prevent a much needed mortgage for repair or improvement of the property.

#### Article 14

Is paragraph (2) (land jointly owned by partnerships and associations) meant to apply to communal housing associations ("condominiums")? Why can't the land under such housing be held in ownership, like any other residential land? Jointly owned land under multifamily apartment buildings is likely to be one of the predominant forms of residential land ownership, and this paragraph seems to prohibit such ownership. In so doing, it contradicts Article 38 (3) of this law.

#### Article 15

(1) Why is paragraph (1) necessary? If necessary at all, it should say simply the land may be granted by lease.

(3) Why is paragraph (3) necessary? What implications attach to being a short lease or a long lease? There are no other references in the law to short or long leases. Perhaps this paragraph is meant to apply only to leases with the state.

Can there be a lease between private parties for more than 99 years? Why not? Can there be a lease for 99 years with an option to extend the term for another 99 years?

Does the second paragraph of (3) deal only with state owned land? If the land is not state owned, but privately owned, the law should not be involved in what rights the lessee has to assign, sublease or mortgage the lease; this is a private contractual matter to be negotiated between the parties. Does the law intend to say that if the lease is not "purchased" by the lessee, the lessee can not assign, sublet or mortgage, even if the landlord agrees to allow such actions? The law should not interfere with the decisions of private land owners.

As a general principle, the rights under a lease should not be dependent upon whether the lessee has "purchased" the right to the lease. A lease under which the price is paid over time, in installments, can be just as valuable as one that is purchased, depending upon the rents, the financial condition of the lessee and the enforceability of the lease under the law.

(4) The right to lease privately owned land is a fundamental right of ownership, recognized even under this law. The 5 year limitation on lease terms serves no apparent economic purpose and distorts economic decision making.

(5) Is paragraph (5) necessary? Isn't it assumed that the land under buildings and structures is leased along with the building and structures? How could it be otherwise?

(6) What does this mean? If the land is in private ownership, or is leased from a private owner, the owner and the lessee have the right to determine whether and for how long to lease or sublease the land. This same comment applies to paragraph (8).

What does "temporarily idle" mean with respect to privately owned land? The private owner of land has the right to use it or not, in his discretion, and depending upon the state of the market; this is a fundamental right of ownership. Does the state intend to confiscate privately owned land that it thinks is not being put to good use?

Part of the economic analysis of land use is to determine not only what is the best use of land, but when is the best time to use it for the intended purpose. The timing of use is as much a market function as the use itself. The concepts of "idle" land or "inefficient use" of land are largely central planning concepts that will often conflict with market forces.

At the same time, it is understandable that the state should not transfer land to be held for speculation, and it is not inappropriate for the state to condition an initial sale or lease of state owned land to the requirement that it be used in a particular way. However, at some point after sale or lease the concepts of "idle" land and "inefficient use" become inappropriate.

#### Article 16

What does this article mean? What is the difference between transfer for temporary use and a lease? Does this mean that the government can take land from its present owner or occupant and transfer it to another occupant for temporary use? If so, it should be subject to the same laws on the taking of privately owned land or leasehold rights as any other taking of the land, including the payment of fair market value of the land or the leasehold.

#### **Chapters 2 and 3**

These chapters establish an administrative structure for land decisions. In my view, the structure raises many questions for the following reasons, all of which apply to the provisions of Chapters 2 and 3:

(1) The powers granted to the various levels of government in the areas of planning and enforcement are overlapping and the location of real authority is often ambiguous. You may often find three different agencies involved in land use decisions and enforcement -- the Committee on Land Resources and Utilization, the land and planning officials at the territorial or regional level, and the planning officials of local governments. This will probably lead to unnecessary conflicts and inefficient, time consuming land use decisions. More attention should be paid to defining the authority of the various levels of government.

The greatest ambiguities appear to be between the local planning and land use function and the authority of higher levels of government. To what extent should higher levels of government have the authority to modify or reject local planning and land use decisions?

In my view, the relationship between this law and the laws of town planning should be more clearly defined.

(2) The system appears to concentrate a great deal of authority in federal bodies, particularly Roskomzem (See Article 17, Paragraph (2); Article 25, paragraph (1)). As a general principle, land use is essentially a local decision affecting the lives and well being of local people; it should be under the control of authorities who are immediately and directly responsible to the local population, who are closely in touch with local needs, and who can respond quickly to changing conditions. If the local authorities prove themselves to be irresponsible or unresponsive to local needs and wishes, or to general principles of law established at the federal level, then there should be some federal intervention to protect the rights of the citizens.

#### Article 17

Item 2 of paragraph (1) says that the federal legislature shall "establish uniform principles for payment of land." This provision illustrates one of the conceptual issues in the law.

The law should recognize that land relationships in Russia will undergo two stages; the first stage, starting now, is the transfer of government owned land to the private market. In this stage it is appropriate for the legislature and the government to be involved in establishing principles for the pricing and payment of land, particularly in the absence of reliable market mechanisms.

However, at some point in the future, land will be privately owned or controlled, and the pricing of that land is not a function of the government; it is a function of the market. To involve the government in pricing privately owned or controlled land on a "normative" basis will almost inevitably lead to distortions in pricing and land use. As mentioned above, there are better ways than normative pricing to prevent excessive profits, including profit sharing between owners or lessees and the state.

#### Article 18

Item 4) of paragraph (1) refers to the limits on holdings under Article 37. As a general principle, limits on amounts of land transferred should be established only for the initial stage of privatization -- when the government transfers public land to the private market. This is not an unreasonable policy when there is great demand for a limited resource.

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However, there should be no subsequent limitations on the amount of land an individual or entrepreneur may accumulate by purchase in the market. To place such limitations will penalize efficient individuals and entrepreneurs who are able to make the most productive use of the land. This is particularly true in agriculture. Free market principles tend to put resources into the hands that can make most productive use of them.

## Chapter 5

### Article 29

The intention of Chapter 5 is unclear. Presumably, the process described applies only to land over which the state has control at this time, during the first stage of privatization of land relationships. At the subsequent stage of development of the market, it would make little sense, and undermine the workings of the market, to allow citizens or entrepreneurs to submit applications for use of land that was in the ownership or under the control (through lease or otherwise) of other citizens or entrepreneurs. "Withdrawal" of land is not a land allocation mechanism, but rather an extraordinary infringement on property rights.

The procedure described in Chapter 5 should apply only to the initial stage of the privatization of land in government control. Once the initial allocation of a parcel of land has been completed, subsequent allocations should be accomplished through the market, consistent with the town planning laws.

(3) Is the "public opinion poll" referred to in (3) a public hearing? If not a public hearing, what are the standards for the poll? Is the poll advisory only?

With respect to paragraph (5) and all other procedures for the allocation of land, shouldn't the authorities be obligated to (1) establish written regulations setting out the standards by which applications for land use will be evaluated; and (2) describe in a written decision the reasons for their approval or rejection of an application. If the authorities do not establish standards and issue reasoned decisions, how will a court or other reviewing authority have a basis for review under the provisions of Article 30 (3)?

Article 33

(1) In the initial privatization of land title documents should be issued based upon the allocation decision of the authorities. For subsequent transactions title documents should be issued upon the request of the parties to the transaction on the basis of their contract for sale or lease of the land.

(3) Presumably, paragraph (3) means that the form of the contract and certificate will be approved, and not each individual certificate or contract transaction.

Article 34

It should be a condition of any transfer of land ownership or control, either from the state or between any private parties, that the land be surveyed or, if necessary, subdivided officially into a separate parcel and the survey or subdivision map be registered among the land records. Management of the subdivision process is the cornerstone of an effective system of land management. This requirement would be an efficient means of updating the local land records and keeping track of changes.

Further, subdivision should only be permitted in compliance with local regulations setting forth standards for rational land use, particularly with respect to issues such as road access and utilities.

Article 34 is another instance where it is suggested that mere title to the land is sufficient for use, without regard to local town planning or building regulations.

Article 35

Again, the right of appeal is not helpful unless local governments are obligated to provide standards against which they will evaluate applications. Otherwise, you are simply asking appeal tribunals and courts to substitute their own judgement for the judgement of the authorities, which is not appropriate. The role of the appeal tribunal should be to assure that the authorities have acted in accordance with the law and their own established standards of evaluation, which must be fair and reasonable, and have applied the standards reasonably and without discrimination.

Article 38

Under the Law on Privatization of the Housing Stock, residential buildings are transferred to apartment occupants as owners of their individual apartments and joint owners of the common parts of the building. Presumably, paragraph (3) of Article 38 is meant to assure that the land under such buildings be transferred to the apartment owners as jointly owned property.

Article 39

This provision of the law demonstrates as clearly as this that the concept of "ownership" intended in the law differs from the concept in market economies.

This provision states that failure to redevelop land within 2 years of destruction of the structures would result in termination of the right of ownership. This is not true ownership -- it is something less. True ownership of land means that the owner can develop it with structures or other uses, or that he can leave it undeveloped.

As a general principle, the state should have no power to require land owners to develop the land in accordance with the permitted use, but only the power to prohibit development of the land for uses that are not permitted under the planning regulations. Market forces should determine when and how development of the land is to occur.

Market economies generally make use of the power to tax land and real estate as the incentive to use the land efficiently. If land is taxed at its potential productive power, then underutilization will become too costly to the owner. Of course, this concept may not be immediately applicable in Russia, where the real estate tax system is only now developing.

However, a distinction may be made between ownership of the land and state leases. It is not unreasonable for the state, in its leasing transactions, to require that the land be used continuously for specific purposes, in which case a failure to rebuild could result in a termination of the lease. However, this provision of the law should not apply to leases of privately owned property. And, in all leases, even state leases, these types of issues should be left to negotiation of the parties, and not governed by law.

In addition, local administrations should be permitted to change the use of land only in accordance with the established laws and procedures for town planning and land

use decisions, and not, as implied in the final sentence of this Article, simply because a structure is destroyed.

## Chapter 6

### Article 40

Item 3) of paragraph (1) suggests that cessation of the activities of the enterprise or association will result in loss of the land. But what if the enterprise or association holds the land in ownership? If the land is an owned asset of the enterprise or association, it should be subject to sale by the enterprise or association in connection with the termination of its activities and liquidation of its assets, which belong to its owners and shareholders. Or, termination of the activities of an enterprise may be through bankruptcy, in which event the land is included in the assets sold to pay the outstanding charges against the enterprise. This provision needs further thought.

Item 3) of paragraph (1) suggests that use of land contrary to its purpose will result in loss of the land. However, if the land is held in ownership this is an extreme solution to the problem. Violations of land use regulations can be dealt with through fines and financial penalties, or refusal of the right to occupy the property for the prohibited purpose, or even criminal penalties against the owner; confiscation of privately owned land for land use violations is an extreme penalty that conflicts with the rights of private ownership.

Item 6) of paragraph (1) suggests that inefficient use of land will terminate ownership rights. What standards determine whether land is efficiently used? Who makes the determination? This appears to be an invitation to arbitrary official action, and perhaps official misconduct. As long as the use does not violate planning laws, the degree of utilization should be determined by market forces or the negotiated terms of a lease, and not by the law. Again, market economies make use of the real estate tax system to encourage efficient use of land.

Item 8) of paragraph (1) suggests that land can be confiscated for failure to pay land taxes. While this is a widely used procedure for the enforcement of tax laws, the legitimate procedural and economic interests of the owners should be protected. Land confiscated for payment of taxes should be subject to the same legal procedures as

enforcement of a mortgage or other legal judgement against the land, including, for example, an auction process and the right of the owner to any auction proceeds in excess of the amount of outstanding taxes.

Article 42

This Article should distinguish between leases made between private owners and leases made with the state. Cancellation of leases between private parties should be subject to the terms of their lease agreement.

No lease, particularly leases between private parties, should be subject to cancellation because the owner of the land or the leaseholder dies. A lease is a property right and a valuable financial asset that should not be subject to such extreme uncertainties.

If the owner of the land dies, the tenant may remain in place regardless of who succeeds as owner of the land. Similarly, if the leaseholder dies, the lease should be subject to sale, assignment or sublease by the estate in order to collect the value for the leaseholder's beneficiaries. In such circumstances, the lease should be terminated only by the voluntary act of the legal representatives of the estate.

**Chapter 8**

Article 50

Establishing land lease rates "normatively," without regard to market forces could result in inefficient use of the land. Even state owned land should be subject to competitive lease rates to assure that the most profitable use of the land is achieved.

You should keep in mind that there is no prohibition against public land owners the state and municipalities - acting entrepreneurially with respect to the land; governments in the United States do this as a matter of course. They seek the highest return on their leases of public land, even by entering into joint ventures and profit sharing arrangements with the private developers of the land. By doing this they achieve the highest returns to the public budget and also assure the highest and most productive use of the land. This law should free public

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land owners to act creatively and entrepreneurially with respect to land which they control, while acting always in the interests of the public.

## Section II

### Chapter 9

#### Article 56

A distinction should be made between the rights of parties to a private lease and parties to state leases. The rights of parties to a private lease should be subject to the agreement of the parties, including the rights to mortgage or sublease. As a general principle, the rights of parties to all land leases, even leases of state owned land, should be subject to negotiation and agreement of the parties. The law should not specify the rights for all leases in all cases.

For example, the holder of land on a long term lease may need the right to seek a change in the land use through the usual procedures, which is prohibited under this law. Why should he not be able to negotiate this right with the owner of the land? Are the only choices to give up the lease or continue a land use that, while reasonable 25 years ago, is no longer the best use of the land.

Perhaps these provisions of the law should clarify that the lessee does not have the legal rights described under Article 56 (2) (3), but that such rights may be negotiated with the land owner.

All leaseholders and other landholders should be compensated for the loss of the value of their lease in the event of a withdrawal of the property by the state. The lease is a property right and a potentially valuable financial asset; it should not be compared to a simple contract. It is a simple matter to determine the value of a lease to a leaseholder by comparing its rent to market rents for comparable properties.

#### Article 57

Many of the provisions of this article are inconsistent with the concept of land ownership in a market system. Land owners are not required to "use land efficiently;" so long

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as the use does not violate use restrictions, it is within their discretion to determine the intensity of land use, or whether to use it at all, in accordance with the requirements of the market. Direct government involvement in determining the "efficient" use of land could result in inefficient land use decisions unrelated to market needs; the government should instead encourage efficient use of land through use of the real estate tax system.

The obligation to use land under leases should be a matter for negotiation between the lessee and the land owner.

The final paragraph of this article assumes that a landowner has the right to terminate a lease simply by compensating the leaseholder for damages. This is a fundamentally incorrect perception of the lease agreement. A lease is a property right, not a simple contract. Consequently, except for a breach of its terms by the leaseholder, termination of the lease prior to expiration of its term is not permitted and can be prohibited by a court.

## Chapter 10

### Article 59

The restrictions on the right of the government to withdraw land do not go far enough. The government should be permitted to withdraw land from private owners only in the following circumstances:

(1) the land is necessary for an important public purpose; withdrawal should not be permitted for private purposes, such as provision of land to a private enterprise.

(2) suitable land for the public purpose is not otherwise available for purchase in the market.

## Chapter 16

It is unclear whether this chapter is meant as the exclusive provisions of the law dealing with land for residential construction. It does not address the issue of

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land for entrepreneurial development of housing by citizens or corporations, but only cooperative and individual construction. It is my opinion that most new housing will likely be built by housing entrepreneurs.

The second issue under this chapter is that land may be conveyed for apartment construction only in unlimited possession or under lease. Why not ownership? Why is the housing owned by apartment cooperatives or condominiums treated differently than individually owned housing? This appears to contradict the intention of Article 38.

#### Section 14

Why should disputes between private land owners, or disputes relating to private agreements governing the control or use of land (leases, etc.), or relating to title to land, be submitted to the administrations rather than directly to the courts or arbitration tribunals? This question is particularly pertinent when the local administration has an interest in the outcome of the dispute, for example when it is a party to the lease of the land.

Property rights are objectively determinable legal rights, based upon legal agreements (title certificates, leases, etc.) enforceable by the holders in courts of law. They are not merely conditional or revocable privileges subject to political or administrative resolution, unless the interested parties agree to submit the dispute to such resolution.

Even though the law allows decisions of the executive bodies to be appealed to courts, the parties to the disputes should have the right to bring the disputes directly to courts or arbitration tribunals. Alternatively, the executive bodies might be required to establish independent administrative tribunals to hear and decide land disputes.

#### Section 15

##### Article 128

Confiscation or withdrawal of land for violations of the law is too harsh a penalty in most instances. This is particularly true for land held in ownership or under long

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term leases for which compensation has been paid or under which significant investments have been constructed. The better approach would be to impose fines, penalties and contractual damages, or to permit courts to nullify or suspend the prohibited action.

Penalties for violation of private agreements relating to land should be resolved in the courts and should be subject to the terms of the private agreements.

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**EXHIBIT C**

## REAL PROPERTY TAXES: ISSUES OF ENFORCEMENT <sup>1</sup>

Stephen B. Butler  
The Urban Institute

### A. MUNICIPAL LIEN FOR TAXES

(1) What is the lien?

A lien is a right granted to the tax collector by law to make a claim against the taxpayers property for unpaid taxes.

(2) When does the lien arise?

The lien arises at the moment the taxes are assessed against the property and remains in effect until they are paid.

(3) What property does it cover?

The lien covers the real property against which the taxes are assessed; it does not cover any other property of the taxpayer.

(4) What amounts does it cover?

The lien covers the amount of the taxes, interest on late payments, penalties for late payments, and the costs of actions taken to collect the tax.

(5) How does the lien affect other interests in the property?

Because of the state's paramount interest in collecting taxes, the lien has priority over all other liens and encumbrances, including mortgages, whether created before or after the creation of the lien.

(6) Is the lien reflected in a reegistered document?

The lien exists as a matter of law, and generally does not have to be documented in the land records. However, it

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<sup>1</sup> Outline of a seminar presented to the senior staff of the Moscow Tax Inspectorate on April 13, 1993.

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is probably good practice to put notice of unpaid taxes in the land records after a period of time.

(7) How is the lien enforced?

It is enforced by levy and sale of the property to which the lien attaches.

(8) Who has the right to enforce the lien?

The lien may be enforced by the tax collector as the agent of the government.

#### **B. PENALTIES**

Financial penalties for failure to pay taxes when they are due can include an immediate, substantial penalty (approximately 1%-2% of the tax) imposed on the first day that the tax is unpaid.

#### **C. INTEREST**

Interest is charged daily on the amount of the unpaid taxes at a substantial rate. In the USA the penalty interest rate is presently in the range of 18% per annum, compared to an average consumer borrowing rate of 12%-13% per annum.

#### **D. ENFORCEMENT**

(1) By Action

The municipality can go to court to seek to collect the tax and enforce the lien. This is not the usual method; it is too time consuming and inefficient.

(2) Power of Auction Sale

In the US, our real property tax claims are in a manner of speaking not assessed against a person; they are assessed against a piece of property. Consequently, it is immaterial to the taxing authorities who presently owns the property or what rights exist to the property, or whether that person can be located; if the taxes are not paid the property will

be eventually confiscated under the state's right of tax lien.

It is the required practice to send personal notice of the tax to the owner shown in the public records. However, for purposes of enforcement it is immaterial whether an owner actually receives notice of the tax. It is sufficient if prior to taking action to enforce the tax lien a notice of the unpaid tax is posted at the property and published in the press. In effect, it is the obligation of the owners to assure that the ownership records are accurate.

Nor must a person be permitted to appear in an enforcement proceeding, though he can seek to raise a defense in court. It is rather our practice to give adequate rights to protest the amount of the nature and amount of the tax in proceedings prior to commencement of enforcement.

Municipalities generally have the right to sell the property at auction without judicial supervision after following statutory procedures.

The auction sale procedure generally does not result in an immediate transfer of title to the auction purchaser, but rather a conditional transfer of title for a period of redemption set by law. During that period of redemption the taxpayer can redeem his property for the amount paid by the bona fide purchaser, and the bona fide purchaser has a lien on the property for that amount plus interest and costs. Upon expiration of the redemption period the bona fide purchaser can "foreclose" his lien by going to court for confirmation of the auction sale. The redemption period differs by jurisdiction, and can be as long as one year.

The auction sale procedure is generally as follows:

- (a) Demand made to the taxpayer for the unpaid taxes;
- (b) Publication and Notice of the unpaid taxes and the intention to sell the property; notice can be by media, personal and posting.

Personal notice should be given to all parties with a registered interest in the property, particularly mortgagees. It is probably good practice to allow mortgagees to file a notice with the tax records that they should be notified prior to any tax enforcement action.

- (c) First Period of Redemption Prior to Auction;
- (d) Auction Sale
  - (1) Competitive Bids Required
  - (2) The municipality or any other party may bid
  - (3) There may be an official starting price; but this is not the usual American practice
  - (4) Surplus proceeds not needed to pay taxes are paid to the taxpayer
- (e) The auction purchasers certificate of title is delivered to the land registry, but not registered;
- (f) Second Period of Redemption;
- (g) Upon expiration of the Second Period of Redemption the auction purchaser seeks Court confirmation of the sale and registers his certificate of title; all other rights to the property are terminated.

It is not necessary to terminate all prior rights, e.g. mortgages, but it is probably the predominate approach.

(3) Summary Procedure

Summary procedure differs from the auction sale in that the title to the property is taken by the municipality, which later sells or otherwise disposes of the property. (Property acquired by the City of New York by this method has in recent years served as the foundation of a major program of housing rehabilitation to provide housing for people of low income.) This is probably the method preferred by large cities.

Use of this method may be limited in certain jurisdictions to properties in which the value of the property is less than the amount of taxes owed.

The usual procedure would be as follows:

- (a) Municipality files a petition with the court listing the properties on which taxes are unpaid.

(b) The court reviews the petition to assure statutory compliance; this may require appointment of appraisers, etc.

(c) Publication and notice; media, posting, registered mail.

(d) Period of Redemption and to file defenses and challenges

(e) Final Judgement of the court; Certificate of Foreclosure

(f) Acquisition and Disposition by Municipality

**E. GRACE/DEFERRAL**

There might be a procedure for granting deferral of tax obligations in extraordinary circumstances.

This procedure would require definition of the following:

(a) circumstances under which deferral is granted

(b) application process

(d) time limits for application

(d) designation of the decision making body?

**F. APPEALS**

The objective of our real property tax system is to give the taxpayer the opportunity to contest the amount of the tax before it gets to the stage of enforcement. The typical grounds of a challenge is that the property was valued excessively in relation to comparable properties.

Consequently, under our system substantial emphasis is placed on the importance of notice to individual taxpayers of the amount of the tax and the method of calculation.

A second objective of our system is to allow tax appeals to reach the courts only as a last resort. The law of most American jurisdiction requires the taxpayer to "exhaust his administrative remedies" before he can get into court.

Administrative remedies typically consist of a taxpayer's right to demand a series of hearings, including the following:

(a) Informal hearing with the tax office to present evidence and arguments.

(b) Formal hearing with a tax tribunal of the tax office or the municipality at which a record is kept and a formal decision made.

Most US jurisdictions have a tax appeals commission or board. Some states also have tax commissions which hear appeals from local commissions.

(c) If all prior appeals are unsuccessful, the taxpayer may appeal to a court; in many jurisdictions such appeals are heard and disposed of on a priority basis.

Appeals of any sort do not defer the obligation to pay taxes. In practically all jurisdictions the tax, or a very large portion of it, must be paid as a condition of taking the appeal. In fact, pursuing an appeal without paying the tax will not stop the municipality from confiscating the property. Tax appeals are settled by reimbursement of excess taxes to the taxpayer.

The time for appeals should be strictly limited; appeals rights can be forfeited, provided adequate notice was given.

Courts may need the right to assess fines or penalties for frivolous appeals.

In our proceedings, there is usually a legal presumption in favor of the municipality that all necessary administrative steps have been performed, e.g. assessment, notice, demand, etc.; the taxpayer is obligated to show defects in procedures.

**EXHIBIT D**

**MEMORANDUM**

**TO: MRS. KUSNETSOVA**

**CC: MR. MASLOV**

**FROM: MR. BUTLER  
MR. STRUYK  
THE URBAN INSTITUTE**

**RE: ON PROCEDURE OF ACCEPTANCE AND MAINTENANCE  
OF HOUSES SOLD IN DULY AUTHORIZED WAY AT  
AUCTION SALE**

**DATE: APRIL 15, 1993**

Upon first reading the referenced decree, we believed that it represented a generally good approach to privatization of the newly built housing. We still believe the general direction of the decree to be correct, but have heard from you and others that some problems have arisen in the actual implementation. Please allow us to provide you with the following comments at this time.

(1) We at first thought that the purchasers of the newly constructed apartments were to be required to join the housing association as a condition of taking occupancy of the apartment. We based this conclusion on a review of Appendix 2 of the decree.

We understand that at this time occupancy and possession is being given without having obtained the binding contractual agreement of the new owner to join the housing association, and that later attempts to obtain that agreement are being met with some resistance.

Please allow us to express the view that nothing prevents you from requiring new owners to become members in the housing association as a condition of purchasing the apartment. This is a simple matter of contract, and violates known legal rights of which we are aware. Citizens do not have a "right" to purchase the new apartments free of all reasonable requirements as to the form of communal management.

A better approach to this problem would probably be to make membership in the association an explicit provision of the contract of sale of the new units and note the requirement of such membership in the documents of title. In effect, membership in the association and abiding by its rules and procedures becomes a condition of ownership.

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These agreements should be completed before the keys to the unit and documents of title are delivered to the new owners.

(2) To best accomplish the objectives of our point number one, above, the housing association should be established as a legal entity and properly registered prior to the auction sale of any units in the building. The association should be established by the developer and owner of the building (in this case the city), and the initial documents would reflect that they would be modified to reflect the admission of new owners as sales of apartments proceed.

If there is any question about the right of the municipality or its existing departments to establish an association for this purpose, then upon completion of the building it could be transferred on a temporary basis to a new legal entity for the sole purpose of creating the association and selling the units. Such an entity is easily established as a semi-public arm of the municipality. However, at this time we are not aware of any restrictions on the rights of the municipality or its departments to create and register the association.

If there is some question about the ability of a single entity to create and register a housing association, simply transfer one apartment to another department of government and have both departments form an association.

The point is, you should not let narrow legalities interfere with making sense out of this situation.

If the association exists at the time the units are sold, the new owners would be required to actually sign the foundation documents prior to receiving the keys to their units.

(3) Finally, the contract for maintenance of the building during the first several months after the units are sold should be between the housing association and the administrative districts; individual apartment owners should not be permitted to enter into separate contracts with the administrative districts. If the contract is binding on the association, it will be binding on the members of the association as well.

After the initial period of transition -- say, two or three months -- the association should have the right to terminate the contract with the administrative district upon 30 days notice and to hire new management for the building.

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By allowing individual apartment owners to enter into separate contracts with the administrative district, it undermines the entire concept of the housing association.

We believe the foregoing is generally in line with your thinking. Should you wish to discuss these points, Mr. Butler will be here on this trip until April 24.