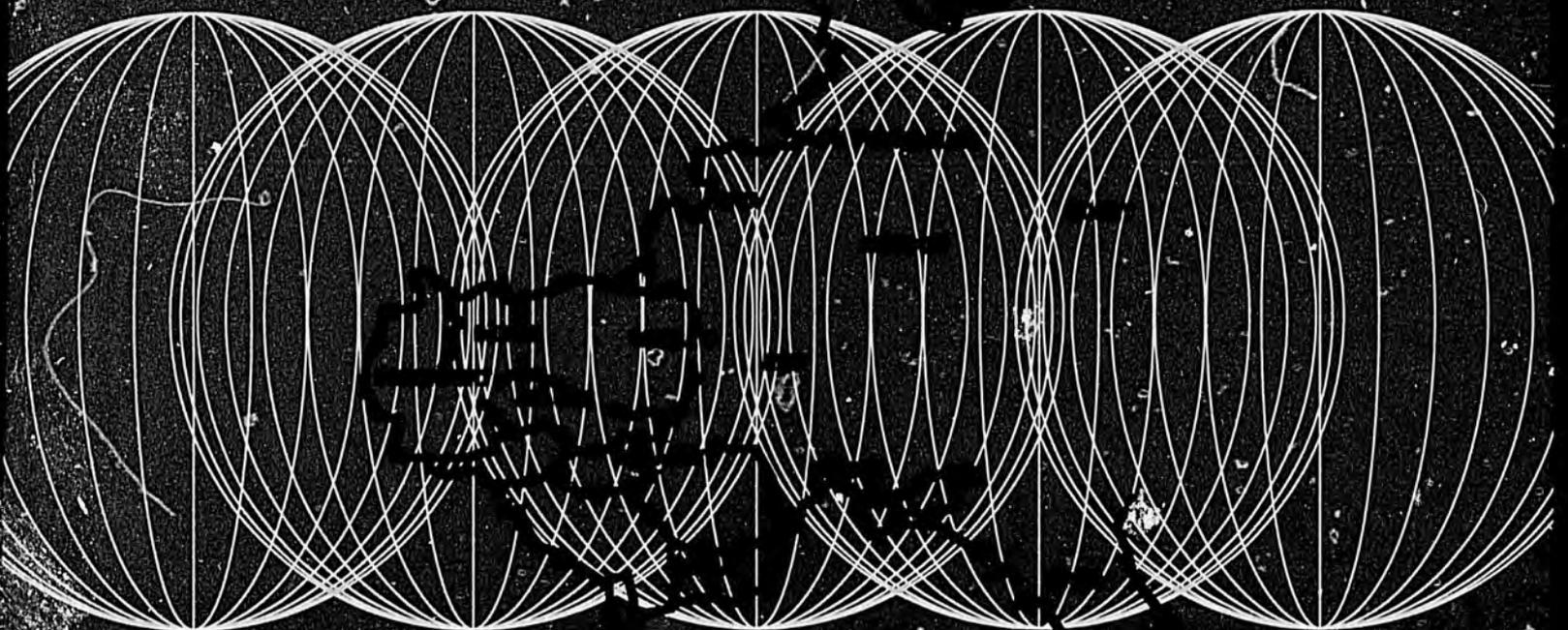


**FROM PLANNING TO MARKETS
HOUSING IN EASTERN EUROPE**



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

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

TRIP REPORT

JANUARY 22, 1993 — FEBRUARY 6, 1993

Prepared by

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ABSTRACT

This report summarizes the activities of Urban Institute consultant Stephen Butler's trip to Russia from January 22, 1993 through February 6, 1993 on behalf of the U.S. Agency for International Development. This trip was one in an ongoing series of trips made by Butler to provide assistance in creating a legal framework for the housing sector in the Russian Federation and City of Moscow. The focus of this trip was on three key areas: housing finance, housing law and condominium law.

In the area of housing finance, this trip Butler completed a series of seminars to Mosbusinessbank on the legal aspects of mortgage loan origination. Butler continues to work closely with government officials to finalize the legal framework for real estate secured lending. Toward this end, Butler has completed a mortgage law study, analyzing the existing Russian law on securing financing and offering suggestions for clarification and modification.

With the December 1992 passage of the Law of the Russian Federation on the Fundamental Principles of Federal Housing Policy significant progress is underway to revise and update Russian housing law. Butler is currently working closely with Gostroi to devise a new Housing Code to complement the new Fundamentals law. Based on Butler's October draft condominium law the City of Moscow has prepared its own draft condominium law. Butler met with Moscow city officials to discuss the draft law and offer suggestions for areas of improvement. In this report, he highlights several potential problem areas in the Russian draft.

This report also contains a list of meetings Butler attended and a work production schedule for the next six week period.

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

**TRIP REPORT
JANUARY 22, 1993 — FEBRUARY 6, 1993**

This report summarizes the activities of Stephen Butler, legal advisor under the U.S. Agency for International Development's Shelter Sector Reform Project, Russian Federation/City of Moscow, before and during a mission to Russia from January 22, 1993 through February 6, 1993. Butler worked closely during the mission with Raymond Struyk, the project's Director and a resident advisor in Moscow, and other local members of the technical assistance team. As before, the purpose of the trip was to provide technical assistance with creating a legal framework for the development of a market-oriented housing sector in the Federation and the City of Moscow. On this trip, the majority of time was spent on issues of housing finance, housing law and privatization and condominium laws.

This report summarizes the issues raised at the various working meetings; the recommendations made to address those issues; and the agenda for further work in the coming months.

A list of working meetings during the trip is included as the last section of this report.

A. HOUSING FINANCE

MOSBUSINESSBANK

The primary purpose of this visit was to provide a series of seminars to MOSBUSINESSBANK (MBB) on the legal aspects of mortgage loan origination. The seminars were conducted over 7 days for an average of 3 hours per day and were attended by the entire staff, legal and underwriting, of the bank's new residential mortgage loan unit. The seminars were based upon materials developed prior to the trip, which are attached as Exhibit A.

The seminars were very well received, with obvious interest and lively exchanges. The objective of the seminars was to review American practice and discuss it in terms of the unique legal and institutional context of Russia today.

The next step in the process is for the MBB staff to develop their own drafts of materials for residential mortgage loans, including due diligence requirements, closing procedures, and basic legal documents such as notes and mortgages. Those documents will be provided in the near future for review and will be discussed and refined on the next trip to Moscow. At the end of the process, the bank should have

a comprehensive legal manual for origination of mortgage loans, supplemented by the further work to be done in mortgage loan underwriting procedures.

It is expected that the bank's work will be ready for review before the next trip planned for April 1993.

Mortgage Law Study

An extensive study of the existing Russian law of secured financing is being prepared, including a discussion of suggestions for clarification and modification. The study will be ready for translation into Russian at the end of February.

Meetings with The Supreme Soviet Institute on Legislation and Civil Law

As part of the program's work on the Russian mortgage law, the technical assistance team met several times with Mr. Makovsky, the head of the Civil Law Division of the Supreme Soviet's Institute on Legislation and Civil Law. The Institute is the main source of legislative drafting for the Supreme Soviet in the area of private civil law, and Mr. Makovsky is the chief advisor on the laws dealing with real estate mortgages.

Following a lengthy discussion of Russian law and the team's recommendations for change, Mr. Makovsky stated that he was in substantial agreement as to the state of the law and the potential areas for improvement.

Mr. Makovsky is presently advising the Supreme Soviet on the pending Law of Mortgage, which will not be simply a codex of the existing Law on Collateral, but will seek to modify all of the perceived errors in the Law on Collateral pertaining to real estate secured lending.

Mr. Makovsky provided a draft of the proposed Law on Mortgage and requested comments; these will be provided at the end of February. In the meantime, Makovsky has a draft of a paper prepared by Butler on the present state of the law and is considering the recommendations carefully.

The timetable for the proposed Mortgage Law is six weeks to two months. This is an opportunity to have a significant impact, and it is important to translate and distribute this study of the existing law as soon as possible.

Seminar on Mortgage Law

During this trip Butler presented a lecture on the Russian Law of Collateral, with a discussion of the current state of the law and recommendations for future changes, to a group of approximately fifty attorneys, bankers and administrators from

Federal and Moscow departments. The seminar was covered by the press and reported in some detail the following day.

Attorneys from the Supreme Soviet Institute on Legislation and Civil Law who attended reported that the lecture was well received and very helpful. They are awaiting the completion of the paper on the existing law, on which the seminar was based.

B. HOUSING ISSUES

Based on the December 24, 1992 Law of the Russian Federation on the Fundamental Principles of Federal Housing Policy, the Housing Division of Gostroi (the State Committee on Construction and Architecture), the successor agency of Minstroi, is starting to prepare the new Federal Housing Code. The Housing Division, and preparation of the new Code, is under the supervision of Mr. Anvar Shamuzafarov, with whom the technical assistance team has had a long and close working relationship.

In a meeting with Mr. Shamuzafarov he asked for an outline structure for the new Housing Code; it was agreed that Butler would prepare such an outline. Mr. Shamuzafarov is anxious to provide an new and fresh structure to housing law, in keeping with the spirit of the new Fundamentals. After discussing the respective views of the contents of the Housing Code, it was agreed that two versions of the outline would be prepared—one to correspond to his views and one that corresponds with those of the legal advisor.

The disagreement on the contents of the proposed Housing Code exists only insofar as Mr. Shamuzafarov wants to address many issues that the technical assistance team believes cannot be addressed without attention to other existing laws. Butler has repeatedly urged that contradictions in laws are beginning to mount, and that the new law should not stake out territory that is already covered in other laws without seeking to modify also the other laws.

An example of this issue is the treatment of land. Mr. Shamuzafarov would like the Housing Code to contain an extensive discussion of land rights and distribution of land for housing purposes. Butler's position has been that the Land Code must also be addressed if conflict and confusion are to be prevented. Mr. Shamuzafarov acknowledges the problem, but believes that he must stake out an aggressive position on land in order to spur action from the more conservative Supreme Soviet committees that deal with land issues. He expects that at some point he will remove the land issues from the Housing Code if he receives assurances from other lawmakers that the issues will be addressed in appropriate amendments to the land laws.

Before leaving Russia, Butler met again with the staff of the Housing Division to discuss the broad issues of the new Code and to establish a timetable and agenda for the work.

The Housing Code will be a major part of the legal assistance program over the coming months. The deadline for preparation of the Code is June 1993, which allows a series of intensive meetings on the technical assistance team's recommendations when Butler returns to Russia in April. It is expected that those meetings will be a major focus of the next trip.

C. CONDOMINIUM LAW

On the basis of the condominium law and materials prepared during Butler's October mission, the Legal Departments of the City of Moscow and the Moscow Department of Communal Services have prepared their own draft of a condominium regulation for the City. The draft retains many of the principles established in Butler's earlier proposal, with a few notable exceptions.

Butler met with attorneys for the Housing privatization Office, the City Corporation Counsel, the Department of Communal Services, and an independent Russian lawyer whom the technical assistance team occasionally uses for outside advice. Butler met also with Mr. Lev Ivanov, the Chairman of the Mossoviet Housing Committee.

A major issue with the City's proposal is that condominium associations are defined as voluntary organizations. Apartment owners can choose not to participate in the association, and make their own arrangements for management and maintenance of the building and apartment. Clearly, this is a recipe for disaster. The city's lawyers acknowledge that under the proposed system there could be several associations formed for one building, or that individual apartment owners can reach separate management agreements with outside organizations, but claim that the law prevents them from taking a stronger approach to requiring unified management structures.

In a series of meetings it became clear that Butler and the City's lawyers disagree in several important respects on how the existing body of law must be interpreted. Although the argument may ultimately prove wrong, in a time of transition, particularly considering the unformed nature of Russian Federal relationships, local jurisdictions must interpret the law to address pressing needs in an aggressive way; they should not throw obstructions in their own path. So far, this argument has received a better response from lawmakers than from lawyers.

A second problem with the proposed regulation is that it retains building common areas and facilities in public ownership. This is basically a legal *non sequitur*. There appears to be a hidden agenda somewhere, probably arising from the desire of the municipal building maintenance organizations to maintain control and jobs. But this agenda is never explicitly mentioned in the discussions, and should perhaps be addressed head on.

Mr. Ivanov, the Chairman of the Mossoviet Housing Committee, is aware of the technical assistance team's views on the law and wholeheartedly supports an aggressive approach to these issues. He does not like the City's draft regulation and feels that much more can be done. The team is providing to him comments on the law.

There apparently is a distinction being made between existing housing and newly developed housing. The latter is not subject to the same legal issues, to the extent they really exist, as the existing housing. It is therefore likely that a more aggressive approach will be taken with respect to newly completed municipal housing. In that regard, Butler reviewed and commented upon a November 1992 regulation of the City government regarding owner's associations in newly completed housing. That regulation provides that owners' associations must be established for such housing and that membership in the associations is mandatory for all new occupants and owners.

Going forward, it appears that the lawmakers in Mossoviet will insist on certain changes to the City's regulation that resolve some of the most obvious issues. It is worth noting that the December 24, 1992 Law on the Fundamentals of Federal Housing Policy addresses the condominium form of ownership. There may be, then, some opportunity to deal further with some of these issues in the Housing Code on which we will be working over the coming months.

Comments on the City's proposed Condominium Regulation and the Regulation Regarding Management and Maintenance of Newly Constructed Housing are attached as Exhibits B and C, respectively.

D. FURTHER WORK

In the near term Butler will be working on the following products:

- (1) Completion of the Study of Russian Law of Secured Lending (approximately the last week of February).
- (2) Comments on the Draft Law of Mortgage (approximately the last week of February)

- (3) Outline of the Housing Code (February/March).
- (4) Review and Comment on MBB materials on the legal procedure for mortgage origination (approximately the last week of March).
- (5) Outline of Existing and Pending Russian Law (approximately the last week of February).
- (6) To the extent time allows, Butler will be conducting some basic research into the laws of land ownership and the administrative process for distributing and reallocating public and enterprise land.

E. LIST OF MEETINGS

(1) *MOSBUSINESSBANK*

Seminars with the entire staff of the mortgage lending unit.

(2) *Gostroi*

Mr. Shamuzafarov, Director of Housing
Mr. Smirnov, Deputy Director of Housing
Mr. Aristoff, Professional Staff Member

(3) *Mossoviet*

Mr. Ivanov, Chairman of the Housing Committee

(4) *City of Moscow*

Mrs. Terokina, Office of Privatization
Department of Communal Services
Corporation Counsel's Office

(5) *Supreme Soviet*

Mr. Makovsky, Chief of Private Commercial Law, Supreme Soviet Institute on Legislation and Civil Law.

(6) *Others*

Oxana Yunina, Institute on Local Government Law

EXHIBITS

Exhibit A

Outline of Material for Discussions on Legal Issues of Residential Mortgage Origination and Documentation

- I. Introduction**
- II. The Loan Application**
- III. The Loan Commitment**
- IV. Disclosure Documents**
- V. The Process of Completing a Loan Transaction**
- VI. Loan Transaction Checklist**
- VII. Promissory Notes**
- VIII. Mortgages**

Exhibit B

Struyk/Butler memorandum of February 2, 1993 to Maslov commenting on City of Moscow condominium law

Exhibit C

Butler memorandum of January 30, 1993 to Struyk regarding Department of Communal Services regulation "On Procedure of Acceptance and Maintenance of Houses Sold in Duly Authorized Way at Auction Sale"

EXHIBIT A

OUTLINE OF MATERIAL FOR DISCUSSIONS ON LEGAL ISSUES OF
RESIDENTIAL MORTGAGE ORIGINATION AND DOCUMENTATION

The Urban Institute/Mosbusinessbank

January, 1992

Prepared by:

Stephen B. Butler

- I. INTRODUCTION
- II. THE LOAN APPLICATION
- III. THE LOAN COMMITMENT
- IV. DISCLOSURE DOCUMENTS
- V. THE PROCESS OF COMPLETING A LOAN TRANSACTION
- VI. LOAN TRANSACTION CHECKLIST
- VII. PROMISSORY NOTES
- VIII. MORTGAGES

SECTION I.

INTRODUCTION

The material that follows is a brief, general introduction to the legal processes and documentation used in single-family residential mortgage loan transactions in the United States.

The material is offered as examples only, and will need to be adapted to reflect Russian law and legal procedures, particularly as embodied in the Civil Code, the Law of Civil Procedure and the recently enacted Mortgage Law.

The documentation focuses specifically on mortgage loans for existing single family residences, either apartments in commonly owned buildings or free standing homes.

Not covered in these materials are legal issues involved with mortgage lending for construction of either single family homes or multifamily buildings developed for rental or sale. It should be noted that mortgage lending for construction frequently entails different concerns and requirements than are covered here.

Also not covered in detail in the following material are the issues that might arise in the course of legal review of a proposed residential mortgage loan. For example, while the following material identifies the need to obtain and review any leases or common ownership agreements affecting the property to be mortgaged, it does not discuss the standards for reviewing such documentation.

The following material attempts to cover the basic legal issues from the perspective of the mortgage lender's attorney in the chronological order in which these issues might arise. Accordingly, the material starts with some comments on the loan application process, moves to a discussion of the loan commitment or contract to make a loan, and ends with the actual process of completing the legal formalities of the loan transaction, a process known in American legal terminology as "closing."

A description of the closing process is provided along with a "checklist" of typical documentation used in residential mortgage transactions in the United States. Finally, examples of actual legal documents, including promissory notes and mortgages, are provided.

The following material may, through a process of revision and modification where necessary to bring it into

conformity with Russian law , serve as the outline for a practice manual to be used by the bank's attorneys in processing residential mortgage loans.

SECTION II.

THE LOAN APPLICATION

The residential mortgage loan transaction begins with the acceptance of a loan request or application from the borrower. The application forms used by most banks calls for the borrower to disclose all information relevant to his financial condition and ability to enter into and repay the mortgage loan, including employment history, income, assets, and debts and other financial obligations.

The actual form and processing of mortgage loan applications is generally not a responsibility of attorneys. However, there are certain aspects of loan applications that may have legal consequences and therefore should receive attention. Generally, the attorney should be concerned with aspects of the transaction that might lead to allegations of fraud or misrepresentation by potential borrowers, or assertions by an applicant that a contractual promise or obligation has been created and broken. Such aspects might include the following:

1. It should be clear to the applicant that the loan application is not a contract or commitment to make a loan, but only to review the potential borrower's eligibility. The bank reserves the right to reject the application in accordance with its own lending standards, unless other standards are required by law.
2. Completion of the requirements of the application is the responsibility of the applicant.
3. If the bank has quoted an interest rate or other loan terms to the potential borrower, and agreed to make the rate and terms available until a specified date, the applicant should be advised that the rate and terms may change if the borrower has not completed his application by the specified date.

If terms and rate are not set at the time of application, the applicant should be aware that the terms of the loan will be set at the time of commitment in accordance with the bank's terms for similar loans at that time.

4. If an application fee is accepted the disposition of that fee should be disclosed. The disclosure should

follow the bank's policy or the policy established by law, if any.

5. The bank has the right to make inquiries based upon the information contained in the loan application, including inquiries of the applicant's employer or requests for confirmation of bank accounts or other financial assets. If the bank transfers the loan to another investor or lender, it has the right to disclose to such investor or lender the information contained in the application.

6. The bank has the right to request additional information from the potential borrower beyond the information requested in the application form.

7. The bank is relying on the information provided by the potential borrower. If at any time it is discovered that the information is false or fraudulent, the bank will have the right to cancel any loan commitment or terminate any loan, and the borrower would be liable to the bank for any damages caused by the bank's reliance on the information contained in the loan application.

8. The loan transaction involves matters of a legal nature and the applicant is free to retain an attorney of his own choosing.

Examples

The best way to deal with these legal issues is to include appropriate disclosures in all application documents or in a separate disclosure document signed by the applicant at the time the application is made.

Examples of the types of disclosures that might be made include the following:

General Acknowledgement

The applicant specifically acknowledges and agrees that: (1) the loan requested will be secured by a mortgage on the property described in this application; (2) all statements made in this application are made for the purpose of obtaining the loan indicated in the application; (3) verification or reverification of any information contained in the application may be made at any time by the bank, its agents, successors or assignees from any source named in this application, and the original of this application will

be retained by the bank even if the loan is not approved; (4) the bank, its agents, successors and assignees will rely on the information contained in this application and the applicant has the continuing obligation, up until the time the loan is made, to modify or supplement the information provided in the application if any of the material facts represented should change; (5) if the loan is made, ownership or management of the loan may be transferred at any time by the bank without notice to the applicant, and the bank may disclose any information contained in this application to any transferee of the loan; (6) by accepting the application the bank makes no representation to the applicant regarding the property, its condition or value.

Certification

The applicant certifies that the information provided in this application is true and correct as of the date of this application and understands that any intentional or negligent misrepresentation of the information contained in this application could result in civil liability for monetary damages to the bank, its agents, successors and assignees, insurers and any other person who may suffer any financial loss due to reliance upon any misrepresentation made in this application.

Nature of the Application

This application is not an agreement to make or to accept a loan. The bank may reject the application on the basis of its own lending standards, subject to the requirements of the law, if any. The applicant may withdraw this application at any time and, if the application is approved by the bank, decline, without penalty, to take the requested loan.

The bank's approval of the loan will be evidenced by its issuance to applicant of a commitment to make a loan. A binding agreement to make and to accept a loan will not exist until such commitment is signed by the applicant and delivered to the bank in accordance with the instructions set out in the commitment.

Completion of Application

It is the applicant's obligation to provide to the bank all information requested by the application. The bank will not begin to process the application until all necessary information has been provided by the applicant.

Expiration of Terms

If any terms or conditions of the requested loan have been represented by the bank to be fixed at the time of application, such terms or conditions will be subject to change in the event that the applicant has not completed its application and signed a commitment with the bank within [] days from the date of this application.

If the rate and terms of the requested loan have not been set as of the date of this application, such rate and terms will be set on the date of the commitment in accordance with the bank's rate and terms for similar loans at that time.

Additional Information

In the course of its investigation of the information contained in the application the bank may request additional information or documents to be provided by the applicant.

Application Fee

The application fee paid by borrower to the bank in connection with this application will be retained by the bank even if the application is rejected by the bank because of borrower's failure to meet the bank's credit standards. By accepting the application fee the bank has made no representation to the applicant regarding the likelihood of the application being approved.

Representations of Bank Employees

The bank's employees are not authorized to make any oral statements, representations or promises with regard to the loan for which applicant has applied, and applicant may not rely on any such statements, representations or promises not in writing.

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Legal Representation

The loan transaction involves matters of a legal nature. The interests of the bank and the applicant may not be the same. The applicant is free to retain an attorney of his own choice, at his own expense. Notwithstanding that the applicant may retain his own attorney, the bank's attorney will provide all legal work for the loan transaction, including the preparation of documents. The bank may retain for this work an attorney who is not an employee of the bank, in which event the applicant would be responsible to reimburse the bank for the amount of the fees charged by such attorney.

Costs of the Transaction

The applicant will be responsible for all costs of the loan transaction. The bank has given to the applicant a statement of the potential costs of the transaction, but such statement is only an estimate made by the bank in good faith and does not necessarily include all of the costs the applicant may be required to pay. The statement does not include any amounts the applicant may be required to pay to the seller of the property or to any other person pursuant to an agreement with the seller of the property.

18.

SECTION III.

THE LOAN COMMITMENT

The loan application generally is processed and approved by financial professionals, not attorneys. The bank's attorneys may become involved in processing the application from time to time when specific legal issues, such as matters affecting ownership of the property, arise. Upon the approval of the application the loan file may be turned over to the attorney for preparation of a loan commitment.

Unlike the application, the loan commitment is a binding contract to make a loan between the bank and the applicant. Its legal implication is that either party may require the other to complete the loan transaction. In practice, at least in the United States, courts will not force an individual to take a loan. They will, however, usually allow the forfeiture to the bank of all fees and deposits made by the borrower to the bank upon acceptance of the loan commitment.

It is more common for a court to require a bank to make the promised loan. Alternatively, a court may require the bank to pay to the borrower any financial damages incurred by the borrower because of the bank's default. Such damages might include, for example, the difference in the borrower's payments under the committed loan and any other loan the borrower is forced to take because of the bank's default.

Why are commitments issued? Usually, upon approval of an application, there is a delay of some time before the transaction is completed and funds made available to the borrower. Issuance of the commitment provides the borrower with greater certainty regarding the timing, risk and costs of his own contemplated transaction, for example the purchase of an apartment.

The bank, on the other hand, must plan its allocation of funds and undertake a substantial amount of work to complete the approved loan, and would not want to do either without some expression of commitment from the borrower. Usually the commitment is accompanied by a fee that would cover the bank's costs in the event the borrower failed to complete the transaction.

What are the legal concerns in issuing a commitment? They are the same concerns as in any proposed contract, including the following:

1. The relevant financial terms of the loan should be clearly described. The attorney should consult with the financial professionals in the bank to be certain that the commitment reflects the loan to be made.

2. All other requirements that the bank will impose on the borrower as a condition of making the loan must be described. Frequently such requirements will arise in the course of processing the application, as more information becomes available to the bank. These requirements may be minor and likely to be met, so may be included in the commitment as conditions of completing the loan.

3. There should be a time limit for acceptance of the commitment and, following acceptance, for completion of the loan transaction. The borrower should understand that he is responsible for meeting all terms and conditions of the commitment by the stated expiration date. Commitments should be extended only by a written agreement of extension provided by the bank.

4. The commitment should make clear to the borrower that actual completion of the transaction will depend upon a final review of ownership of the property and execution of legal documents approved by the bank and its attorneys.

An example of a loan commitment that might be used in lending practice in the United States is attached.

Section III

LOAN COMMITMENT

Additional Terms and Conditions²

[INSERT ADDITIONAL TERMS AND CONDITIONS]

Expiration or Extension

This commitment will expire on _____. If, for any reason, the completion of your loan transaction ("closing") does not occur by that date, the obligation of [Bank] in this commitment will terminate and cease to have any legal force or effect. Any extension of this commitment will be within the sole discretion of [Bank] and must be in writing.

If this commitment is to be extended, [Bank] will have the right to change any of the terms and conditions of the loan specified in this commitment, including the interest rate.

Accuracy of Application

This offer and agreement are made in reliance on the accuracy and completeness of all information submitted in your loan application. Verification of the accuracy and completeness of all such information is a precondition to any obligation on the part of [Bank] to make this loan.

Funds for Closing.

At the time of closing of the loan, you must be prepared to provide sufficient funds to pay for the following: all amounts due under your purchase contract with the seller of the Property, including the balance of the purchase price, if any, as well as any adjustments with the Property seller for taxes and like charges and assessments against the Property; the [Bank's] legal fees and other costs of closing; and the amounts of any funds for taxes, property or mortgage insurance, if any, required to be paid or obtained by you under the terms of this commitment. For the estimated amounts of these fees and expenses, you are referred to the good faith estimates provided to you by the

² Additional terms and conditions should include any outstanding requirements and obligations of the borrower such as the obligation to deliver required documents, the obligation to provide mortgage insurance or the obligation to satisfy and remove prior claims, liens or encumbrances on the Property.

[Bank]. The funds you provide must be in the form specified by [Bank].

Your Responsibility for Costs

If the closing of this loan fails to occur, you agree to be responsible for all legal costs and other expenses of [Bank] incurred in processing this loan. For the estimated amount of these costs you should refer to the good faith estimate of costs provided to you by [Bank]. You will not be responsible for these costs if the failure to achieve closing of the loan is due to [Bank's] failure to comply with its agreements as set forth in this commitment.

Insurance and Taxes

Unless [Bank] gives you a written waiver of this requirement, you will be required to pay prior to closing (1) the first year's premium for the insurance policy covering the Property, and (2) the amount of property taxes next due with respect to the Property. You will be required to provide at closing a copy of your property insurance policy and evidence satisfactory to [Bank] that insurance premiums and property taxes have been paid in accordance with the requirements of this commitment.

Starting with your first payment date under the loan, [Bank] may require you to make monthly payments to [Bank] in an amount equal to one-twelfth (1/12) of the estimated cost of annual insurance premiums and property taxes for the Property, and [Bank] will pay premiums and taxes to the appropriate parties from the amounts so deposited by you.

If the mortgage loan is for an apartment in a commonly owned building, you will be required to provide a copy of the building insurance policy and a statement from the owner's association or insurer that insurance premiums have been paid through the date of the closing.

Evidence of Ownership

Before the closing of this loan, [Bank] or its attorney will examine the status of ownership of the Property. [Bank] will have no obligation to close the loan unless, in the opinion of [Bank] and its attorney, you have good record ownership of the Property. This means that your ownership, with the exception of the mortgage to be placed on the Property under this commitment, must be free of all claims, liens, encumbrances that are or may become superior to the claim of [Bank] under the mortgage,

2/2

and other defects in ownership rights that would, in the opinion of [Bank] and its attorney, make the Property an imprudent investment.

Other Financing

Without the prior approval of [Bank], which approval may be withheld by [Bank] in its sole discretion, you may not use other financing in addition to the loan from [Bank] to purchase the Property.

Due on Sale

This loan is personal to you, the borrower, and the obligations under the loan may not be assumed by another party without [Bank's] written consent. If you sell or otherwise transfer the Property without such consent, [Bank] has the right to declare the entire outstanding balance of the loan and other charges immediately due and payable.

Legal Documents

At closing you will sign and deliver to [Bank] such legal documents as [Bank] and its attorney consider necessary to protect the interests of [Bank] in this loan transaction. The loan shall be evidenced by a promissory note secured by a mortgage on the Property. The note, mortgage and other legal documents pertaining to the loan shall contain such terms and conditions, not inconsistent with this commitment or applicable law, as are acceptable to [Bank] and its attorney.

Mortgage Insurance

(Insert requirement for mortgage insurance, if any.)

Title Insurance

(Insert requirement for title insurance, if any.)

Cancellation of Commitment

[Bank] reserves the right to cancel this commitment if, prior to closing of the loan, (1) there is an adverse change in your financial status from that reflected in the loan application, (2) there is a material adverse change to the condition of the Property, (3) proceedings are commenced by any governmental authority to take the Property, or (4) the Property is subject to any violation of law.

2/3

Schedule of Closing.

Upon your acceptance of this commitment, please contact the [Bank] at the following telephone number: _____, to make the necessary appointment for closing of the loan.

[Bank] requires that any additional requirements to your loan approval set out in this commitment be met prior to scheduling a closing of your loan, therefore your prompt attention to these requirements will assure you of the earliest possible closing date. A closing will not be scheduled until the [Bank] has completed all of the necessary legal documentation.

Acceptance of this Commitment

[Bank's] obligations under this commitment will become null and void unless you have delivered to us a signed copy of this commitment along with the required commitment fee within [] days of the date of this letter.

Very Truly Yours

[Bank]

Authorized Officer

AGREED AND ACCEPTED

Borrower

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Section III

COMMITMENT EXTENSION

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Section III

COMMITMENT EXTENSION LETTER

[Date]

[Borrower's Name and Address]

Subject: Mortgage loan
for property located at
_____.

Dear []:

[Bank] hereby agrees to extend our commitment dated
_____ to _____, as
requested.

All other terms and conditions of the commitment remain
in full force and effect.

[Bank]

Authorized Officer

SECTION IV.

DISCLOSURE DOCUMENTS

Disclosure is a general term for all written information provided to the prospective borrower at the time he applies for the loan and up until the time of closing. It may include descriptions of the borrower's legal rights and obligations during the application process and after the commitment is issued, as well as detailed descriptions of the terms of the loan for which the borrower is applying.

Disclosure requirements in residential mortgage loan transactions can be imposed as a matter of law, as they are in the United States, or they can be a matter of the bank acting in its own interests in the absence of relevant law. Russia does not presently have laws governing the type and amount of information to be provided to mortgage loan applicants. However, it is still in the bank's interests to devise and put into effect its own program of mortgage loan disclosure.

Why is it in the bank's interest to educate its borrowers as thoroughly as possible? First, the mortgage loan is a new product in Russia, and appropriate disclosure may be helpful simply in selling the product.

Second, Russian contract law does allow the nullification of contracts for fraud, misrepresentation, and false pretenses. In complex financial transactions such as mortgage loans, which generally involve normal working people and not sophisticated businessmen, the possibility of allegations of fraud or misrepresentation on the part of the bank is lessened by a program of adequate written disclosure to prospective borrowers.

Third, the Civil Code and recent proposals concerning Russian mortgage law suggest that the court in which a mortgage must be enforced has the authority to restructure or defer enforcement of a mortgage loan under certain circumstances. It is generally in the nature of courts to use their powers on behalf of persons whom they thought were poorly advised or even manipulated by more sophisticated business organizations. Evidence of an appropriate disclosure program could help avoid the appearance of unfair dealing.

Fourth, a program of adequate written disclosure protects to a certain extent against non-authorized representations or promises made by bank employees in the course of originating mortgage loans.

Fifth, in the absence of governing law at this time, absolutely open dealing may serve to distinguish responsible, professional lenders from those that do not adhere to such high standards.

Sixth, adequate disclosure will perhaps serve to decrease the amount of time and trouble in the servicing phase of the loan.

Finally, it can perhaps be anticipated that at some point Russia will enact law governing the information disclosure aspects of mortgage loans, and to implement a program from the beginning may both influence the direction of the law and ease the transition if such a law is passed.

The process of disclosure should assume that the bank's prospective borrower's are totally uninformed about the legal and financial aspects of the requested mortgage loan and must be educated with the material provided by the bank. At this time, no concept is too basic to be overlooked.

The main areas of disclosure are (1) a description of the loan process and the rights and obligations that may arise, (2) a description of the costs to the borrower for issuance of the loan, and (3) a description of the borrowers continuing rights and obligations once the loan transaction has been completed.

The description of the loan process and the rights and obligations of the parties pending completion of the loan transaction was covered to some extent under Sections II and III, dealing with the application process and the loan commitment. Disclosure of important financial and legal terms should be an integral part of the application process and issuance of a commitment.

Attached are some additional examples of disclosure documents, including an estimate of costs to the borrower and a description of a typical adjustable rate loan.

The point at which disclosure is provided to the borrower should be as early in the process as possible, preferably at the time of or shortly after application, but in no event later than issuance of a loan commitment.

It does no harm to reinforce disclosure at various points in the loan process by including disclosure material with commitment agreements or among the final loan closing documentation. It is good practice to have potential borrowers sign or otherwise acknowledge receipt of copies of disclosure documents for the bank's files.

Section IV

DISCLOSURE OF LOAN TERMS

DISCLOSURE OF LOAN TERMS

This document will give you some important information about your loan. Features of the adjustable interest rate mortgage you are applying for are summarized below. Please read this information carefully and question any items that are unclear to you.

Adjustable Rate

You are applying for an adjustable interest rate mortgage loan ("ARM"). The interest rate and monthly payment on this loan are subject to change at the end of every [] full calendar months.

Index

Interest rate adjustments on your ARM are tied to an index that changes periodically. This index is []. The index is published every [] in [] or may otherwise be obtained by you as follows: [].

Margin

As used in these document the margin is the number of percentage points added to the index rate to obtain the interest rate. For example, a margin of 2.50% added to an index of 10.00% will yield a 12.50% interest rate. Your margin will be fixed for the entire term of your loan at the percentage stated in addendum A to this document.

Initial Interest Rate

Your initial rate of interest will be set no sooner than [] days prior to day on which you complete the loan transaction ("closing") in accordance with the terms of a commitment issued to you by [Bank]. The rate stated on addendum A to this document is the current rate, and your rate may be different at the time of closing. Should your rate change prior to the closing, you will be notified by us.

The initial rate [does] [does not] reflect the margin plus the current index. The initial rate will remain unchanged for the first [] months following your closing. When this period expires, your new interest rate will be fixed by adding the margin to the index rate then in effect.

Interest Rate Adjustments

The initial interest rate on your ARM will be adjusted according to movements of the index rate on the first day of the month after the [] month following your closing, and on that same day every [] months. Your new interest rate will be set by adding the margin to the most recent index rate available [] days before the change in your loan rate becomes effective. This amount will be rounded to the nearest one-eighth of one percent (.125%).

The effect of rate increases is shown in the chart provided at the end of this document. The chart shows the effect of rising, falling and stable index rates on the loan interest rate and the monthly payment on the ARM.

Interest Rate Maximums

The interest rate changes on your ARM will be limited as to increases and decreases. The rate will not increase by more than 2.5% at any adjustment date, and not by more than 5% over the entire term of the loan.

Borrower Notification

You will be sent a written notice 30 to 45 days before your interest rate adjustment takes effect. The notice will tell you your new interest rate, its effective date, the remaining principal amount of your loan, and the new amount of your monthly payment.

Initial Monthly Payment

Your initial required monthly payment is specified in addendum A to this document. This monthly payment amount is the monthly payment amount necessary to pay the full loan, principal and interest, in equal monthly payments over its term.

Monthly Payment Changes

Your monthly payment will be adjusted when and if your interest rate is adjusted. The new monthly payment will be that payment necessary to repay the entire loan, principal and interest, in equal monthly payments over the term of the loan at the new interest rate.

Prepayment

There is no financial penalty for prepayment of this loan.

Property Taxes; Property and Mortgage Insurance

In addition to the monthly payment of principal and interest, we will require you to include in your monthly payment an amount equal to 1/12 of (1) your annual real property taxes, (2) the annual premium on your loan insurance (if required and available), and (3) your annual premiums on property insurance. We will pay the amounts so paid by you directly to the proper entity. If you do not pay these amounts, then we will have the right to demand that you immediately repay your remaining loan balance. If this balance is not paid we will have the right to make a claim against your home in a court of law or other tribunal and sell your property at public auction.

Assumability

This mortgage loan may not be assumed by a purchaser of your home without the express written consent of the [Bank]. If you sell your home without first paying the entire balance of amounts due under our mortgage loan we will have the right to demand immediate payment of your remaining loan balance. If this amount is not paid we will have the right to make a claim against your home in a court of law or other tribunal and sell your home at public auction.

Rights of the Bank

The loan will be secured by a mortgage on the applicant's property. At closing the applicant will sign a promissory note in the amount of the loan and a mortgage which will be registered against the property in the appropriate public registry. The legal documents to be signed by the applicant will contain many provisions dealing with the rights and obligations of the borrower and the lender, and the applicant will be required to closely review those provisions before closing of the loan.

Most significantly, the mortgage documents will identify certain actions or failures to act on the part of the borrower that could result in the lender demanding immediate repayment of the entire outstanding loan amount. Further, if that amount is not repaid on demand, the lender will have the right to make a claim against the mortgaged property in a court of law or other tribunal and to sell the mortgaged property at public auction, or to exercise such

other rights as the law and the applicable mortgage documents give to the lender.

Example

The following chart shows the effect of rising, falling and stable index rates on the loan interest rate and monthly payment. This example uses an ARM in the amount of [] made for a term of [] years with an initial interest rate of [] adjustable every []. The loan margin is []. The loan has a [%] adjustment limit and a [%] limit on total increases over the life of the loan.

A. Rising Index

| <u>Year</u> | <u>Index rate</u> | <u>Interest rate</u> | <u>Payment</u> |
|---------------|-------------------|----------------------|----------------|
| [INSERT DATA] | | | |

b. Falling Index

| <u>Year</u> | <u>Index rate</u> | <u>Interest rate</u> | <u>Payment</u> |
|---------------|-------------------|----------------------|----------------|
| [INSERT DATA] | | | |

C. Stable Index

| <u>Year</u> | <u>Index rate</u> | <u>Interest rate</u> | <u>Payment</u> |
|---------------|-------------------|----------------------|----------------|
| [INSERT DATA] | | | |

Applicant's Acknowledgement

I/we understand that this information is made available on behalf of [Bank] for the applicant(s). This disclosure statement is not an agreement to make a loan to applicant(s), but only a description of the type of loan for which applicant(s) have applied. I/we further acknowledge receipt and understanding of a copy of this information.

Borrower

Borrower

Date: _____

Date: _____

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Section IV

ESTIMATE OF COSTS

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Section IV

ESTIMATE OF BORROWER'S COSTS

This form does not cover all items you may be required to pay for in cash prior to completion of your loan transaction. The following amounts are only estimates based upon the amount of the loan you have requested and the prevailing rates and prices for the items listed below on the date of this estimate. Such rates and prices may change between this date and the date of closing your loan.

| | |
|-----------------------------|-------|
| Application Fee | _____ |
| Loan Commitment Fee | _____ |
| Loan Discount Points | _____ |
| Mortgage Registration Tax | _____ |
| Bank's Legal Fees | _____ |
| Prepaid Loan Interest | _____ |
| Mortgage Insurance Premium* | _____ |
| Property Insurance Premium* | _____ |
| Property Taxes** | _____ |
| Property Transfer Tax | _____ |
| Deed Registration Tax | _____ |
| Property Survey | _____ |
| Appraisal Fee | _____ |

* First year premium
 ** Amount next due

This estimate is not a commitment of any kind by the Bank and it is intended solely to advise the applicant of the potential costs to the applicant in the event that the loan application is approved.

I/We hereby acknowledge receipt of this estimate of costs:

Borrower

Borrower

SECTION V.

CLOSING THE LOAN

Once the loan is approved and the file delivered to the attorney, what process follows?

In the United States, at least, the completion of the loan transaction ("closing") usually is the responsibility of attorneys or specialized insurance companies that insure the bank's interest in the mortgaged property ("title insurers"). The attorney's role is to organize and coordinate the closing, as well as to assure that the client's interests are protected.

Any party to the transaction, including the borrower, seller of a property or bank, can be represented by an attorney in the closing transaction, as discussed further below. However, for purposes of this discussion it is assumed that the bank's attorney will be primarily responsible.

The responsibilities of the bank's attorney include the following:

1. Upon receipt of the file, prepare the commitment, or review a commitment prepared by the bank's loan officers.
2. Investigate and analyze legal matters that may affect ownership of the property and the ability of the bank to take a valid, enforceable and superior mortgage interest in the property. Such legal matters are discussed further in Section VI, but for example may include: proper issuance of the borrower's certificate of title; the existence and terms of any common ownership documents or leases affecting the property; or the existence of any claims for unpaid taxes or judgements.
3. Review and prepare the basic legal documents of the transaction to assure conformity with the requirements of law and the terms of the agreement between the bank and borrower. The usual documentation may have to be modified, or new documentation introduced, in response to any unusual features of the transaction uncovered in the course of the attorney's review.
4. Determine, by obtaining appropriate information and representations from the borrower, that no adverse

changes have occurred or are threatened to the property or the borrower's financial condition.

5. Once all conditions of the loan have been met, supervise the proper execution of the documentation by the parties and the proper registration of all appropriate documents in the public registries.

6. Supervise the transfer of funds among the parties to the closing, and prepare a financial accounting of the flow of funds at closing. This role may occasionally be assumed by a bank loan officer, but it is generally advisable for the attorney to review and be familiar with the financial aspects of the loan transaction.

Parties to the Closing.

The usual parties to a loan closing may include the lending bank, the borrower, the seller of the property in a purchase financing transaction, and the holder of an existing mortgage on the property, if any. Each party may be represented by an attorney if they choose. In Russia, it may also be necessary to have a notary present at the closing, a matter discussed further below.

As property markets develop further, other parties may attend closings, most particularly the representatives of title insurers if, as in the United States, they play a significant role in the closing transaction.

Types of Closing Transactions.

In Russia, for the time being, it is likely that closing transactions will fall into one of the following four categories:

1. **Simple Financing.** In this transaction the borrower is already the owner of the property and there is no existing mortgage. The borrower is placing a mortgage on the property to raise funds for personal use. Since there is no property seller or existing mortgage holder, the attorney need not be concerned with the legal transfer of the property from the seller to the borrower or the termination of the existing mortgage on the property.

2. **Simple Refinancing.** In this transaction the borrower already owns the property but there is an existing mortgage. For example, the borrower wants to

increase the amount of his mortgage loan or obtain better terms from another lender. In this transaction the attorney must arrange to have the existing mortgage paid from the proceeds of the loan and appropriate documents of termination registered with respect to the existing mortgage.

3. **Sale of Property Without Existing Mortgage.** In this transaction the owner of a residence is selling it to the bank's borrower. The bank's attorney must investigate the seller's ownership rights and assure that they are properly transferred to the borrower. The attorney will also be responsible for assuring that the seller of the property is paid his price directly from the proceeds of the mortgage loan.

As a general matter, the bank's attorney will not be involved in the contractual relationship between the seller and the bank's borrower, except to pay funds to the seller at the direction of the borrower.

4. **Sale of Property With Existing Mortgage.** In this transaction the bank's attorney must not only assure that the property is properly transferred to the borrower, but also that the seller's existing mortgage is paid from loan proceeds and properly terminated before the bank's mortgage is registered.

The Basic Issue.

The main problem of closings can perhaps be summarized as follows: each of the parties has something the others need, but no one wants to hand it over until they have money in hand or are assured that their interests are protected.

The bank does not want to disburse its loan proceeds to the borrower until it has been to the public registry and assured itself that no adverse interests have been filed against the property that are superior to the interest of the bank's mortgage. This must be done at the time of registration of the bank's mortgage or shortly before.

The seller does not want to deliver a document of transfer of the property until he is assured of having his purchase price.

The existing mortgagee does not want to deliver a termination of its mortgage until it is assured of repayment.

The borrower does not want to deliver a signed promissory note to the bank until it has the loan proceeds.

In light of these conflicting interests, the actual registration of the legal documents and disbursement of funds becomes the crucial organizing principle of the closing.

Attorney as Fiduciary.

In the United States and elsewhere, the problem of conflicting interests is solved in one of two ways. In certain jurisdictions, attorneys are deemed to be fiduciaries with respect to the transaction. They maintain segregated bank accounts in which all funds for a closing are deposited and from which funds are disbursed upon satisfactory completion of the transaction (registration).

In common practice, an attorney may be the fiduciary for a transaction even though he represents one of the parties to the transaction. The attorney's behavior is regulated by professional ethics and possible challenges to his license to practice law. (It should be noted that in the United States the bank's attorneys conducting closings are most often independent, and not employees of the bank.)

In most mortgage lending transactions, the bank's attorney is the responsible party, even though other parties may be represented by their own attorneys. In such cases, the parties to the transaction deposit their documents and funds with the bank's attorney, and they hold him/her responsible to assure that the transaction proceeds according to agreement.

The most likely disruption of a closing is that upon attempting to register the documents, the attorney discovers that other interests adverse to the interests of one or more of the parties have been registered before the closing occurred. In such cases the attorney would either terminate the transaction by returning the documents to the parties or seek further instructions from the parties. The likelihood of even this occurring is greatly reduced by appropriate review and analysis of the record well before closing and perhaps again shortly before closing.

The second way the issue is handled in the United States is to use the title insurer as the fiduciary for the transaction. Since the title insurer is insuring the proper registration and enforceability of the bank's mortgage, it assumes the responsibility to properly register the other

crucial documents, including documents of transfer and mortgage termination.

Funds are deposited with the title insurance company and the insurance company assures that they are paid to the property seller or the existing mortgagee. The insurance company will also assure that all property transfer and mortgage registration taxes are paid.

In some jurisdictions the title insurer will issue its insurance policy at the closing itself, and the bank will disburse funds immediately on the basis of this assurance. The title insurer takes the risk that no adverse interests have been registered since its last investigation. Generally, it will search the records the morning of the closing.

In other jurisdictions the company will simply take possession of documents and funds and not register or disburse funds until the state of the record has been confirmed.

State Notary.

There are presently no title insurance companies in Russia. Therefore, it is likely that the organizational and fiduciary role at closings will be assumed by the bank's attorneys.

An interesting question is whether the State Notary system may be involved in closings as the fiduciary party. The law requires that property mortgages be in notarial form, so there is the likelihood that a Notary will be present at some point during a loan closing. Also, the role is similar to functions presently preformed by Notaries. A possible scenario would be that funds would be deposited with a Notary while the bank's attorney, because of expertise, continued to supervise document registration. The Notary would disburse funds upon notification from the bank that the registration has been successfully completed.

An issue that may arise is the apparent shortage of State Notaries in Russia today. One way to deal with this may be to designate licensed attorneys as Notaries for the purpose of notarizing mortgage loans.

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Likely Scenario.

Assuming that the bank's attorney will be the responsible party for the closing, the responsibilities are clear and are discussed further above and in Section VI and VII. The attorney will:

1. Arrange for the closing, probably in the bank's offices.

2. Arrange for the delivery of necessary documents from other parties, including documents of transfer or mortgage termination, to the closing, preferably in advance of closing to assure time for review. Documents may be subject to a form of escrow agreement among the parties, an example of which is provided in Section VI.

3. At closing, see that all remaining documents are signed and delivered.

4. Assure that all parties are in agreement as to the financial terms of the transaction and that the flow of funds upon completion is clear to all. In this matter the attorney may be aided by a loan officer.

5. Supervise the proper registration of appropriate documents.

6. Supervise the distribution of funds to appropriate parties. Again, this may be accomplished with the participation of a loan officer of the bank.

SECTION VI
RESIDENTIAL MORTGAGE LOAN
TRANSACTION CHECKLIST

1. Commitment Letter
2. Commitment Extensions
3. Disclosure Documents
4. Documents Relating to Ownership ("Title")
 - (a) Contract of Sale
 - (b) Borrower's Certificate of Ownership
 - (c) Seller's Certificate of Ownership
 - (d) Proposed Document of Transfer ("Deed")
 - (e) Land Lease
 - (f) Other Property Lease
 - (g) Tenant Lease
 - (h) Testamentary Documents
 - (1) Will
 - (2) Executor's or Court Certificate of Ownership
 - (i) Title Report
 - (j) Copies of Public Records
 - (k) Borrower's Title Affidavit
 - (l) Property Survey/Map/Legal Description
 - (m) Evidence of Permitted Use
 - (n) First Mortgage Documents (if a second mortgage loan)
 - (o) Termination of First Mortgage (if a refinancing)

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Section VI

5. Insurance
 - (a) Property Insurance
 - (b) Mortgagee Endorsement to Property Insurance
 - (c) Title Insurance
 - (d) Mortgage (Credit) Insurance

6. Borrower's Affidavit

7. Taxes
 - (a) Evidence of Payment and Amount of Real Estate Taxes
 - (b) Evidence of Payment of Income Taxes
 - (c) Calculation of Amount of Property Transfer Tax; Tax Documents
 - (d) Calculation of Amount of Mortgage Registration Tax; Tax Documents

8. Common Ownership Documents
 - (a) Condominium or Other Declaration of Common Ownership
 - (b) Owner's Association Charter
 - (c) Owner's Association By-Laws
 - (d) Association Financial Statement
 - (e) Association Letter Regarding Charges

9. Borrower's Corporation Documents (if not a natural person)
 - (a) Charter
 - (b) Bylaws
 - (c) Director's Resolution Regarding Loan
 - (d) Partnership or Joint Venture Agreement

Section VI

(e) Evidence of Proper Registration as a Corporation or other Juridical Entity

10. Brokerage Agreement
11. Promissory Note and Addenda
12. Mortgage and Addenda
13. Certificate of Mortgage Registration
14. Borrower's Instructions Regarding Disbursement of Loan Proceeds
15. First Mortgagees Instructions Regarding Payment of Existing Mortgage (if a refinancing)
16. Signed Accounting of Sources and Disbursements of Funds
17. Signed Receipts for Disbursements
18. Escrow Instructions

NOTES TO TRANSACTION CHECKLIST

1. Commitment Letter

Prior to closing it is the attorney's responsibility to review the original commitment letter to determine whether the conditions of the commitment, if any, have been satisfied or are to be satisfied at the closing of the transaction. The attorney should also review the commitment to determine that the documentation for the transaction conforms to the original terms of the agreement.

2. Commitment Extensions

It should be confirmed that the transaction is closing within the time period specified by the commitment or any extensions to the commitment. Proposed closings beyond the expiration date set in the commitment or any extensions should be confirmed with the responsible business representative of the bank.

3. Disclosure Documents

It is the attorney's responsibility to determine that disclosure documents have been provided to the borrower in accordance with bank policy and legal requirements, if any. The disclosure documents should be reviewed against the terms of the loan commitment and other legal documents.

4. Documents Relating to Ownership ("Title")

(a) **Contract of Sale.** If the borrower is financing the acquisition of a home, the contract of sale between the borrower and seller should be reviewed to determine that the sale transaction is generally in accord with the representations of the borrower. Areas of review would include the specified purchase price, the continuing effectiveness of the contract under contract time periods, and any other agreements that would affect the title or condition of the property or the financial obligations of the borrower.

(b) **Borrower's Certificate of Ownership.** In a transaction not involving an acquisition, the attorney should review a copy, and perhaps the original, certificate evidencing the Borrower's ownership of the property. In a developed system of property registration and title insurance, it is generally not necessary to review original documents of this sort, but simply to investigate the

record. Given the unsettled nature of property registration in Russia today, it may be advisable for the time being to review original documents.

(c) **Seller's Certificate of Ownership.** In an acquisition transaction, it may be advisable to review a copy of the title certificate of the seller of the property, as well as the public records. Again, as more confidence develops in the property registration system it may be possible to rely on the record for this type of property history.

(d) **Proposed Document of Transfer ("Deed").** In an acquisition transaction, the attorney should review and confirm the legal sufficiency of the form of the document intended to transfer ownership of the property from the seller to the borrower.

(e) **Land Lease.** The attorney should review the terms of any lease affecting the borrower's right to occupy the land on which the residence is located. It may be necessary to obtain the agreement of the land owner to additional provisions pertaining to the rights of the bank, including the right to be notified in the event of a violation of the lease by the borrower and the right to a reasonable period of time to cure any violations by the borrower.

(f) **Other Property Lease.** If the transaction involves the mortgage of leasehold rights to residential property, the lease must be reviewed and, if necessary, modified to protect the rights of the bank.

(g) **Tenant Lease.** If the borrower will not occupy the property, the attorney should review any existing or proposed leases to tenants. Leases for a long term at less than market rents or leases that otherwise give extraordinary rights to tenants may diminish the value of the property in the event of a foreclosure on the mortgage.

(h) **Testamentary Documents.** If the borrower's ownership arose through descent or bequest, the attorney would want to review the terms of the original will and any documents of title issued in the course of probate proceedings.

(i) **Title Report.** At some point it may become feasible to obtain reports on the status of ownership of the property from bank legal staff or independent outside contractors. The report would be based on a thorough review of the public records and other pertinent documents and

would identify existing public or private regulations, rulings, transactions or agreements that affect the ownership of the property. Such reports would serve as the basis for issuance of title insurance.

At this time it might be possible to consider training attorneys or other legal specialists within the bank to search public records and prepare a report on title to the property.

(j) **Copies of Public Records.** The attorney should him/herself review copies of documents pertaining to ownership of the property and not rely on summaries provided by public agencies or other professionals. Copies of such records should routinely be part of a title report.

(k) **Borrower's Title Affidavit.** The attorney should obtain from the borrower an affidavit certifying to the status of title to the property, including the existence of any mortgages, easements or other rights of use and occupancy that do not appear from the public record. An example of a typical affidavit of title is attached.

(l) **Property Survey/Map/Legal Description.** The attorney should review any available maps or surveys showing the borders of the land on which the residence or building is located. Of particular concern are encroachments onto the property by adjoining property owners or encroachments of the borrower's property and structures onto adjoining properties. Violations of existing planning regulations may also be apparent from available maps and surveys of the property.

The bank may consider requiring that accurate maps or surveys, showing property boundaries, be prepared or available for any property on which a mortgage is to be made.

The attorney should review the description of the property set out in the mortgage and other legal documents against the property map. The description of the property set out in the mortgage should refer to a registered map, where available, set out the boundaries of the property by distances and direction, or both.

(m) **Evidence of Permitted use.** In some instances it may be advisable to investigate that residential use is in fact permitted on the land under existing planning laws or other public regulations. This would be more likely to be necessary in areas of new housing development.

(n) **First Mortgage Documents.** If the loan is to be a second mortgage loan on the property, the attorney should review the legal documents of the first mortgage loan to determine if there are any provisions affecting the rights of the borrower to place a second mortgage on the property or which might affect the rights of the second mortgagee.

The attorney may also request a letter from the first mortgagee stating that there are no violations of the terms of the existing first mortgage loan.

(o) **Termination of First Mortgage (if a refinancing).** If an existing mortgage is to be redeemed with the proceeds of the loan, the attorney should obtain from the existing mortgagee and review for legal sufficiency the form of document that will be used to terminate the existing mortgage.

5. Insurance

(a)-(b) **Property Insurance.** The attorney or an authorized business representative of the bank should review and approve the borrower's insurance policy for the property.

The attorney should confirm that the insurance policy includes a specific agreement of the insurance company ("mortgagee endorsement") recognizing the bank's interest in the property and the right of the bank to collect insurance proceeds in accordance with the terms of the mortgage.

In the case of loans in commonly owned apartment buildings, the attorney would review the policy of insurance for the entire building.

(b) **Title Insurance.** While not available in Russia today, title insurance is an essential element of the mortgage finance system in the US. Title insurance insures the lender that the mortgagor has good title to the property and the right to place the mortgage; that the mortgage interest of the lender is superior to other interests in the property; and that the mortgage interest has been properly registered and is enforceable by the lender. Title insurance may either be provided by independent attorneys or by insurance companies. The process of issuing title insurance would rely on gathering and reviewing most of the documentation discussed under number 4, above.

(c) **Mortgage (Credit) Insurance.** Mortgage insurance guarantees to the lender that the amounts due under the mortgage loan will be paid in the event that the borrower fails to honor his obligation. Mortgage insurance is issued on the basis of the same type of financial analysis as underlies issuance of the mortgage loan. The attorney's responsibility would be to see that the terms of the insurance policy conform to the terms of the loan and properly protect the bank's interests.

6. **Borrower's Affidavit.**

At closing of the transaction the attorney may obtain an affidavit from the borrower that confirms the continuing validity of representations made in the application process and deals with such other matters as the attorney may deem relevant to the transaction. An example of a Borrower's Closing Affidavit is attached to this section.

7. **Taxes**

(a) **Real Estate Taxes.** The amount of property taxes and the amount due and owing at the time of closing should be investigated. Official tax bills and paid receipts are generally sufficient. The bank may want to receive from the borrower the amount of any taxes on the property presently owed or coming due within the near term and make such payments itself.

(b) **Income Taxes.** Since it appears that amounts owed for personal income and other personal taxes have priority over a mortgage in foreclosure proceedings, the bank might want to obtain some evidence that the borrower does not have a large outstanding tax liability.

(c) **Property Transfer Tax.** There will likely be a tax on the transfer of residential property. The attorney should determine the amount of the tax for the transaction and include any necessary tax documents in the closing documentation to be signed by the seller and borrower. The bank may want to collect from the seller at closing the tax due and make arrangements to pay it. (In many systems payment of the property transfer tax is a condition of registering a deed of transfer and is routinely done by attorneys or title insurance companies in the course of closing a loan transaction.)

(d) **Mortgage Registration Tax.** Public Registries are authorized to collect a tax or fee for the registration of a mortgage. Generally, this tax or fee is paid by the borrower. The attorney should calculate the

amount of the tax for the transaction and collect the amount from the borrower at the closing. Any required tax documents should be prepared and signed at closing of the transaction.

8. Common Ownership Documents

(a)-(d) **Organization Documents.** If a loan is made on an apartment in a condominium or other commonly owned property, the attorney should obtain and review the basic legal documents establishing the regime of common ownership. Standards for review of common ownership documents should be established.

Generally, the financial statements of the owner's association are reviewed by a business representative of the bank.

(e) **Association Letter.** It should be the practice to obtain from the owner's association of the commonly owned building a letter to the bank setting out pertinent information regarding the financial obligations on the apartment to be mortgaged, including: the amounts of regular periodic charges for maintenance and operations; a certification of the amounts presently held in reserves for repair and maintenance; and a statement of any amounts presently due and owing with respect to the apartment. A form of this letter could be prepared by the bank and submitted to the owner's association for completion. A typical form of letter is attached.

9. Borrower's Corporation Documents (if not a natural person)

(a)-(d) **Corporate Documents.** If the borrower is not a natural person, the attorney should obtain and review the corporation, partnership or joint venture documents of the borrower to ascertain the authority to enter into the loan transaction. The attorney might require a resolution of the board of directors or the partners specifically authorizing the loan transaction and designating the officers or partners authorized to act on behalf of the entity.

(e) **Evidence of Registration.** The attorney may obtain and review evidence of proper registration of the entity to the extent that such registration may effect its rights to enter into the transaction or the enforceability of the bank's rights under the mortgage.

10. Brokerage Agreements

In a private purchase and sale transaction there may be a broker involved and real estate commissions owing. The attorney may want to review any brokerage agreements for terms affecting the borrower. To the extent that claims for brokerage commissions may affect the property or the financial condition of the borrower, the bank may want to assure that commissions are paid from the proceeds of the loan at closing.

11. Promissory Note and Addenda

The attorney is primarily responsible for preparing the note in accordance with the requirements of law and the terms of the transaction.

12. Mortgage and Addenda

The attorney is primarily responsible for preparing the mortgage document in accordance with the requirements of law and the terms of the transaction.

13. Mortgage Registration Certificate

The attorney is primarily responsible for assuring that the mortgage is properly registered in accordance with the requirements of the law. This remains true even though an outside contractor may physically register the mortgage. Prior to disbursement of any funds under the loan to the borrower, the attorney should review the Certificate of Mortgage Registration issued by the public registry.

14. Borrower's Instructions Regarding Disbursement of Loan Proceeds

Under the terms of the transaction the loan proceeds are the property of the borrower. However, in most instances the bank will require that disbursements be made directly to the final recipients of the funds, which might include the seller of the apartment or another mortgagee in the case of a refinancing of the loan. To make these disbursements directly to persons other than the borrower the attorney should obtain a signed instruction from the borrower as to the intended disbursement of the proceeds.

15. First Mortgage Payment Letter. If the proceeds of the loan are to be used to redeem an existing mortgage loan, the attorney should obtain a letter from the existing mortgagee

setting out the amount to be paid to the mortgagee as of the proposed date of closing the loan transaction.

16. Signed Accounting of Sources and Disbursements of Funds.

In many instances the attorney will be responsible for preparing an accounting of the sources and uses of funds at closing of the transaction, though frequently such accountings are prepared by the business department and the attorney supervises the collection and disbursement of funds at the closing. In either case, the attorney should review for accuracy and have signed by all parties a financial accounting statement that describes the amounts of funds received by the borrower and the bank, the amounts disbursed by them and in all cases the purposes of funds received and disbursed. An example of a typical financial accounting is attached to this section.

17. Receipts for Disbursements

Where possible at closing the attorney should receive signed receipts for disbursements mad both to the borrower and to others on behalf of the borrower.

18. Escrow Instructions

It is likely that funds will not be disbursed until the mortgage has been properly registered or other conditions have been met. In such cases it will be necessary to execute an agreement between borrower, lender and seller, and perhaps other parties as well, that designates an agent to hold documents and funds until such time as the conditions have been met and thereafter to disburse funds in accordance with the instructions included in the escrow agreement. Appropriate escrow agents might include the attorney for the bank or a notary. An example of an escrow agreement is attached.

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Section VI.

STATEMENT OF RECEIPTS AND DISBURSEMENTS OF FUNDS

Section VI.

STATEMENT OF RECEIPTS AND DISBURSEMENTS OF FUNDS

Name of Borrower(s):

Name of Bank:

Name of Seller(s):

Property Location:

Name of First Mortgagee:

Closing Date:

1. AMOUNTS DUE FROM BORROWER:

| | |
|----------------------------|-------|
| Application Fee | _____ |
| Loan Commitment Fee | _____ |
| Loan Discount Points | _____ |
| Mortgage Registration Tax | _____ |
| Bank's Legal Fees | _____ |
| Prepaid Loan Interest | _____ |
| Mortgage Insurance Premium | _____ |
| Property Insurance Premium | _____ |
| Property Taxes | _____ |
| Property Transfer Tax | _____ |
| Deed Registration Tax | _____ |
| Property Survey | _____ |
| Appraisal Fee | _____ |

| | |
|------------------------------|-------|
| Payment of First Mortgage | _____ |
|------------------------------|-------|

| | |
|---------------------------------------|-------|
| Payment of Property Purchase Price | _____ |
|---------------------------------------|-------|

| | |
|----------------------------|-------|
| Adjustments with Seller | _____ |
|----------------------------|-------|

| | |
|------------------------------------|-------|
| 2. <u>Total Due From Borrower:</u> | ===== |
| | _____ |

3. AMOUNTS DUE TO BORROWER:

| | |
|----------------------------|-------|
| Proceeds of Loan from Bank | _____ |
| Purchase Contract Deposits | _____ |
| Amounts Pre-paid to Bank | _____ |

4. Total Due to Borrower:

5. NET DUE FROM BORROWER AT CLOSING: (2)-(3)

6. AMOUNTS DUE TO PROPERTY SELLER:

| | |
|--------------------------------|-------|
| Property Purchase Price | _____ |
| Property Tax Adjustments | _____ |
| Maintenance Charge Adjustments | _____ |
| Utility Charge Adjustments | _____ |
| Rent Adjustment | _____ |
| Other: _____ | _____ |

7. Total Due To Seller:

8. AMOUNTS DUE FROM PROPERTY SELLER:

| | |
|--------------------------------|-------|
| Payment of First Mortgage | _____ |
| Contract Deposits Held | _____ |
| Property Tax Adjustments | _____ |
| Maintenance Charge Adjustments | _____ |
| Utility Charge Adjustments | _____ |
| Rent Adjustments | _____ |
| Other: _____ | _____ |

9. Total Due From Seller:

10. NET DUE TO SELLER AT CLOSING: (7)-(9)

11. DISBURSEMENTS BY BANK:

On behalf of Borrower:

| | |
|----------------------------|-------|
| Net Price To Seller | _____ |
| Payment of First Mortgage | _____ |
| Mortgage Registration Tax | _____ |
| Property Transfer Tax | _____ |
| Amount Due to Bank | _____ |
| Mortgage Insurance Premium | _____ |

| | |
|----------------------------|-------|
| Property Insurance Premium | _____ |
| Property taxes | _____ |
| Other: _____ | _____ |
| Net proceeds to Borrower | _____ |

=====

12. Total Disbursements
on Behalf of Borrower: _____

On Behalf of Seller:

| | |
|------------------------------|-------|
| Payment of Seller's Mortgage | _____ |
| Mortgage Registration Tax | _____ |
| Property Transfer Tax | _____ |
| Other: _____ | _____ |
| Net Amount to Seller | _____ |

=====

13. Total Disbursements
on Behalf of Seller: _____

Borrower and Seller hereby authorize Bank to make the above disbursements directly to the party or parties to which payment of such disbursements is due.

Borrower

Seller

[Bank]

Authorized Officer

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Section VI.

ESCROW AGREEMENT

Section VI.

ESCROW AGREEMENT

This agreement is made this _____ day of _____, 1992, among [Name of Bank] ("Bank"), [Name of Borrower] ("Borrower"), [Name of Seller] ("Seller") and [Name of Prior Mortgagee] ("First Mortgagee").

Borrower has agreed with Seller to purchase from Seller the property located at _____ (the "Property"), and Bank has agreed to make a mortgage loan ("Mortgage Loan") to Borrower in the amount of _____ to finance Borrower's purchase of the Property. First Mortgagee presently holds a mortgage ("First Mortgage") on the Property in the amount of _____, which it has agreed to terminate upon repayment of all amounts due.

To facilitate the [purchase and sale] [financing] of the Property the parties to this Agreement have agreed as follows:

1. Borrower has deposited with Bank Borrower's promissory note ("Note") in the amount of _____ evidencing its indebtedness to Bank for the Mortgage Loan, and a mortgage ("New Mortgage") in like amount to be placed on the Property.

2. Bank holds on behalf of Borrower the proceeds of Borrowers Mortgage Loan in the amount of _____.

3. Seller has deposited with Bank the necessary document ("Transfer Document") to transfer the Property from Seller to Borrower.

4. First Mortgagee has deposited with Bank a document ("Mortgage Termination") terminating the First Mortgage.

5. Bank is authorized by the parties to this Agreement to investigate the status of ownership of the Property and, upon satisfying itself that ownership of the Property conforms to its agreements with Borrower, take the following actions in the order set out below:

(a) Cause to be registered in the appropriate public registry the Mortgage Termination;

(b) Cause to be registered in the appropriate public registry the Transfer Document;

(c) Cause to be registered in the appropriate public registry the New Mortgage;

(d) Upon proper registration of the documentation as aforesaid, cause to be disbursed to the parties from the proceeds of the Mortgage Loan the following sums, which disbursement shall be in the form of the Bank's check or wire transfer to the account or accounts specified by the parties in writing:

| <u>Party</u> | <u>Amount</u> |
|-----------------|---|
| First Mortgagee | _____, plus interest due to the date of receipt, as described in the instructions of First Mortgagee attached to this Agreement as Schedule A |
| Seller | _____ |
| Borrower | _____, in the manner specified in the statement of disbursements between Borrower and Bank attached to this Agreement as Schedule B. |

6. If the ownership of the Property is not as represented to Bank by Borrower, or is otherwise inconsistent with the agreements of Borrower and bank regarding ownership of the Property, Bank shall have no obligation to make the proceeds of the Mortgage available to Borrower but instead shall have the right immediately to return to First Mortgagee and Seller, respectively, the Mortgage Termination and the Transfer Document and to terminate this agreement and all prior agreements between Borrower and Bank. Upon termination of this Agreement pursuant to this paragraph 6 Bank shall return to Borrower the original Note.

7. Bank's termination of this Agreement in accordance with paragraph 6 and return of the documents to Seller and First Mortgagee shall be without liability of any sort to Seller or First Mortgagee. Bank assumes no obligation to Seller or First Mortgagee with respect to any terms or conditions of any agreements between them and Borrower.

8. If not completed before, this agreement shall terminate automatically within three (3) days of the date hereof and all documents returned to the parties unless the parties shall agree in writing to an extension of this agreement.

[Bank]

[Seller]

[Borrower]

[First Mortgagee]

Section VI.

CONDOMINIUM CERTIFICATE

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Section VI.

CONDOMINIUM RESALE CERTIFICATE

[Name of Bank] has requested that the [Name of Association of Owners], the owners' association ("Association") of the property located at _____ (the "Property"), provide you with the following certification in connection with the sale of Apartment No. _____ (the "Apartment") in the Property from [Name of Seller] ("Seller") to [Name of Purchaser] ("Purchaser"). The undersigned, being an authorized officer of the Association and acting on its behalf, certifies to [Name of Bank] as follows:

1. The documents ("Governing Documents") attached and entitled _____, are accurate and complete copies of the legal documents governing the creation, organization and operation of the Association as of the date of this certification.

2. The balance sheet and financial statement of the Association attached to this certificate and dated _____ are accurate and complete copies of the most recent balance sheet and financial statement of the Association.

3. The operating budget of the Association attached and dated _____ is an accurate and complete copy of the current operating budget of the Association.

4. The amount of charges and assessments for common maintenance and management costs of the Property currently due and payable by the Seller are: _____ (if none, so state).

5. The monthly charge for common maintenance and management expenses allocated to the Apartment is: _____.

6. Capital expenditures approved by the Association as of the date of this certificate but not reflected in the current operating budget include the following: _____ (if none, so state).

7. Unsatisfied judgements against the Association and any court actions pending against the Association include the following: _____ (if none, so state).

8. The attached insurance policy covering damage or destruction to the Property is an accurate and complete copy of the Association's insurance policy. The policy is in

full force and effect and all premiums have been paid to the date of this certificate.

9. To the best of our knowledge, no alteration or improvement to the Apartment violates any provision of the Governing Documents.

10. To the best of our knowledge, the Property or Apartment is not in violation of any health or building law except as follows: _____ (if none, so state).

11. The attached lease of the Property is an accurate and complete copy of the lease covering the Property. The lease is in full force and effect and all obligations of the Association current as of the date of this certificate.

12. The Association has no rights with respect to the Apartment that would restrain or otherwise interfere with the proposed sale.

Date: _____

[Owner's Association]

Authorized Officer

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Section VI.

AFFIDAVIT OF OWNERSHIP

Section VI.

AFFIDAVIT OF TITLE (OWNERSHIP)

I/We, the undersigned, have applied to [Bank] for a mortgage loan to be secured by our property located at _____ (the "Property") and for the purpose of inducing [Bank] to make the mortgage loan hereby represent and certify to [Bank] as follows:

1. I/We are the owners of the Property.
2. I/We have owned the Property for _____ years last past, and my/our enjoyment of the Property has been peaceable and undisturbed and the ownership of the Property has never been disputed or questioned to my/our knowledge, nor do I/we know of any facts by reason of which the ownership or possession of the Property by me/us may be disputed or questioned, or by reason of which any claim to any of said Property might be asserted adversely against me/us.
3. There are no present tenants, lessees or other parties in possession of the Property except _____.
4. That during the time of my/our ownership, I/we have not conveyed any portion of the Property nor done any act or allowed any act to be done which changed or could change the boundaries of the Property.
5. That I/we have allowed no encroachments on the Property by any adjoining property owners nor have encroached upon any adjoining property.
6. That I/we have allowed no easements, rights of way, or other rights of passage to others over the Property and have no knowledge of such adverse rights.
7. That I/we have no knowledge of any taxes, charges (including common ownership charges for management and maintenance) or special assessments which are not shown as existing liens by the public records or which I/we have not disclosed to [Bank].
8. That I/we have no knowledge of any violation of any covenants, restrictions, agreements, conditions or public regulations affecting the Property.
9. That there are no court actions ongoing or threatened that might affect our ownership of the Property.

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Section VI.

10. That there are no existing or potential claims for material provided or labor performed in the improvement of the Property.

11. That I/we make this affidavit for the purpose of inducing the granting of a mortgage loan by [Bank].

Date: _____

Section VI.

BORROWER CLOSING AFFIDAVIT

Section VI.

BORROWER CLOSING AFFIDAVIT

The undersigned ("Borrower(s)") have made an application dated _____ (the "Application") to [Bank] for a mortgage loan in the amount of _____ to be secured by a mortgage on our property located at _____ (the "Property"). To induce the [Bank] to complete the loan transaction contemplated in the Application, Borrower(s) certify to [Bank] as follows:

1. There has been no material change in the financial condition of Borrower(s) since the date of the Application.

2. There has been no material change to the condition of the Property since the date of the Application.

3. All other information contained in the Application remains substantially true and correct as of the date of this certification.

4. Borrower(s) have not filed for any protection under the laws of bankruptcy or insolvency, or had an action in bankruptcy or insolvency filed against them, since the date of the Application.

5. There is no court action against Borrower(s) pending or threatened that could effect the financial condition of Borrower(s).

6. Since the date of the Application, there has been no judgement of a court or other public tribunal in a matter affecting Borrower(s) that may affect Borrower(s) financial condition.

7. All personal income taxes and other taxes, fees or assessments due from Borrower(s) to any governmental authority are paid through the date of this certification.

8. Borrower(s) are not in violation of any contract, agreement or obligation, enforcement of which would affect Borrower(s) financial condition.

9. Borrower(s) are citizens of [] and to the best of their knowledge there are no restrictions on their rights to own and mortgage the Property.

10. Borrower(s) intend to use and occupy the Property as their principal place of residence.

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11. Borrower(s) have been advised of the financial terms and conditions of their mortgage loan. Borrower(s) understand that failure to comply with the terms and conditions of their mortgage loan could result in a demand by the [Bank] that all amounts due under the loan be paid immediately, and that failure to pay such amounts could result in a claim against and loss of the Property.

12. Borrower(s) make this certification to induce Bank to make the mortgage loan.

Date: _____

Borrower

Borrower

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Section VI.

DISBURSEMENT AUTHORIZATION

Section VI.

BORROWER'S DISBURSEMENT AUTHORIZATION

[Date]

[Bank] is hereby authorized to disburse the proceeds of its mortgage loan to [Borrowers] for property located at [] in the following manner:

Name

Amount

Borrower

Borrower

SECTION VII.

PROMISSORY NOTES

The promissory note is the basic documentary evidence of the borrower's debt to the bank. It is not itself a mortgage on the borrower's property.

There is no legal requirement either in Russia or in the United States legal system that there be separate promissory notes and a mortgages for a mortgage loan transaction. The Russian Mortgage Law specifically acknowledges that the debt instrument may be one and the same as the mortgage instrument.

Rather, the use of promissory notes arose in the United States system primarily because of laws governing the transfer of notes and other financial instruments, and the rights and obligations of the transferees of the notes. In brief, a note containing the typical provisions of a property mortgage is not a "negotiable" financial instrument, and the transferee of the note could therefore be deprived of certain important rights with respect to the debtor. This is a very complex body of law that apparently does not exist in the Russian legal system at this time.

Whether the Russian law of financial instruments develops along the same lines as the United States, and therefore whether it will become customary to use separate note and mortgage documents, will remain to be seen. For the purposes of this material it is assumed that separate documents will be used.

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**SUPPLEMENTARY PROVISIONS REGARDING
INTEREST RATES**

Frequently, to protect the borrower against very sharp increases in interest rates, loans with variable interest rates or payments will provide for maximum interest rate adjustments and maximum final interest rates. . The legal provision typically used in adjustable rate notes and mortgages is as follows:

Limits on Interest Rate Changes

The Interest Rate I am required to pay at the first Change Date will not be greater than ____% or less than ____%. Thereafter my adjustable interest rate will never be increased or decreased on any single Change Date by more than two (2) percentage points from the rate of interest I have been paying for the previous ____ months. My interest rate will never be greater than _____%, which is called the "Maximum Rate."

As another protection to borrower's against sharp changes in interest rates, adjustable rate loans may allow the borrower to choose to limit the total amount of his monthly payment on the loan. If the borrower so chooses, the difference between the amount of interest actually due on the loan and the amount of the limited payment is added to the principal of the loan. A typical legal provision is as follows:

Borrower's Right To Limit Monthly Payment

(1) Unless paragraphs (3) and (4) of this section will not permit me to do so, following the third and each later Change Date I may choose to limit the amount of my new monthly payment to the amount I have been paying multiplied by the number 1.075. This amount is called the "Limited Payment." If I choose a Limited Payment as my monthly payment, I must give the Note Holder written notice that I am doing so at least 15 days before my first new monthly payment is due.

(2) If I choose a Limited Payment, my monthly payment could be less than the amount of the interest portion of the monthly payment that would be necessary to repay in full by the maturity date, at my current interest rate

and in substantially equal monthly payments, the amount of the unpaid principal I owe . If so, each month that the amount of my monthly payment is less than the interest portion, the Note Holder will subtract the amount of my monthly payment from the amount of the interest portion and will add the difference to my unpaid principal. The Note Holder will also add interest on the amount of this difference to my unpaid principal each month. The interest rate on the interest added to principal will be the rate required under section [] of this note.

(3) My unpaid principal can never exceed a maximum amount equal to one hundred twenty-five percent (125%) of the principal amount I originally borrowed. My unpaid principal could exceed that amount if I choose a Limited Payment. If so, on the date that my paying the Limited Payment would cause me to exceed that limit, I will instead begin paying a new monthly payment until the next Change Date. The new monthly payment will be in an amount which would be sufficient to repay my then unpaid principal balance in full on the maturity date at my current interest rate in substantially equal monthly payments.

(4) Beginning with the first monthly payment after the final Change Date, I will pay the Full Payment as my monthly payment.

If these limitations on adjustments and payments are chosen, the appropriate language should be included in the note and in the mortgage.

Section VII

FIXED RATE NOTE

Section VII

ADJUSTABLE RATE NOTE

Section VII

GRADUATED PAYMENT NOTE

SECTION VIII

MORTGAGES

At the present time there are few legal requirements affecting the form of real property mortgages in Russia. The Civil Code requires that all pledge contracts indicate the name and place of residence or location of the parties, an inventory of the property pledged, an appraisal of the property, its location, and the essence of, amount of and deadline for fulfillment of the obligation secured by the pledge. (Article 195) Pledges of residential property are to be in written, notarial form. (Article 239)

The recent Mortgage Law requires that the property mortgage be in writing and notarial form (Articles 10, 43), and that it contain terms stipulating the type of mortgage, the liability secured by the mortgage, the amount of the liability, the deadline for fulfillment of the liability, the composition and value of the property, and any other terms to which the parties agree. (Article 10)

The approach of the Russian mortgage law is to permit the parties to agree on all terms of the document not required by the law, which may include significant rights of the lender. In the absence of contrary agreement between the parties to the mortgage, the law provides rules that will be invoked to interpret rights and obligations under the mortgage agreement.

In preparing a form of mortgage, the objective should be to: (1) assure that the requirements of the law have been met; and (2) assure that any other terms and agreements required by the bank are clearly expressed and do not violate the law.

EXHIBIT B

MEMORANDUM

**TO: MR. MASLOV, MOSCOW HOUSING DEPARTMENT
MR. IVANOV, MOSSOVIET**

**FROM: STEPHEN B. BUTLER
RAYMOND STRUYK**

THE URBAN INSTITUTE

DATE: FEBRUARY 2, 1993

RE: RECENT DEVELOPMENTS IN CONDOMINIUM LAW

We have reviewed the recent draft of the regulation governing housing communities in the City of Moscow and have the following comments and questions:

1. **Ownership of Common Facilities.** The proposed regulation states that the common areas and facilities of a building will be owned by state and municipal authorities. This position appears to us to contradict the intention of the Law on Privatization and the December 24, 1992 Law on the Fundamentals of Federal Housing Policy.

What is the practical purpose served by preserving state and municipal ownership of building common areas and facilities? It denies to the individual apartment owners full ownership rights in their homes (Can one be truly said to "own" a home if he doesn't own the access and mechanical and electrical equipment?). It may deny them as well the right to make important management decisions with respect to the operation and management of the buildings in which they live.

If the municipality is concerned that it may not have the right to participate in the management decisions of buildings in which it continues to control apartments, it has the choice of either participating as a member of the housing community, as we have recommended in earlier comments, or negotiating a management joint venture with the private owners. On management joint ventures, you should refer to the recent Decree of the Moscow Mayor "On Procedure of Acceptance and Maintenance of Houses Sold In Duly Authorized Way at Auction Sale" (November 11, 1992).

In any event, if major decisions affecting a building are made on the basis of voting rights allocated in proportion to the amount of residential space owned, the municipality would continue to hold a voting interest in the affairs of the building.

We have been told that public ownership is necessary because there is no procedure for assessing property taxes on common facilities. We are not certain what this means. As a practical matter, it is not the accepted practice to tax common facilities in a building, as the value of such facilities is reflected in the tax imposed on the individual apartments.

It is our view that true ownership as contemplated in the Law on privatization and the Fundamentals of Federal Housing Policy will only be achieved if ownership rights in the entire building are recognized, and artificial distinctions between apartments and common areas and facilities are eliminated. The municipality's right to participate in the affairs of mixed ownership buildings can be dealt with more creatively than by denying to citizens true ownership rights to buildings.

2. Membership in Housing Associations. The question of membership in housing associations is a potentially serious problem.

The proposed regulation seems to say that membership in a housing association is voluntary, and that apartment owners may decline membership or, having joined, withdraw from the association at any time. How does this affect the management of the building? If all apartment owners are not members of a common association, how are decisions made that affect the entire building, for example repair of a lift, roof or common entry? How are decisions made at all? How are disputes among owners resolved without the cost and inconvenience of lawsuits and arbitration?

We have been advised by lawyers for the City and the Housing Department that it is not possible under Russian law to require that apartment owners become members of a common housing association; that to do so would contradict the provisions of the Law on Ownership.

We recommend that a closer review of the law be made. For example, consider the following possibilities:

(a) if local law requires that apartment owners in privatized buildings participate in a common housing

association, is that a contradiction of the Law of Ownership, or a supplement that is necessary to provide for rational housing management and preservation and implement the true intentions of the Law on Privatization? Do the laws intend that new owners be left to a chaos of ineffective building maintenance and management?

(b) may local government make reasonable laws consistent with the Law on Ownership to provide for proper management and maintenance of the privatized housing stock? Can local government do this with respect to mixed ownership buildings?

(c) to prevent strain on the judicial system, may local government require that owners of apartments in commonly owned buildings participate in reasonable procedures for decision making and dispute resolution?

(d) to protect the property rights and interests of all new owners, may local government require participation in common housing associations?

In our view, the possibility of apartment owners refusing to cooperate in common management associations, or the possibility of several competing management associations in one building, could raise serious problems if there is no efficient means of making decisions or resolving disputes.

At a minimum, the regulation should provide that (1) the formula for allocated interests and financial liabilities in the building apply to all apartment owners, whether or not they are members of the housing community; (2) management decisions of the building will be made by vote of all apartment owners in accordance with the allocated interests in the building; (3) reasonable regulations for the use of common areas enacted by a majority of the allocated interests, and which do not contradict the Law of Ownership, apply to all apartment owners, whether or not they belong to the housing community; (4) owners holding a specified amount of the allocated interests can insist on a meeting of all owners to consider common decisions; and (5) decisions of apartment owners taken at a properly called meeting with a specified quorum are binding on all apartment owners, whether or not they are members of the housing community.

The proposed regulation seems to imply that the organizational and financial rules of the building will apply only to those owners who become members of the housing community. This could, in our view, cause serious problems.

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It should also be noted that the legal issues affecting existing buildings, to the extent that they really exist, do not affect new buildings. In newly occupied buildings the developer or municipality could establish a single housing community as the governing body of the building. Membership in the community would be a condition of occupancy, and not left to the decision of the apartment purchasers. In addition, the management structure could be imposed on the building itself, as a restriction on the land use, and therefore not be dependent upon the decision of individual purchasers.

3. Enforcement of Financial Obligations. The proposed regulations suggest that housing communities have the right to enforce financial obligations, in the form of fines or penalties, only against members of the housing community. How does the regulation intend to enforce the obligations of those who do not become members of the housing community?

Is it intended that those who do not join the housing community will sign separate contracts with housing management organizations, and the enforcement of their financial obligations left to the contractual obligation with the management organization? If so, how does an individual apartment owner sign a management contract for maintenance of a lift? a roof? utility trunk lines? a common entry? How would this work if those who did not join the housing community chose to contract with a management company different than the company chosen by the housing community?

It is an easy matter to say that utility charges will be enforced by the utility companies, but quite another matter to enforce the financial obligations for maintenance of the building's common areas and elements.

If it is intended that apartment owners will seek to enforce financial obligations against each other in court or arbitration under the provisions of the Law on Ownership, this is a difficult, costly and uncertain way to collect charges for routine maintenance obligations.

It is likely that maintenance will not be financed by apartment owners on a consistent, responsible basis unless the right to enforce financial obligations against all apartment owners, whether or not they are members of the housing community, resides in one authority. The logical place to put enforcement power is in a housing community.

4. **Ownership Rights in Land.** The proposed regulation provides that land is allocated to housing communities on a leasehold basis only. Unless we are shown otherwise, we believe that recent changes in the law allow the municipality to convey residential land for ownership. We believe further that land ownership is an important aspect of housing ownership, and would urge you to consider this issue.

The only true guarantee of housing ownership is ownership of the underlying land, as under any other form of ownership the rights of use can be terminated at some future time.

Again, the question must be asked--what practical purpose is served by allocating residential land on a leasehold basis only? The municipality's right to control the use of land can be implemented through planning and zoning regulations. And, if members of a housing community decide, through established procedures, to sell their land for a use permitted under the planning and zoning regulations, isn't it their right to do so? Why should the rights to land under apartment building in Moscow be different than the rights to land under cottage homes in the Moscow Oblast?

If there is some concern that the transfer of land in ownership could result in an unfair transfer of wealth to a fortunate few, the municipality could require that it be paid a portion of the sales proceeds in the event that the land is sold at some future time.

In our view, land should be treated as another common facility of the building, ownership of which should be allocated and held in the same way as the other common facilities of the building.

On the issue of enforcement of financial obligations discussed above, how are lease payments to be made on the land? Are they to be made by each apartment owner in proportion to his allocated interest? What will be the result if some apartment owners don't make lease payments? Can the municipality terminate the lease?

It appears that the tax system is becoming quite complex, with individual apartment owners responsible for taxes on their apartments, separate taxes on common areas and facilities, and lease payments, rather than simply a single tax on their apartment which would include the value of land and common areas.

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5. **Rights of Creditors.** Our proposal included detailed provisions dealing with the rights of lenders that make mortgage loans for the purchase or improvement of apartments. We included these provisions because the concepts were new to Russia, but acknowledge that the same objective may be achieved through the private agreement of borrowers and lenders or in the foundation documents of individual housing communities. However, we recommend that the regulation at least state that the foundation documents of a housing community may provide that the approval of all or a stated percentage of the lenders holding mortgages on apartments in a building be obtained prior to actions that may impair the security of such lenders. We believe that under the present regulation alone, many lenders may consider the risk of lending for apartment purchase too great.

EXHIBIT C

MEMORANDUM

TO: RAY STRUYK

FROM: STEVE BUTLER

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

DATE: JANUARY 30, 1993

Regarding your memo of January 25 on the referenced regulation of the Department of Communal Services, I don't see it as a big problem, but I could be missing something. Let's see if we agree on what it does.

1. It applies only to newly completed buildings that are as yet unoccupied and which will be sold as individual units in auction sale or in their entirety to organizations.

2. It requires the MHD to ensure the creation of cooperative associations or other common ownership associations for such buildings. (Section 5)

3. It requires the REUs to accept buildings for management at the request of the housing associations. (Section 3)

4. It provides for temporary management by the local authorities and REUs during the formative period, which is not unreasonable under the circumstances. The period of temporary management is set by agreement of the parties. If the building is fully privatized, the new owners have the right to immediately select management, or to enter into an agreement with the authorities for a one year management contract. Again, not unreasonable.

If it is a mixed building, there must be an agreement between the owners and the authorities regarding management. Presumably, this means that in mixed buildings the REUs will have the right to manage, though under a negotiated agreement. (Appendix, Article 4)

5. It requires private owners to maintain their flats at their own expense, and to contribute to common charges.

6. It requires purchasers to agree to become a member of the housing association (Appendix 2), which cannot be done on existing buildings and is a major issue which we are all struggling with.

7. In mixed buildings, it requires the municipality to be financially responsible for the expenses of the municipal flats, and to agree to an allocation of charges with the private owners. I have been pressing for this all along, though my preference was for the municipality to participate as a member of the housing association.

8. Appendix 4 is not a charter of a housing association; it is a joint venture agreement between a private housing association and the municipality for management of the the mixed building. It is anticipated that the housing association will be organized by its own charter, which we hope will be subject to a condominium law of some sort.

9. It requires everyone to contribute to reserve funds. (Appendix 4, Section 2.1)

10. It requires everyone to be responsible for special assessments. (Appendix 4, Section 4.1)

11. Apparently, it leaves control of the commercial space in the hands of the municipality for the time being, or allows it to be sold by the municipality. The owners or tenants of commercial space are to contribute to the financial management of the building.

12. It even establishes a condominium lien for assessments by prohibiting the further sale of the unit if there are outstanding charges.

13. The contract forms themselves are simple but not badly done.

Pending further discussions with you, I think the flaws in the regulation are as follows:

(a) In mixed buildings, it is not clear how long the REUs retain the right to management. For example, if the building achieves 50% privatization, can the private owners association demand to control management?

(b) In mixed buildings, the municipality does not participate in the owner's association, as I have recommended, but rather joint management is achieved through a joint management agreement. Consequently, decisions must be made by negotiation and agreement or, as the proposed contract stipulates, in the courts.

Perhaps they have decided that the municipal authorities cannot legally participate in an owner's association (though I believe the December 24 Fundamentals

specifically allow them to). In which case the joint management agreement is workable so long as it provides for the possibility of private owner control at some point of privatization.

With respect to resolution of disputes between the municipality and owner's association in mixed buildings, it would probably be better if they were submitted to arbitration or mediation rather than to the courts.

(c) The regulation states that in mixed buildings the REUs management contract can be concluded with individual flat owners and with the owner's association. I don't think individual contracts are necessary or advisable in the new buildings (though they may have to be made in existing buildings where an owner refuses to join the housing association). If my reading of this regulation is correct, joining the ownership association is a condition of living in the new buildings, as it should be, and all contracts for maintenance should be with the association.

(d) I'm having a problem with the technical terms of ownership. The regulation provides that the flats are "shared property," which I believe is different than the concept of individual ownership that is included in the Privatization Law and the Fundamentals. It is perhaps closer to the cooperative form of ownership. The commercial spaces are also "shared property," but I don't see this as a problem. The common areas are "joint property," as they should be, as it is the same as our notion of "undivided interests."

Before commenting further, I need more guidance on why the concept of "shared property" is applied to flats at this time; it is the first time I have seen it done.

(e) The provisions on the commercial space are somewhat vague. For example, if the space is sold to purchasers other than the owners' association, are the purchasers required to join the owners' association? If not, why not? The regulation provides that disputes between residential and commercial occupants will be decided in the courts. But on what basis if there is no common agreement between them? Usually it is better to make the commercial owners part of the association, but to give them some protections against the power of the residential majority.

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