PA-ABT-975

PRELIMINARY DRAFT

Abt Associates Inc.

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PRIVATIZATION OF HOUSING IN MONGOLIA

BUILDING THE FINANCIAL, LEGAL, AND ECONOMIC FRAMEWORK

Prepared for the
State Privatization Commission,
Government of Mongolia
and
United States Agency for International Development
by
Abt Associates Inc.

December 19, 1992

**Prepared under Contract No. DPE-0016-Q-00-1002-00
by Abt Associates Inc.
under subcontract to Price Waterhouse Inc.**

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1.0 INTRODUCTION AND OVERVIEW

Background. This paper is based on ongoing USAID funded technical assistance to the State Privatization Commission of Mongolia in its efforts to privatize the state-owned housing stock. The overall focus of the technical assistance is to assist in the transition to a market-based shelter sector, including the development of housing finance, a legal and administrative infrastructure, and the building trades and construction industries. The major and immediate focus, however, is privatization of the state-owned housing.

The technical assistance seeks to assist the Government of Mongolia transform its enthusiastic but as yet partially formulated approach to privatization to one which links privatization more closely to the development of the overall shelter sector. Since the Government has wished to continue the same "full steam ahead" approach which it has applied to industrial privatization in Mongolia, the technical assistance has necessarily combined hands-on responsiveness with policy development. Thus, this paper addresses the design and *implementation* of policies for privatization.

While there has been agreement among most government officials with regard to moving ahead rapidly with privatization of housing, there has been far less agreement on (1) the procedures for privatization of units and common areas; (2) the policies for unit and building valuation; and (3) payment policies for individual households. Thus, the ultimate goal regarding the proportion of units to be transferred within a given time frame, given expectations about income and subsidy policies, has not been fixed. If the housing stock is simply given away, for example, in the absence of policies regarding rent, housing vouchers, and the rights and duties of ownership, problems will arise regarding transfer, payment for maintenance and utilities, and management of the stock. On the other hand, if incentives for privatization are weak and/or the price prohibitive, the Government will have preempted the ability to take advantage of a push toward a market sector.

The State Privatization Commission (SPC) realizes the desirability of placing privatization per se in the longer term context of development of a market-oriented housing sector. Thus, the technical assistance to the State Privatization Commission has two major aspects:

- assisting the SPC in formulating clear goals for the privatization of housing and establishing procedures to accomplish these goals;
- assuring that the privatization process is linked to, and stimulates, the formation of a market-oriented shelter sector.

Setting priorities for the many aspects of these two broad goals requires considering both *timing* and *policy formulation.* Put very simply, Mongolia lacks much of the framework for housing reform: most aspects of the "enabling structure" are either missing or very nascent.

Newbury, for example, argues that while privatization is not less important than market structure, to achieve the full benefits of privatization, a competitive market structure is essential.[1]

The problems of the "enabling framework" have been examined at length for Eastern Europe (and now for Russia and the newly independent states). Many of the issues facing Mongolia are, of course, the same as those faced in Eastern Europe: insufficient legal and administrative infrastructure; lack of experience in private housing management; a housing shortage coupled with lack of adequate capital; limited expertise in building and development; and lack of an effective system of housing or construction finance.

Mongolia's cultural and economic history, however, has led to a situation in which the problems are particularly severe. For decades, Mongolia was dependent on the Soviet Union for investment, trade, financing, critical imports, and technical assistance. Prior to the period of Soviet dominance, Mongolia's largely nomadic culture left a strong legacy of communal sharing but little legal or financial infrastructure on which to base a market economy. A capital market is only just now coming into being: a two-tiered banking sector was recently created, but given the lack of banking experience, private capital, and household savings, it appears that the housing sector will have to forge ahead in parallel with the capital market.

In order to develop a market-oriented housing sector, Mongolia must deal with the numerous financial, legal, and administrative issues which are involved in this transition. While this is also true in Eastern Europe, there seems a marked difference of degree in Mongolia. We have endeavored to show that housing reform can be an important part of transition to a market economy and a major stimulus to development. The exhibit on the following page presents this notion in schematic form. This diagram was developed to convey to the State Privatization Commission the possible linkage effects of housing privatization:

- the development of the overall shelter sector involves not only the transition of the existing stock, but also the development of housing and construction finance, the building materials and developer trades, and management of that segment of the housing stock which is likely to stay in public ownership for a considerable time;

- these shelter-related activities have important links to development in the rest of the economy. The multiplier effects of construction on the rest of the economy, the incentives stemming from housing finance on savings and development of a banking sector, and the requirement for developing the legal infrastructure necessary to a market economy, (of ownership and conveyancing, for example) are all assisted by evolution of shelter policies.

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[1]Newbery, Sequencing the Transition, p.9.

MONGOLIA
INTEGRATION OF SHELTER SECTOR DEVELOPMENT WITH OTHER GOVERNMENT OF MONGOLIA DEVELOPMENT GOALS

SHELTER-RELATED DEVELOPMENT:

INDUSTRIAL AND SMALL BUSINESS PRIVATIZATION AND DEVELOPMENT	Housing Privatization Housing Finance Land Use Planning Building Trades Housing Management	FINANCIAL AND LEGAL DEVELOPMENT

Clarifies and enhances the voucher program for small business privatization ← PRIVATIZATION → Legal Infrastructure:
- Condominium Act
- Landlord/Tenant Laws

Rent and valuation policies geared toward private market

HOUSING FINANCE → Develop Mortgage Finance Laws

Initiates household savings

Enhances development of a banking sector.

LAND USE PLANNING → CADASTRE SYSTEM

Land Transaction Act

Legal infrastructure for urban development

Development of private sector developers and building materials industry

Big 'multiplier' impact from construction ← BUILDING TRADES

Development of private service sector to support housing still owned by the State in the transition period ← MANAGEMENT OF PUBLICALLY OWNED HOUSING

Comparisons with Eastern Europe, Russia, and the NIS

Experiences with housing reform in socialist economies, begun in Eastern Europe, and now proceeding in Russia and the NIS, provide an important framework for analyzing the problems posed by Mongolia's somewhat unique set of circumstances.[2] A summary article on progress in Eastern Europe, by Kingsley and Struyk, notes that while significant privatization has taken place, progress toward an efficient housing sector will depend on additional reforms. These include, for example, rent increases, the availability of housing allowance programs and mortgage financing, development of legal infrastructure, and the ability to conduct appraisals and record title.[3] These same issues are also of major concern in Mongolia, but it will take some time before all of them can be addressed.

Differences between the housing sectors of socialist and market-based housing sectors are, of course, profound and fundamental.[4] However, the differences among socialist economies have also become increasingly apparent. Mongolia's particular economic and cultural history, its years of extreme dependence on the Soviet Union, in combination with the "full steam ahead" attitude with regard to privatization across all sectors of the economy, create a difficult set of issues.

Thus, despite similarities in the over-arching problems of the enabling framework, Mongolia poses some unique and interesting differences:

- Unlike much of the former communist bloc, Mongolia does not have a cultural history of private property. This is an ancient, largely nomadic civilization. Thus, there is a nearly complete absence of the legal infrastructure necessary to accommodate the ownership or transfer of private housing;

- The capital market and banking sector in Mongolia are in an extremely formative stage. There is little understanding of the basic concepts of banking and credit markets, and no experience at all with housing finance. Eastern Europe, on the other hand, has at least had experience with housing finance, despite the need for reform;

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[2]Annex 5, Housing Privatization Policy, reviews the lessons learned from international experience of housing privatization.

[3]The bibliography notes only a limited selection of the now extensive literature on privatization in Eastern Europe. Kingsley and Struyk have recently summarized the problems of privatizing housing in "Progress in Privatization: Transforming Eastern Europe's Social Housing".

[4]See Renaud, Housing Reform in Socialist Economies for an in-depth analysis of these differences.

- There are literally only two forms of housing in Mongolia: privately-owned "ghers" (transportable, round, felt-covered tents constructed over a rigid wood frame) and state-owned apartment blocks (almost all constructed of pre-cast heavy concrete panels). The apartment blocs, which house approximately one-half of the households, are nearly all massive, Russian-built highrises;

- Correspondingly, there are only three basic types of communities: urban apartment dwellers, urban gher cities, and rural gher dwellers. Many of the ghers are in the rural areas; some are reasonably stationary, but other households remain nomadic. However, there are also sizeable gher villages in the cities (there are only three cities, all small by international standards);

- Equity considerations between gher and apartment dwellers are especially intense, particularly if the flats were to be "given away" with no corresponding compensation to the gher residents (for example, gher owners could receive land, or be permitted to bid for apartments);

- In contrast, Eastern Europe has always had a sizeable private sector. On average, only about 30 percent of the housing stock in Eastern Europe is state-owned, a share which rises to roughly 50 percent in the cities. There is also a strong cooperative sector. In Mongolia, all the apartments are state-owned; there simply is no housing of modern construction owned privately, no single family housing except for the ghers, and no cooperative experience.

- Mongolia's immense dependence on the Soviet Union was mentioned above. As a result of its withdrawal, Mongolia is expected to become desperately poor in the medium-term. Per capita income is, roughly, only a fifth or less of that in much of Eastern Europe. It is estimated that the departure of Russian barter-style trade and subsidized financing will cause a substantial fall in GNP (estimates range from 25 to 50 percent).

- Construction of new housing is virtually shut down; partially finished apartments stand empty. The exit of the large Russian construction companies (kombinats), in combination with the cutoff of imported building supplies, leaves Mongolia with crucial gaps in construction technology, materials, and management.

- Although the Privatization Commission is anxious to create a Housing Bank, there is next to no banking experience and no source of long-term funds for housing (either public or private). Household savings in the financial sector are nearly non-existent. The Government has recently initiated reforms of the banking sector, but it will likely remain state dominated (and interdependent with the state enterprises it finances) for some time.

- As compared with Eastern Europe, communication systems, information technology, and translation into languages other than Russian are limited.

- Finally, perhaps even more than in Eastern Europe, tenant rights are considered inviolate by many. For example, if it proves impossible to relocate households who do not which to privatize, the transfer of whole apartment blocs will be very difficult. Similarly, recourse for non-payment (of rents or condominium levies) must be addressed.

Does the experience in other countries provide any prognosis regarding success of the program? Slovenia and Lithuania both privatized 80 percent of their state-owned units in less than a year. On the other hand, Hungary has privatized only 20 percent in two years, and Poland has fared even less well than that. In some respects Mongolia may be somewhat more similar to Russia, where 70 to 80 percent of the housing is public, than to Eastern Europe. Many cities in Russia only begun their programs in 1992; nevertheless, an early review is pessimistic with regard to both the scale of the potential transfer in Russia and the inequities among purchasers, renters, and those on the waiting list.[5] Thus, given Mongolia's extreme poverty and the equity considerations between apartment and gher residents, there appears to be cause for concern.

Setting the Stage for Privatization

Because the agenda with regard to privatization and other shelter issues is so massive, a prioritization of the various tasks was suggested to the State Privatization Commission. We divided the privatization activities into three groups and left some concerns for later consideration. In order of priority, the three groups of activities are:

Priority I -- Setting the Economic Stage for Privatization

- Gradual increases in charges for rent and utilities (these are currently well below what is required to cover costs for services, maintenance and especially for capital repair);

- Establishment of a "safety-net" policy for households below a poverty level. Units occupied by these families will continue to be rented; presumably the State will need to subsidize payments for rent and utilities (admittedly, this will be difficult because the State has so little money);

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[5]See Kosareva and Struyk for an analysis of privatization in Russia and comparison with other countries.

Priority II -- Goal Setting/Procedures Required to Begin the Privatization Process

- Establishment of clear goals regarding *privatization timing and depth*. The "polar" extremes are (1) giving the stock away (nearly) free and clear versus (2) sale at "market" price (with or without mortgage finance). Intermediate approaches to valuation and transfer might involve sale at a "realistic" price, related for example, to the purchasing power of a selected portion of the income distribution;

- Establishment of *valuation procedures* designed to accomplish two goals: (1) setting the *absolute* level of prices consistent with the goals set forth above regarding depth and timing; and (2) establishing a *relative* level of prices across units that will be regarded as "fair" and will assist the development of an appraisal capability. (we have suggested a "hedonic simulation" to assist in analyzing the pricing data; see Appendix I);

- Establish payment policies for households wishing to privatize, achieving the desired combination of vouchers, cash, installment payments, and/or free squares meters;

- Establish legal procedures for formation of condominiums. While all aspects of the legal framework need to be addressed quickly, absence of a Condominium Declaration and Condominium Association By-laws and Articles were selected as first priority. It is felt that an ability to levy and collect assessments is particularly crucial.

- Establish rules for the "density" of privatization. If all occupants of a building do not wish to privatize, establish the necessary mix within buildings of private and state ownership before the building can be converted;

- A publicity campaign clearly explaining the procedures, regulations, and payment policies for privatization (including the role of the "small" vouchers).

Priority III -- Shelter and Housing Finance Developments Which Might Proceed in Parallel to Privatization or, in Some Cases, Begin at a Later Stage

IN PARALLEL

- Develop the additional crucial aspects of the legal framework, including a cadastre system, a land transactions act, laws related to mortgage financing, and landlord/tenant laws;

- Enhance the institutional capacity the state-run Housing Company and Housing Authorities, including training in condominium operation, record keeping, data base development, and public housing management;

- Plan for the establishment of a housing finance institution, with explicit plans for later privatization. Installment payments, if they are part of the privatization payment scheme, would be handled separately in the interim; introduction of mortgage financing is expected to take some time;

ADDITIONAL ACTIVITIES

- Develop private sector construction and building trades industries;

- Privatize the housing management companies;

- Develop land use and urban planning for both apartment and gher city dwellers.

As discussed in more detail in the following sections, there are a number of important assumptions underlying these priorities. The need for establishing priorities seemed clear. The State Privatization Commission, with limited staff and resources, is responsible for carrying out privatization of industry and agriculture as well as housing. Thus, the absorption rate for policy reforms (and indeed entirely new ways of thinking about legalities and markets) is necessarily limited.

The remaining sections of the paper provide more detail with regard to the economic, institutional, and political background of the privatization program (Section 2.0), the procedures for privatization (Section 3.0), the suggestions with regard to housing finance (Section 4.0), and the requirements of the legal framework (Section 5.0).

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We would like to acknowledge the ongoing support given to the Abt team by Mr. Gerelchuluum, Secretary, State Privatization Commission, and his staff, especially Ms. Narantungalag; the Mayor and Deputy Mayors of the City of Ulaan Baator; senior staff of the Ulaan Baator Housing Company; Earl Kessler, Director, USAID/RHUDO/Asia, and his staff, especially Barbara Foster and Julie Otterbein; William Nance, AID Representative, Mongolia and his staff; especially Mary Jordan; and our interpreters Mr. Choinaran and Mr. Gal, Mrs. Chinbat and Mrs. Baljinnyam.

2.0 BACKGROUND TO THE PRIVATIZATION OF HOUSING

2.1 Small Enterprise and Industrial Privatization

The government intends to transfer 100 percent of its holdings in small enterprises and 80 percent of all state assets to the private sector by September 1993. The balance, which include strategic sectors such as energy, military, water, education, healthcare and communications, will remain in government hands. Existing joint ventures in various sectors will be renegotiated and could be privatized at a later stage. In 1990, over 95 percent of the economy was under state and cooperative control.

There are two parts to the Mongolian privatization -- the "small" and the "big" privatization. The "small" assets consist of assets like shops, restaurants, livestock and machinery. The "big" privatization is of over 500 enterprises like flour mills, shoe factories and knitting factories with annual turnover of more than 3 million tugriks ($15,000 at the mid-1992 market rate of exchange or $75,000 at the official rate).

Mongolia is one of the first countries to use the "voucher" approach to privatization. Each member of the population alive in 1991 was given three red vouchers worth T 1,000 each ($5 at the market exchange rate), and one blue voucher worth T 7,000. The red vouchers have been used in the "small" privatization and the "blue" vouchers are to be used in the "big" privatization. The vouchers were distributed through local branches of the state bank and at administrative units used to distribute food ration coupons.[6]

The small privatization has essentially been completed, although many red vouchers have not been used. As many as 60 percent in the capital city have not been used, most still being held by the original holders rather than traders. Of the 6 million red vouchers printed, 70 percent have been distributed throughout the country and 60 percent of those have been used. The red vouchers are tradable. Exchange centers were set up where people can buy or sell vouchers for cash. Foreigners are also allowed to purchase the red vouchers.

About 2,500 small enterprises have been privatized. Small enterprises are valued by State Privatization Commission (SPC) according to a fairly mechanical procedure. Workers can buy the enterprise at the appraised value using the red coupons. If they do not, the enterprise is auctioned, with the winner paying in red coupons. About 60 percent of the small businesses privatized in Ulaan Baator were bought by their workers. The small enterprises to be sold by auction were announced one month in advance in the newspapers. They had an initial price set in terms of vouchers; participants in the auction had to pay an initial deposit of 10 percent of this price and T 500. The winner had a month to pay the rest of the vouchers; vouchers were returned to the losers.

[6] These vouchers were supposed to be green. Unfortunately, when it came time to print them, no green ink could be found. A typical Mongolian problem today.

Trading in coupons is permitted. However, local authorities have set up coupon trading centers which have somewhat distorted the market. Depositors of the coupons at those centers left an asking price with brokers there, usually close to the nominal value. Since the market price outside the center fell to 20 percent of the nominal value of the coupons, the coupons deposited at the centers did not sell. In response to a public outcry, the authorities forced all purchasers of small businesses to buy half the coupons required from the official trading centers. This meant that the purchasers of small businesses paid more for their enterprises than they were worth, in terms of the market value at that time. Many enterprises have subsequently gone out of business.

The initiative for the large privatizations comes from the enterprises themselves. They submit restructuring and reorganization plans to the SPC. Shares are issued based upon the net asset value of the enterprise. The SPC review of these proposals is very strict. Workers have a preferential right to buy shares in their own enterprise up to the total face value of their blue vouchers. The stock exchange distributes the remaining shares to the public (in practice, the great majority of the total shares). A network of brokers assembles coupons from clients and bids for shares at the auctions held by the stock exchange. An open book system ensures that the broker does not simply purchase shares for friends. The bidding begins at the face value of the share. If no offers are received, the auctioneer drops the price. Each broker can place bids for shares at the going price or higher. The broker is responsible for the collection of the shares he wins from the Stock Exchange and for distributing them to his clients.

The "big" privatization began late last year. The first phase accounts for 51 percent of the total transfer of state enterprises in terms of fixed asset value. Over time the SPC will determine a balance sheet book value of 700 large state enterprises. At least 200 are expected to be declared bankrupt. The remainder are being converted to joint-stock companies and auctioned to the public for blue vouchers on the new stock exchange. About 20 percent of the shares in the large enterprises will be distributed to their workers, who are expected to pool their vouchers to purchase larger stakes. So far, 250 enterprises have been identified for privatization; of these, 130 have been valued; and of these, 30 have actually been privatized.

The big privatization has also had its difficulties. For example, a number of building materials companies were broken into smaller enterprises and then privatized. The team learned of one brickmaking factory for which workers paid T 100 per share. Each share in now valued at T 5 on the stock exchange.

Agricultural assets are also being privatized. So far over 60 percent of the livestock have been transferred into private ownership using the rose vouchers. The land has not yet been privatized. The agricultural cooperatives are becoming voluntary organizations, with their facilities and equipment purchased with blue vouchers.

The SPC has calculated that the total value of all the assets to be privatized is T 21 billion (or T 10,000 per person in the population of 2.1 million). Sixty-five percent, or T 14 billion has been privatized so far. Housing has been valued at T 4 billion.

2.2 Institutional Framework

The Government, which was elected in the first ever free elections in January 1991, is led by the Prime Minister, three Deputy Prime Ministers, and 11 Ministers (soon to be increased to 16). There are 18 provinces (aimags) and 3 cities (on equal level as provinces), 260 districts (somons), which are small "urban" areas, with about 20-30 in each province.

The Chairman of SPC is the First Deputy Prime Minister. The permanent head of SPC is the Secretary. SPC defines the policy framework within which the local privatization commission must operate. SPC is responsible for advising firms on valuation methods, for publicizing the privatization, for adjudicating disputes between local commissions and firms, for joint venture policy and for share issuing policy. Members of SPC sit on the Valuation Commission, which sets initial price, in terms of vouchers, for each enterprise to be privatized.

Membership of the SPC is as follows:

1. Ministry of Finance
2. Ministry of Justice
3. Ministry of National Development
4. Ministry of Agriculture
5. Ministry of Trade and Industry
6. State Commission of Construction and Urban Planning (soon to be a Ministry)
7. Central Bank
8. First Deputy Prime Minister
9. Executive Secretary (Secretary of the Commission)
10. Stock Exchange Chairman
11. Head of Statistics
12. Ulaan Baator Mayor

The Commission meets weekly. It has a permanent staff of 14, including staff from the Commission of Construction and Urban Planning, Ulaan Baator city, Ministry of Finance, Central Bank, and Ulaan Baator Housing Company as well as its own. SPC is planning to recruit 3 additional staff to help with the privatization of housing.

Local privatization commissions are responsible for implementing the privatization. In the case of the capital city, the First Deputy Mayor heads the Privatization Commission. Since July 1991 the Ulaan Baator Privatization Commission privatized 8 service centers, many restaurants, and about 300 service shops, using the small voucher system.

The Ministry of Construction and Urban Planning, which until recently was a Commission not a Ministry, has a permanent staff of 40. The Ministry plans to add 20 more staff: civil engineers, architects, and construction material technicians. The Ministry controls construction, inspection, and review. It will establish and carry out human settlement and urban planning policies and programs.

Under city government, the Ulaan Baator Housing and Communal Services Company is responsible for management of state housing stock in Ulaan Baator. This was a national Ministry until 1990; now each city and province has separate management responsibility. The Company has 20 employees in headquarters and manages 13 Housing Authorities around the city, each responsible for part of the stock in that area. There are weekly meetings at headquarters with directors of the Authorities. Through the 13 Authorities, the Company manages: 1,435,000 square meters of living space and 48,500 units of housing where 240,000 people live (out of Ulaan Baator's population of 570,000). There are 707 apartment buildings (23 percent brick; 67 percent panelized), of which 21 percent were built between 1954 and 1969; 12 percent were built between 1970 and 1978; and 67 percent were built since 1978.

The Company collects T 241,500,000 annually, of which T 55,000,000 is for the rent itself, the rest for utilities. The Company spends T 35,000,000 annually for capital repairs and maintenance. This is enough to repair only 5-10 buildings per year, although they estimate such expenses are required for 40-50 buildings per year. Each Authority collects the rent and manages building, outdoor and apartment maintenance, repairs, heat, electricity, water, trash, garbage, and cleaning. Rent is T 3 per square meter per month, increasing to T 4.5 per square meter in winter months (8 months a year). The area concerned is the livable space, bedrooms, living rooms, but excludes kitchen, bath, and hall. Rents are also collected from businesses in the building: shops, barbers, photographers, etc.

Authorities are supposed to produce a surplus of revenue over expenditure, half of which goes to Central Government, a quarter to the Company, and a quarter remaining with the Authority. This final quarter is used for housing for the Authority's staff. Many Authorities are verging on bankruptcy since expenses have risen, through price liberalization, faster than rents. Only the government can increase rents. Rent increases are planned for early in 1993.

We visited a number of the Authorities, including Number 10, which is one of the largest. It has 13 buildings, 4,500 units, 145,000 square meters. There are 10-12 entrances per building, 1 for every 36 units, and 1 elevator each for each entrance. This Authority has 240 employees, mostly in maintenance (almost 19 units per employee). Authority receives about T 1,500,000 per month in rent and heat; about T 400,000 per month for electricity. Total annual revenues is about T 20,000. Rent arrears are a low 1 percent.

Housing Authority No. 11 has 2,400 units; 12,000 residents; 4 buildings of 12 stories each; and 75,000 square meters. It has 150 employees (16 units per employee) who are pair T 1,700,000 in annual salaries. This Authority has a much higher arrearage of about 20 percent. Turnover is 10-20 units per year.

We have more detail on Housing Authority 2 (Annex 2). It has 4,700 units in 89 apartment buildings. Twenty thousand residents live in 143,000 square meters of living space. The Authority has 186 employees, who are paid a total of T 2.8 million annually (equivalent to about half the budget for heat).

2.3 The Macroeconomic Environment

In the current adverse macroeconomic conditions, with GNP having fallen by 16 percent in the first six months of the year, most households are focusing on survival. Only when the economy begins to recover will most households begin to save for and invest in housing. This means that some of the benefits of privatization will come in future years rather than immediately.

The macroeconomic crisis has its origins in the withdrawal of the substantial Russian budgetary and trading support for the Mongolian economy as well as the adjustment required to achieve a market economy.

The economy was highly subsidized by the USSR. As a result, the economy grew very rapidly in the 15 to 20 years prior to 1990. The *per capita* rate of growth of Net Material Product averaged 3.4 percent between 1970 and 1986. Industry, transport and telecommunication grew particularly rapidly. Industry is now 27 percent of GDP and services is twice as high a proportion of GDP as in China. The investment rate in the 1980s was higher than any other CMEA country, 30 to 40 percent of NMP. The rate of increase of investment was also very high, averaging 15 percent per annum. With the personal savings rate at less than 1 percent (as in most CMEA economies), this investment had to be financed by the USSR. Between 1985 and 1989, the negative external balance financed 82 percent of investment. There was budgetary support too; the Soviet Union contributed 17 to 55 percent of government revenue in the years of the 1980s. And trading support. Ninety percent of Mongolia's exports were to the CMEA countries. But there was a price to pay: a massive debt to the USSR was built up, equivalent to 9.8 billion transferable roubles. Servicing this debt has absorbed 5 percent of export earnings since 1986.

The withdrawal of Russian support resulted in a severe crisis in 1990 and 1991. Exports came to a halt. Investment and construction fell to very low levels and factories became idle. The first ever food rationing was introduced. In 1989 investment as a proportion of NMP was 42 percent and foreign savings 29 percent; by 1990 they had fallen to 26 and 15 percent respectively. The Ministry of National Development estimated that the investment needed to replace Russian support would be $6 billion for the period 1991-95, of which $5 billion would have to come from foreign loans and assistance. That is equivalent to $500 per person per annum.

The situation has probably deteriorated over the past year. There have been difficulties in implementing trade agreements that were made in 1991. The barter of copper for petroleum has ceased: in fact copper has been exported and no payment received; petroleum has been paid for but none received. Output fell by as little as 16 percent in 1991 only because the country was able to draw down inventories; it is expected to fall by more this year. The output of two key commodities, coal and electricity is lower than a year ago. The output of meat products is less than one third of the level a year ago. Inflation is even higher this year than last because of price liberalization and the Government's expansion of credit to keep industry producing.

The liberalization of the exchange rate, resulting in a substantial devaluation, has made it much more costly to import the spare parts needed to keep transportation moving and enterprises running. In the housing sector, crucial building materials and spare parts are unavailable.

The situation will be partially ameliorated by the $320 million of support pledged by donors for the coming year. Of that, $75 million is balance of payments support; the balance is projectized.

The impact of these adverse macroeconomic conditions on households has been considerable. The consumer price index is now 3.4 above the January 1991 level or 2.2 higher than at the beginning of this year. Unemployment is expected to rise to 100,000 by the end of the year when unemployed school-leavers are added to the labor force. The safety net for the poorer families is not high. Unemployment pay is only T 347 per month in the cities and T 216 in the rural areas (this will be increased in the next week or so).[7] The per capita income of the median family in Ulaan Baator is only about T 765 according to a recent government survey. The minimum wage is only slightly higher than this median family income, T 700).[8]

Although many wage controls have been relaxed in the past year, the demand for labor is so low that incomes are tending to fall, especially in urban areas. Given the high rate of inflation, real income is falling considerably. According to the monthly Family Expenditure Survey carried out by the State Statistical Office in accordance with international standards, family incomes in June were lower than in May in urban areas. In contrast, for seasonal reasons, rural income rose in June.

The demographic situation exacerbates these adverse macroeconomic conditions for the privatization of housing. The population is very young. The dependency ratio is exceptionally high: it was 81 percent in 1985; China's was 54 percent. The labor force participation rate is very low, especially given the fact that many women are members of the labor force. The high

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[7] The official exchange rate in mid-1992 was about 40 tugrik per dollar; unofficially, the rate was closer to 200.

[8] The distribution of per capita monthly income on which the median income mentioned in the text is based is as follows:

Income	Percentage of families
<140	3
141-347	17
348-548	24
549-749	17
750-950	12
951-1151	9
>1151	17

population growth rate, 2.5 percent, means that the population will remain youthful for some years. The young tend neither to save nor to have assets.

2.4 Impact on Housing Privatization

It is difficult to be optimistic about the demand by households to privatize state-owned flats in such macroeconomic circumstances. The Government cannot financially subsidize the privatization, for example, rehabilitate the buildings prior to privatization. But the Government's fiscal situation is so weak that it cannot afford to do this. Revenue collections since the beginning of 1992 has been less than expected. New sources of revenue--customs duties and the import surcharge -- have yielded disappointing results, partly because of the depressed foreign trade and partly because of administrative difficulties. The Government's energy costs have increased as have salaries and wages, due to increased compensation. The monthly deficit has varied between T 270 and T 880 million this year. The Government plans to rectify the situation by introducing a sales tax and by reducing the size of the civil service.

Even if the Government had the resources, housing does not seem to be among its expenditure priorities. In its submission to the IMF, dealing with overcoming the fiscal deficit, the Government states that "Investment activities will continue to be limited to essential repair and maintenance of infrastructure, with priority accorded to outlays that can be financed by concessional donor assistance." Further, housing is not one of the top seven sectors with priority access to foreign exchange.

What is perhaps more significant than the fiscal problems of the Government as a whole are the problems of that part of Government that is responsible for the implementation of privatization, the cities and provinces. There has been a significant decentralization of government since the late 1980s. The local government share of government expenditure is now about 50 percent. However, since its share of revenue is much less, local government tends to be in chronic deficit. While central government has been in surplus for three of the first six months of this year, local government has had a rising deficit: its deficit for June was T 680 million. Since the rents collected by local government (through the Housing Company) fail even to cover maintenance costs, local government has no surplus to subsidize the privatization of housing. In fact, one of the reasons given to privatize housing is to improve government finances by removing the maintenance burden.

It is likely that if the privatization is to carried out without financial subsidies and/or substantial discounts, household demand will be very low, and will come from the richest 10 percent or so of the current occupants of the flats. As discussed elsewhere in the report, even this demand will be low, if rents are not raised to an economic level (which would also somewhat soften the fiscal constraint by adding to local government revenues if Government does decide to give some financial subsidies, to the less well off, for example).[9]

There may be reason to be optimistic that the increase in rents required to encourage families to chose to buy their flats may be introduced. The Government is certainly accustomed to the implementation of quite radical price reforms. In January 1991, all wages and state-controlled prices were doubled. A major series of price and other reforms were introduced six months later, before the privatization program began: most loss-covering credits and subsidies to enterprises were abolished; prices not freed in January were then freed; wage decontrol began; anti-monopoly and bankruptcy laws were passed; and licensing and currency surrender for foreign trade were abolished. Price liberalization has continued in 1992. The budgetary subsidy for the manufacture of children's clothing was eliminated and retail prices liberalized for new supplies. Wholesale prices of coal and electricity, and transportation charges were adjusted by between 40 and 300 percent. Ceiling prices for some essential goods were raised by 2 to 4 times. Medicine and flour and bread prices are scheduled to be liberalized before the end of the year.

One problem is that household spend very little of their income on rent and utilities. According to the Family Expenditure Survey, in May urban families allocated 4.3 percent of their expenditure to "housing and communal services" and 0.9 percent to "other services". The figures for rural households was 0.3 and 0.4 percent respectively. Of course housing and utility costs will be higher in the winter, but the proportions are still very low.

These low percentages do not accord with popular perception. People asked by members of the team how much they personally spent on rent frequently replied with proportions varying between 25 and 50 percent. Many people seem to think in terms of their personal income, not family income as a whole. However, there will clearly be a public relations problem if the Government decides to raise rents to levels that will make it possible for the housing companies to carry out their maintenance responsibilities, let alone raise rents sufficiently to enable them to allocate some of the rent to capital repair.

While the proportion of income allocated to rent is very low by international standards, it is not by CMEA standards. In Russia and China, for example, households allocate even less of their income to housing, only 2 percent. Of course they have very little choice in the matter:

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[9] The distinction between financial and economic subsidies should be clear. An example of a financial subsidy is a payment made to a bank from the government's budget so that the bank can offer loans to households wishing to buy their flats at less than the cost of funds to the bank, in other words, less than market interest rates. An economic subsidy does not require an outflow of funds from government, but it means, for example, that a household is charged less for its flat than the real cost of that flat to the economy, its opportunity cost, in economic jargon. The rent now paid by the occupant does not include the cost of land. But that land does have value--people would be prepared to pay thousands of Tugriks for a piece of land equivalent to the flat's share of the land occupied by the block of flats. So there is an economic subsidy for land. It is to be expected that there will be economic subsidies for the privatization of housing; but it is likely that the government cannot afford financial subsidies. However even the former needs justification: the government could sell the land and improve its finances.

most housing is allocated and priced by the State. However, proportions of 10 to 25 percent across the range of income should be expected in a country at Mongolia's stage of development, and its shelter needs in terms of protection from a severe climate.

The deal offered to households to privatize will have to be adjusted to reflect the macroeconomic circumstances. This applies to both the valuation of the housing and the payment policy. Privatization pricing, valuation and payment options are discussed in the next chapter.

3.0 HOUSING PRIVATIZATION: GOALS, STRATEGIES, AND DEVELOPMENT OF A PRIVATE HOUSING MARKET

The privatization of the state-owned housing stock is an important goal of the privatization program of the Government of Mongolia. The major policy design for the program is being undertaken by the State Privatization Commission (SPC); the procedures will be carried out by the associated privatization committees of the Provinces and the major cities: Ulaan Baator, Erdenet, and Darkhan.

The privatization of housing is a major undertaking. There are about 125,000 permanent dwelling units in Mongolia, all in urban areas. There may be as many as 360,000 informal units, mainly ghers. The principal focus of the privatization will be on the 48,000 units, in 707 buildings, owned by the state in Ulaan Baator. Each of twelve housing authorities manage 50 to 60 buildings there. Over 40 percent of households in Ulaan Baator live in ghers, or gher-like units. As well as the current stock of housing, there is the future stock to be considered. The demand for new housing is high. Based on a population growing at 2.6 percent, about 9,00 units will be required for urban dwellers this year.

The SPC has been anxious to begin the privatization process early in 1993. The Government understands the need for more thorough preparation before privatization begins so that the transfer process will proceed more efficiently, and, equally important, so that the long-term goal -- development of a private sector housing market -- is kept clearly in mind. The Prime Minister has said that the privatization must go ahead "gradually, step by step."[10] Experience elsewhere in the world, including Great Britain, the United States, Eastern Europe, the NIS, and China, suggests that privatization of housing is neither easy nor quick. The reasons for careful preparation in Mongolia involve a complex of economic, legal, and administrative issues, which are briefly noted below.

Economic and Social Concerns. Housing is a long-lived and expensive asset which, in market economies, represents the major asset held by homeowners. It will take some time before households can fully understand the implications of the owner/renter decision. It will also take time for some to assemble sufficient resources to ensure that they can make the required payments. As discussed in Section 2.0, the medium-term prospects for the macro-economic environment are not good. *Because real income (and therefore living standards) may fall for many households, due to inflation and unemployment, it may not be possible to complete the desired privatization process for some years.* The managers of some of the Housing Authorities have carried out informal surveys of their tenants wishes to privatize. They report that most tenants do not want to privatize. Most believe that privatization will leave them less well off than before. They fear having to pay the "market price" for the apartment when they have so few savings. But most of all they are concerned about having to assume the maintenance

[10]Private communication.

responsibilities now undertaken by the state, through the Housing Authorities. The benefits of ownership are not clear to most families.

Legal Framework. Ideally, the legal framework for ownership, renting, and transfer of property of property should be in place before the process can begin. Otherwise, outcomes will be disputed or uncertain and will not support development of a private market as effectively as if the legal framework were better developed. The legal framework, which is discussed in Section 5.0, involves at least the following:

- Landlord and Tenant Rights and Responsibilities;
- Condominium Law, including the State as Condominium Member;
- Transfer of Property and Land Transactions;
- Loan Collection and Recovery (Securitization); and
- Cadastre System.

Administrative Concerns. The privatization process is administratively complex. This is partly a matter of the legal issues involved and partly a matter of the procedural activities which must be dealt with (including the appeals predicted by the SPC in disputes over valuation policies). These administrative policies should be in place before privatization begins, so that procedures for unit valuation, payment (including installment borrowing) and transfer of ownership are completed according to the relevant norms.

Attention must also be given to the coordination of responsibility for that portion of the housing stock that is not privatized, and the authority to set policies regarding rental housing. For example, for that portion of the Ulaan Baator housing stock that remains under city ownership, the city must have the ability to set rent and other policies so that the housing can be adequately managed and maintained.

3.1 The Goals of Privatization of Housing in Mongolia

There are numerous goals which, after discussion with the SPC, we feel are important for the specifics of the privatization program in Mongolia. These goals involve both facilitation of the privatization process and opportunities to provide incentives for development of a market-based housing sector. The goals also assume that the state will realize at least some portion of the value of the units: that is, the units will not simply be given away. The goals include the following:

- to continue the transition to a market economy and reduce the role of the state;

- to provide opportunities and incentives for development of a Housing Bank and a market-oriented system of housing finance;

- to provide incentives for increased housing construction by the private sector;

- to provide households with both increased control over their living environment and a valuable asset, the worth of which will increase over time;

- to reduce the fiscal demands on the state, cities, and provinces;

- to increase the value of, and the use of, the remaining small vouchers;

- to provide a fund for construction of additional housing;

- to help stop deterioration of buildings and units through increased maintenance and capital repair by private owners;

- to encourage labor mobility;

- to encourage private savings;

- to increase the range of choices in housing.

3.2 Housing Privatization Strategies: Steps to be Taken Before Privatization Begins

The Government and the State Privatization Commission are now preparing "Guidelines for Housing Privatization." The policies and procedures that should be in the Guidelines and therefore in place in order to begin privatization include the following (these are the policies listed under Priorities I and II as noted in Section 1.0):

- plans for gradual increases in rent and utility charges. In the long-term, charges will reflect true costs, but the process of increase must be coordinated with increased in income and consideration of ability to pay. The Government will decide on a rent increase in January, 1993.

- the overall policy regarding the pace and depth of privatization. This involves the expected speed of privatization and the proportion of total households that are expected to become owners during the first year of the privatization process and during following years. The state does not wish to simply give the units away. We assume that a very high price level (such as one determined by replacement cost) is not desirable because almost no households could afford their housing. Thus, the strategy should choose some intermediate option.

- the strategy should also consider the options for families living in ghers and establish a reasonable approach to equity between gher dwellers and households now occupying apartments. Thus, this overall strategy depends on (1) the goals of the Government of Mongolia with regard to the number of privatized units; (2) the desire of individual households to become owners; and (3) the ability of households to purchase their units given the valuation and payment procedures set in place by the GOM.

- unit valuation procedures which are both defensible from a market point of view and consistent with privatization goals. The valuation procedures should also establish equity of pricing for units of different size, quality, and location.

- payment strategies consistent with both privatization goals and valuation procedures. This may involve a particular combination of vouchers, cash downpayments, installment credits, and discounts of a given number of square meters per person. The SPC should design this strategy so that units can be purchased at a rate consistent with the overall strategy noted above;

- the GOM's approach to the legal framework for condominium ownership, renting, and transfer of property;

- design of data bases and information systems to facilitate transfer, management, and statistical analysis of the privatization process;

- rent and/or ownership assistance policies for households below the poor rate;

- a publicity campaign which explains in detail the privatization process and the owner/renter options for households.

3.3 Privatization Strategies

Numerous aspects of the SPC's Privatization Guidelines still under discussion. As noted above, the SPC's long-term goals for the proportion of households who will become owners and the speed with which this can be accomplished are not clear. It is within this context that we offered our comments on the SPC's strategies.

3.3.1 Rent and Utility Policy

Increases in rent and utility charges are necessary for several reasons:

(1) increased rents are a necessary part of the privatization process. Few households will see any reason to purchase their units if they can live in the same unit with extremely low charges for rent and utilities. At the moment there is strong pressure from the Housing Authorities for the Government to increase rents. This is because their costs have risen greatly following the liberalization of the prices of utilities and the materials needed for maintenance.

(2) given the pressure on the Government to reduce its fiscal deficit and the need to provide adequate funds for maintenance of the buildings, "real cost" should eventually be charged for rent and utilities.

(3) rents should differ for units offering different quality and locational features. (As discussed below, a coefficient system is being developed for valuation of units for privatization. A similar approach could be utilized for rents).

(4) finally, there is no point in subsidizing those households which can pay an appropriate rent. Increased rents are necessary to foster development of a market-oriented housing sector, and subsidies should only be given to those who are unable to pay (see below).

The announcement of rent increases should be kept strictly separate from privatization itself, however. This is to avoid "blaming" the privatization process for the increase. All price increases cause some hardship, and the unpopular feelings should not be associated with the SPC. Rent increases are ultimately inevitable.

3.3.2 The Social Safety Net

The rent policy must be linked to income policy. There is no point introducing increases which no one can pay. On the other hand, as noted above, there is no point in subsidizing households who actually can pay. The compromise is to link rent increases to the expected changes in a target income level, say median income. Below some level, such as the official poor rate, households would need assistance from the state in paying for rent and utilities. Benchmarks in the United States are that households should pay up to 25 or 30 percent of their income for rent and utilities. Benchmarks in Mongolia might be closer to 15 or 20 percent, but this may be too high for the poorest segments of the population, depending on other price and income polices. In any event, rent policies in the context of privatization should be coordinated with officials responsible for both economic reform policies (prices and income) and social welfare policies (this involves the Ministries of Labor and Finance).

It is important that all subsidies be "transparent." The Government should be very clear about who is being subsidized and by how much. That is the best possible way to minimize the subsidy burden on the Government. And if the Government is not recovering the full market values of its assets or enough from the rents to cover the costs of managing and maintaining the buildings, then that too should be clearly accounted for. It would benefit the Government from a public relations point of view if tenants know the size of the subsidies they now receive through their rents. That knowledge would strengthen the case for increasing rents and also encourage households to buy their apartments.

3.3.3 Valuation Policy

Two approaches to valuation have been considered by the SPC: a book value approach and a "point system" approach. We discussed with the SPC that the book value approach was not an appropriate method of estimating current market value. (As they eventually realized, many of the best buildings had the lowest book value because they were the oldest.)

The alternative under consideration by the Commission is a system based on points, using "coefficients" for assigning credits and debits for specific features regarding the unit, its location, and availability of all utilities. We suggested that this was the preferred approach. We refer to this method as the *purchasing power approach*.

There are two important aspects to the valuation strategy:

(1) the *price level* (that is, how high or low the price is set, or the price per point);

(2) the price of one unit *relative* to another unit (that is, how a high quality unit in the center of the city compares with a poorer unit in another area). This relative pricing depends on the values established for the coefficients and the number of aspects of the unit and its location that are taken into consideration.

Policies established for both the price level and the relative price should be clear, consistent, and defensible. This will help avoid numerous appeals by households over the valuation of their unit. In addition, along with the procedures established for payments, the pricing will also help establish the "parameters" of the privatization process: that is, how many people will want to buy their unit and will be able to afford it.

Price Level. We assume that units will not be given away free of charge. This give-away approach denies the state any return from a valuable asset; does little to demonstrate market concepts or provide incentives for occupants to maintain a valuable asset; and provides no incentive to increase income or the rate of saving to purchase the unit in the future. Furthermore, it raises very difficult equity issues for gher residents.

The purchasing power approach starts with a defensible fair market value and then sets the price (or the price per point) so that a targeted number of households are presumably able to buy. The price level is set to be consistent with the financing strategy.

One type of reference level for price is the replacement cost. For example, the reference price would be the price of replacing a good quality unit in a new building in a desirable central location. (Existing units would then have points added or deducted for age or other features; see below). The replacement price level, however, is presumably too high for almost all households and is therefore not a fair market approach.

Another reference point is to collect data on units which have already been trading informally. This price represents the market value of the right of occupancy, and is a guide to understanding the relevant level.

Ultimately, as agreed to by Commission staff, the "market price" is viewed as a relative concept (rather than an absolute as suggested by a book value policy). The price, or the price per "point", will be established based on consideration of the goals for privatization. This approach requires that the Commission also determine the distribution of income. The point system can assume any starting point. The price per point will vary to set the total price at a "reasonable" level.

Although SPC agrees with this approach, there remains some concern about using "market prices" in the current economic circumstances. The Ministry of Construction has been given the responsibility to establish what it calls the basic price, a price based upon replacement costs. This is a great step forward from the original historic cost or book value basic price. The Ministry believes that it should use the 1990 replacement cost rather than the current one because the 1992 cost is two to three times higher and therefore, as it says, not affordable by most households. If the housing is not affordable at the basic price, then the basic price is not the market price, at least in the short term. The market price is by definition the price people are prepared and able to pay for something, be it carrots or apartments. Very few people can afford the replacement cost of their apartments at the moment. In the long term, once the economy has recovered, real wages tart to rise, and the supply of housing can be increased, the market price will be similar to the replacement cost. Because the current market value of the housing is less than its long-term market value, or the replacement cost, there is a case for discounting the 1992 replacement cost in order to encourage families to buy their apartments.

We could use the term "clearing cost" for the price people should pay for their privatized apartments. The clearing cost is less than replacement cost because of the macroeconomic crisis. At the present time this clearing cost is less than replacement cost partly because, at these early stages of the market economy, much of the households' real income is "in kind" rather than in cash -- in the form of subsidized goods and services. Once those subsidies have been removed and incomes have been monetized and begin to rise to market levels, then more income will be in the form of cash. Families will then have more income at their disposal to spend on housing.

In summary, final unit costs, after all deductions, might range between 150,000 to 400,000 tugriks or more. This would allow households with annual incomes of 35,000 or 40,000 or more to utilize cash and/or installment loans to purchase their units. In the United States, the average household purchases a home worth roughly three times annual income. In developing countries and developed countries with very high housing costs, the multiple rises to 4 or 5 time annual income. Note that under this approach, the relative price of the unit is established as a function of unit characteristics. Individual household income does not impact the price of a given unit: that is, the "price" is not reduced for poor households; if an income subsidy is involved, it is calculated as a separate policy. (The national income distribution helps determine the target price level, or equivalently, the price per point.) Affordability will be discussed in more detail in Section 3.3.5.

Coefficient Values: Relative Price. The second major component of the pricing policy is the relative value of units with different characteristics. The Commission has begun to develop a system of coefficients which add or subtract a proportion of the value of the "starting point" unit depending on features of the unit, the utilities, and the location. We agreed that this strategy is appropriate and will yield a very defensible distribution of relative unit prices. The approach is readily adaptable to the point system now being considered by the Commission.

We suggested that the Commission utilize a statistical procedure, frequently used in market economies, to refine its current estimates of coefficient values. This procedure, known as a hedonic index, relates the numerous characteristics of housing to the price actually paid for the unit in a market setting. An adaptation (simulation) of this procedure for Mongolia is discussed in Annex I.

Obviously, in Mongolia, there is not a sample of "market" prices. We therefore suggested staging a simulation which would attempt to replicate the market price. A limited number of housing company officials and/or households will be trained to inspect a randomly selected sample of units. They will fill out a score sheet containing the housing attributes already defined by the Commission (that is, utilities, location, unit features such as balconies, and building features such as height and materials). Additional characteristics, known from past studies to be important in determining value will also be added. Based on clear guidelines regarding an acceptable range of values, the inspectors will establish a "price" that they would bid for a unit with given features. Using a multiple regression approach, these data will yield relative coefficient values. These could then be utilized in the point system as desired by the SPC.

The advantages of the procedure for the valuation process in Mongolia include the following:

- housing is a complex bundle of characteristics involving unit size, unit quality, utilities, building characteristics, neighborhood features, and location. The simulated hedonic approach would help establish the *relative* value of each of these features. Arbitrary assignment of coefficient values can be minimized.

- prospective buyers consider the value of numerous features at the same time. The value of a given feature may depend on the presence of other features or on the overall quality of the unit. The hedonic estimation allows many features to be considered simultaneously.

- setting the coefficient values used in the point system will be assisted by the results of statistical estimation. The estimated values are essentially derived from data expressing the "votes" of a large number of people on the relative value of a large number of different housing units.

- Since the application of the point system approach will be the same for the valuation of each unit, arbitrary decisions regarding value are minimized. The process of privatization should therefore proceed more smoothly and reduce recourse to appeals.

3.3.4 Financing Strategy

As noted above, the financing policies are an integral part of the privatization strategy. In Mongolia, financing might include:

- small vouchers

- cash downpayments

- installment payments, to be indexed and paid over a period of five or ten years, and

- deductions as decided by the Commission regarding square meters for each family member.

Each of these components has distinct advantages. Small vouchers promote a market since (hopefully) they can be traded among those who do, and do not, wish to privatize. Free square meters essentially subsidize large households, which is common to many housing subsidy systems. Cash down payments are required in traditional mortgage financing, and so set a good precedent. The cash can also be used to finance new construction and/or rehabilitation. Discounts could be given for those who pay entirely in cash.

Installment payments are perhaps the most important aspect of the payment. They will allow many more households to privatize and allow the state to set the price at a reasonable level. It is not necessary to have a Housing Bank set up to administer the installment payments. The specific role of the Housing Bank, and the evolution of a market-based system of housing finance are discussed in Section 4.0. As noted there, both lack of capital (public or private) and lack of banking experience preclude establishing a Housing Bank prior to privatization. In the absence of such a bank, several features of this proposed installment system should be noted:

- the installment payments need not result from a loan from a bank, but rather just a payment to the State on behalf of the State and the Privatization Commission;

- these installment payments represent an important source of funds for financing new construction;

- if payment for most or all of the unit is made in cash, the buyer should receive a discount;

- in order to protect the payments from the erosive effects of inflation, the payments and outstanding balance may be adjusted (indexed) to counter the inflationary effects.

3.3.5 Payment Policies and Affordability

Senior staff in the State and Ulaan Baator Privatization Commissions, and the Housing Company understand the need to transfer ownership at as close to market as possible, but they continue to be very worried about the affordability issue. Staff do now realize that the 5 percent households now spend on average in urban areas on rent and utilities is very low by world standards and that they can raise their affordability standards somewhat.

SPC is likely to discount market prices by giving each person free space (3 m2 has been suggested), require a cash plus vouchers deposit and installment payments to cover the rest of the difference between the market price and the value of the free space and the deposits. The very poor will probably be further subsidized. Except for the poor who could not even afford their monthly condo fees or maintenance costs, these subsidies are economic, not financial subsidies, since they would require no financial outlay by the Government.

We ran a simple affordability model to identify conditions under which a substantial portion of the households would want to privatize, in other words, could afford to privatize. The results are shown at the end of this chapter.

Under the conditions for Run 1, which is shown in Annex 1, about 55 percent of households could afford to buy their apartments. The key assumptions are that families spend from 5 percent of their income on housing for the very poor to 23 percent of their income for the rich; each household member receives 4 square meters of free space; financing is for 15 years at 8 percent; and there is a 5 percent downpayment. Note also that we have assumed that the rich live in somewhat larger apartments that also cost more per m2.

The conditions for Run 2, which is also shown in Annex 1, are the same except that families receive 3 m2 per person, a 20 percent discount on the market price (the replacement cost), and a 6 percent interest rate. Under these conditions, almost 80 percent of households can afford to meet the payment requirements.

The deal should not be so generous that the housing is given away and all households become owners of their apartments. First of all, there will be a loss to government revenue if the housing is given away free. Secondly, and more importantly, it is essential for there to continue to be some rental housing stock owned by the state until the private sector is able to construct rental housing. Families in certain circumstances will always prefer to rent their housing: for example, young families with low incomes who want to save to buy a house later; or families living in particular locations for a short period of time; and of course the poor, aged, and infirm. At the moment the private sector is in no condition to invest heavily in the construction of rental housing (although we heard that some entrepreneurs are buying parts of unoccupied or Russian apartments to rent to rich Mongolians and foreigners). So the state will have provided almost all the rental housing from the existing stock of housing for some years. However, the introduction of a market oriented housing sector will in the long run encourage the private sector to invest in rental housing.

Another aspect of the deal is that discounts should be given for households that pay all cash and for households that complete their installment payments early. In economic jargon the "discounted present value" of those early payments is high for the managers of the housing fund. In other words, it is worth something for the managers of the fund to have T 100,000 now rather than in 5 years' time.

The deal should also avoid giving households incentives to conceal income. This is a serious problem in many countries where the conditions for privatization offered to households are linked to their income -- in other words, those with lower incomes paying less. The Mongolian Household Expenditure Survey shows that even in urban areas households earn a substantial portion of their income from non-salary sources. This proportion will probably increase as the market economy expands. So no part of the deal should be "income determined" for the majority of households. However, the very poor will have to be identified and protected with subsidies. Apart from the poor, the only checks on income to be made would be to make sure people can afford to make the installment payments. That being the case, if there is any incentive to lie about incomes, it will be to exaggerate rather than understate income.

3.3.6 Future Trading of Apartments

The Government has said very clearly that the main purpose of the privatization of the state-owned apartments is to extend and deepen the market economy in Mongolia. The Chairmen of the State Privatization Commission confirm that this was the over-riding objective when we met. The principal advantage of a market economy over a centrally planned economy is that it increases wealth and income by encouraging trade. Goods and services which are not traded under a centrally planned economy are traded under a market economy. Housing is not traded in Mongolia. Families are allocated housing by the state, after years on waiting lists in some cases. Few families live in the housing of their choice. Some would pay more for something better; many are struggling to afford what they have. Many studies have shown that if people are able to choose the housing they want, they will not only be better off but they will invest in that housing. And if people can own their own homes, they will save to own something better. It has been shown (World Bank, 1990) that a market oriented housing sector encourages labor mobility -- people moving to the job they are best qualified to do -- and that in itself increases GNP significantly. Some leading housing experts at the World Bank have estimated that GNP is 3 to 4 percent lower when the allocation of housing is centrally planned. In other words, the gain from the market oriented housing sector, with free trading among residents, may be as much as 4 percent of GNP. At this time, Mongolia would benefit greatly from a 4 percent boost to its growth rate.

This means that, in designing the privatization program, the Government should aim to encourage trade in the privatized apartments. It should encourage further purchases and sales following the actual privatization. This freedom to carry out transactions will actually increase savings and investment, and GNP growth, as well as allow households to live in the housing of their choice.

There is another benefit from encouraging trading in apartments. Many people told us they were worried about the impact of the privatization on the households who live in the ghers. Since the privatization of the apartments represents a benefits to the families living in flats that will not be shared by the families living in ghers, there will be some resentment, which could have an adverse political impact. However, if the Government permits free trading once the privatization has taken place, then the gher dwellers will at least have an opportunity to buy apartments. If SPC also privatizes the gher dwellers' land, and they are free to sell the land, then there will be further trading benefits to gher households and to the economy as a whole.

If one of the main guiding principles is to encourage trading and transactions in the housing market, then the deal offered to the households to privatize must also encourage trading. This means that the deal should be designed to encourage a high proportion of the households to buy their apartments and that there should be no constraints on future sales.

3.3.7 Privatization of Whole Buildings and Land

A number of ownership topics, which we have labelled the "density" of privatization, continue to be debated by the SPC. These relevant question include the following:

- should any household be permitted to privatize in any building, even if no other household in that building wishes to do so? Alternatively, should a majority be required in a given building?
- should households privatize just their units or should the common areas also be included? How will maintenance charges be handled if common areas are retained by the state?

The privatization of individual units, without consideration for privatization of the buildings themselves, does not go as far toward the goals of privatization as does the conversion of entire buildings. If only random units are converted to homeownership, there will be no appreciable difference in management -- which is one of the major objectives of the program. Consequently, we recommend that the program be designed in a way that achieves a threshold of interested families, capable of purchasing their units, before any transfer takes place. There would be a simultaneous "closing" for all of those families. Since the State would likely continue to own the remaining units (although there are other alternatives, such as a form of NGO ownership for those units), the threshold should be at 51 percent or higher, perhaps 66 percent majority.

Together with the sale of units to residents, a community association should be formed that would take responsibility for policy, procedures, planning and oversight for that building, or group of buildings. This association would prepare the budget and set the level of monthly fees sufficient to cover basic operating costs, maintenance of the structures and reserves for replacement. If the state remains as owner of some units, it will therefore be the member for those units. The state could continue renting to the residents in state-owned units, but the state would then have to pay the association its proportionate share of condominium fees. Alternatively, the association could manage those units on behalf of the state, collecting the rent from the state's tenants.

An issue that has not been addressed is the determination of whether buildings should be grouped together for the purpose of sale. There appear to be some logical groups: some buildings surround a courtyard and share a common playground; some buildings appear to have been constructed at about the same time in the same locality and share construction techniques (and perhaps defects); some groups of buildings may also share the same electrical distribution center or heat exchangers, et cetera, which would argue for sharing of management responsibility to achieve economies of sale and avoid conflicts. A careful analysis should be made of the distribution of utilities, age and condition of buildings, site plans and sharing of common areas to make this determination. In general, we recommend that buildings be grouped together, where feasible, to reach reasonable economies of scale and to facilitate cooperation among buildings in regard to courtyards, playgrounds, and the like. Groupings that result in from 100 to 300 or even 400 units appear reasonable as regards the management of the properties and the community associations.

Careful definition should also be made of "common areas." When we recommend that the buildings themselves be converted, this includes exteriors, roofs, elevators, stairwells, and any commonly owned or leased space on the underground level. These areas, at a minimum, should be privatized. Likewise, where community facilities such as playgrounds are easily "tied" to a building or group of buildings, these also should be privatized. The area of "common space" that needs closer study is the distribution systems for water, waste water, electric and heat lines, lift stations and the like. It may be more feasible for a governmental entity to continue maintaining these facilities, although charging a fee to the associations for the maintenance as well as the utilities themselves. This could be the housing authority under a re-incarnation, the housing company, or the City of Ulaan Baator. Maintenance could be charged as a percentage of utility consumption, or on a "property tax" basis, keyed to the value of the property itself.

There are, however, particular concerns in Mongolia regarding this approach. First, with regard to the common areas, the SPC does not feel that its citizens will be able to manage maintenance of the common areas. Of particular concern are the elevators, almost none of which are now operating due to absence of replacement parts. Secondly, some advocates of tenant rights hold that the status quo must be inviolate, while others see the need for mobility and exchange of units to enable privatization of all or the majority of units in a building.

It is legally feasible, and administratively possible, to imagine many buildings in which not all households owned their units. The State can belong to the condominium association for units those that still rent. It seems, however, that this would work best if the great majority were owners -- that is, at least 60 or 70 percent, for example. In this case, the condo association of private owners is, in fact, setting overall policies for the building.

In the alternative case, where the state still owns the majority of units, it is difficult to see how the private owners can really establish policy, set charges, contract for maintenance, and so forth. It is our opinion that this situation should be avoided, certainly in the long-term.

Also, in the long-run, it will be useful to make the transfer of ownership complete, that is, to privatize common areas as well. The SPC has valid concerns over maintenance of common spaces, especially for items needing imported materials and parts. Thus, while in the short-term a "partial" transfer system could be retained, ultimately the condominium association must take responsibility for all aspects of the building and its associated land.

3.3.8 Policies for Households Who Do not Wish to Privatize or Cannot Afford to Privatize

Some proportion of households currently in units will either not want to buy their units or will not be able to afford their units. There are several options for these households.

- for households who do not want to buy their units:
  - households who do not want to privatize can simply remain renters in state-owned units;
  - households who do not want to buy their units, but who are resident in buildings where a majority wish to privatize, could be asked if they would move to an all-renter building; this will facilitate privatization of whole buildings.
- for households who wish to buy their units but who are unable to afford them, further decisions must be taken:

— these households may receive economic assistance from the state in order to privatize, (depending on their income eligibility);

— alternatively, these households may receive no assistance and remain renters until they wish to/can afford to purchase.

The second case, treatment of households who wish to purchase but who cannot afford the terms, is a difficult issue which must be addressed by the Commission. We understand the desire to offer units to all current residents. There are, however, arguments for simply letting these households remain renters and receive no assistance from the state for purchase; these arguments include the following:

- renter households who cannot purchase at the present time will have an incentive to increase their income and/or save more in order to purchase their units at a later time;

- these households can always sell their "rights to occupancy" in the informal market and thus realize major gain from their residency (in fact, this is already taking place on an informal basis);

- equity with regard to households who purchase their units with cash and/or installment payments is maintained;

- gher residents represent a substantial proportion of the population in Ulaan Baator and elsewhere. Equity with regard to gher residents is maintained if units are not given away free or at great discount;

- if the sales of units are not assisted by the state, then this avoids having to determine exact family income in order to assess who might be eligible for assistance. Income determination is extremely difficult in situations such as those now faced in Mongolia. It would simplify procedures greatly if no income determination was required (except for households below the official poor rate as discussed below);

- subsidies are targeted only to those who really need them the most (that is, households with income below the poor rate, see below), which is important in a time of severe fiscal pressure.

3.3.9 Policies for Households Below the Official Poor Rate

Two main issues are of concern with regard to households whose income is below the poor rate: rent assistance for those who cannot pay increased rent and utility charges and state policies which carefully target subsidies only to those most in need. Since these households cannot afford to purchase their units, policies with regard to their renter status follow from the discussion in Section 3.3.6 above. Thus, we assume these households will remain renters but receive state assistance for rental payments.

- as discussed above, we recommend that rents and utility payments be gradually increased towards the level of full cost and that this policy be initiated before the privatization process begins. Thus, poor households will require assistance in meeting these payments. One approach is for households who meet the income eligibility rules to receive a housing voucher; the goal is generally to pay the difference between actual rent and some fixed proportion of the income of the poor household;

- the policy of raising rents combined with assistance to poor households is both cost-effective for the state and is most consistent with a move to a market economy. Thus, only those who really need subsidy actually receive it, while rents are increased over time to rational levels, and those who can pay are required to do so.

3.4 The Importance of the Transition Period

As has been discussed, both economic and social circumstances in Mongolia suggest that the process of privatization of housing units will proceed quite slowly. This means that the state (that is, the cities and the provinces) will remain as owner and manager of a substantial portion of the apartments during the transition period. Thus, numerous "transition" policies must be developed to deal with circumstances in the short- and medium-term, including those that deal with the privatization of common areas and the transformation of entire buildings to private ownership. Other transition issues are the privatization of maintenance and services, of construction, and development of a private rental market.

3.4.1 Privatization of Maintenance and Construction

In the long-term, it will be desirable to privatize the Housing Company and Authorities. Competition for service and maintenance contracts will eventually take place among many private companies, who can be contracted by both the condominium associations of privatized buildings and be buildings still under state control. In addition, the private companies need not all be large organizations, as the housing companies are at the present time. Rather, many services can be competed for by small private service groups.

In the transition period, the state housing companies could be encouraged to compete among themselves for jobs outside their own districts. In addition, competition for specialized small services and repairs could encourage the development of small private contractors. This approach would also force the housing companies to examine their staffing levels and procedures to ensure that they are as cost-effective as possible. Aggressive bargaining by the condominium associations will help increase efficiency.

In order to facilitate competition, training can be offered to both condominium associations and housing companies in order to streamline negotiation of rights and responsibilities in service contracts.

3.4.2 Privatization of Construction

Privatization of the construction, building materials, and developer industry is a similar long-term goal. In the transition period, it is assumed that the state will finance and build new units, as well as complete those now begun but unfinished. However, policies should be set in motion to encourage and assist small private contractors to build in the private sector, especially for new single family and garden apartment construction. (As discussed in Appendix I, the construction industry is also an important aspect of the overall technical assistance to the shelter sector).

3.4.3 Private Rental Market

In the medium-term, we assume that the state will continue to own and manage all units not privatized at the present time. As noted above, it is likely that a substantial portion of the units will remain in state hands.

In the long-term, however, it is desirable to shift towards private ownership of rental units and thereby continue to decrease the role of the state. This will take some time, however, since it will require substantial capital for investment in new or existing units. The capital is not available at the present time. Thus, it is all the more important to encourage privatization of maintenance and other services, which will reduce one portion of the burden of the state in the housing market.

HOUSING POLICY TRAINING MODEL – RUN #1

Elements of Land Cost		Elements of Free Space		Maintenance	
Land Cost/Hectare	4,500,000	Average Occupants/Unit	5	Average Charge/Meter	1.7
Density - Units/Hectare	0.000	Free Space/Occupant (sq. m)	4		

Members/	5	Per Capita	100	Income/	500	% of Income	5%	Size of	25
Household	5	Income	250	Household	1,250	for Housing	8%	Apartment	27
	5		400		2,000		12%		29
	5		550		2,750		15%		30
	5		700		3,500		18%		32
	5		850		4,250		20%		33
	5		1,150		5,750		23%		35
Base Cost/	6,000	% Market	0%	Unit Cost	150,000	Land Cost	0	Value of Free	120,000
Meter	6,000	Rate	0%		162,000		0	Space	120,000
	6,000	Discount	0%		174,000		0		120,000
	7,000		0%		210,000		0		140,000
	7,000		0%		224,000		0		140,000
	8,000		0%		264,000		0		160,000
	8,000		0%		280,000		0		160,000
Value of	15,000	% Down	5%	Cash Down	7,500	Cost to	7,500	Terms of Loan	15
Vouchers	15,000	Payment	5%	Payment	16,200	Finance	10,800		15
	15,000		5%		17,400		21,660		15
	15,000		5%		21,000		34,000		15
	15,000		5%		22,400		46,600		15
	15,000		5%		26,400		62,600		15
	15,000		5%		28,000		77,000		15
Interest Rate	8%	Monthly	73	Maintenance	42	Ability to	25	Difference	-90
	8%	Payment	105		45	Pay	100		-50
	8%		210		48		240		-19
	8%		331		50		413		31
	8%		454		53		630		123
	8%		609		55		850		186
	8%		750		58		1,323		515
								Affordability:	55%

HOUSING POLICY TRAINING MODEL – RUN #2

Elements of Land Cost		Elements of Free Space		Maintenance	
Land Cost/Hectare	4,500,000	Average Occupants/Unit	5	Average Charge/Meter	1.7
Density - Units/Hectare	0.000	Free Space/Occupant (sq. m)	3		

Members/	5	Per Capita	100	Income/	500	% of Income	5%	Size of	25
Household	5	Income	250	Household	1,250	for Housing	8%	Apartment	27
	5		400		2,000		12%		29
	5		550		2,750		15%		30
	5		700		3,500		18%		32
	5		850		4,250		20%		33
	5		1,150		5,750		23%		35

Base Cost/	6,000	% Market	20%	Unit Cost	120,000	Land Cost	0	Value of Free	90,000
Meter	6,000	Rate	20%		129,600		0	Space	90,000
	6,000	Discount	20%		139,200		0		90,000
	7,000		20%		168,000		0		105,000
	7,000		20%		179,200		0		105,000
	8,000		20%		211,200		0		120,000
	8,000		20%		224,000		0		120,000

Value of	15,000	% Down	5%	Cash Down	6,000	Cost to	9,000	Terms of Loan	15
Vouchers	15,000	Payment	5%	Payment	12,960	Finance	11,640		15
	15,000		5%		13,920		20,280		15
	15,000		5%		16,800		31,200		15
	15,000		5%		17,920		41,280		15
	15,000		5%		21,120		55,080		15
	15,000		5%		22,400		66,600		15

Interest Rate	6%	Monthly	77	Maintenance	42	Ability to	25	Difference	-94
	6%	Payment	100		45	Pay	100		-45
	6%		174		48		240		18
	6%		268		50		413		95
	6%		354		53		630		222
	6%		473		55		850		322
	6%		571		58		1,323		693

Affordability:	79%

4.0 THE FINANCIAL SYSTEM AND HOUSING FINANCE

This section examines the issues involved in both the short-term and long-term development of housing finance in Mongolia. Some members of the SPC and the Government of Mongolia wish to quickly establish a National Housing Bank to facilitate the financing of housing privatization as well to be a source of funds for new construction. Ideally, the privatization process would represent an opportunity to lay some important groundwork for the financing of housing in the future. However, while in the long-run we support the notion of a separate housing finance institution, the current situation with regard to financial experience and institutions in Mongolia suggests that more time is needed to develop a viable approach. As we discuss, privatization need not be linked to establishment of a housing bank. Financing for purchasing units by their tenants can be offered without involving financial flows. This will allow more time for addressing the problems facing the entire banking sector.

4.1 Overview of the Banking Sector

The capital market and financial institutions in Mongolia are in a very formative stage. Until May of 1991, Mongolia had a monopolistic banking system, with banking operations undertaken by the various regional branches of the State Bank and their divisions. Now, the sector is being reorganized as two-tier; at least ten commercial banks have been formed and the State Bank is reorganizing itself to undertake the functions of a central bank in a market economy.

Three main aspects of the current situation suggest caution with regard to forming a housing bank at present: lack of financial experience, lack of a legal infrastructure, and uncertainties with regard to recapitalization of the financial sector, in part due to uncertainties regarding the course of industrial privatization.

4.1.1 Weaknesses of the Current Financial System

Donor evaluations of the current state of the banking system have indicated a basic lack of understanding of banking concepts in a free market, including the role of competition, the role of a central bank, and the functions of the credit process.[11]

Access to bank credit has generally been restricted to the public sector. In discussing the design of financial systems for Eastern Europe, Stiglitz notes the importance of appropriately designed capital markets in sustaining economic reforms in these countries. Specific problems include the establishment of "hard" budget constraints in financial institutions, the problems of inherited loan portfolios, the creation of new institutions, the introduction of competition, and

[11] A UNDP Interoffice Memorandum, January 9, 1992, summarizes these problems and notes the need for both conceptual and practical training.

the relationship between finance and corporate control. In Mongolia, where banking as we know it does not exist, where industrial development was conditioned to meet Soviet needs, and where privatization of industry is taking place rapidly, without extensive valuation of the industrial assets, these concerns are at the heart of issues surrounding the development of the capital market.[12]

The limited private sector credits that have been recently extended were done without collateral, reflecting the lack of legal framework for property transfer.[13]. Other weaknesses of the financial system include:

- Little understanding of how to appraise risks of loans or to pursue recovery in the case of default;

- Direct or indirect government control of credit distribution;

- Very little privately controlled financial capital, including household savings held in a financial institution; and

- No experience with legal processes of securing a loan and collecting in the case of a default.

These weaknesses are being addressed with the help of various multilateral donors, but progress has been very slow.

Two commercial banks were visited to assess their attitudes to lending for housing and current practices. The largest was the Investment and Innovative Technology Bank, which was one of the two commercial banks set-up by the Central Bank in May, 1991 to take over existing loans. One of its specialties is construction lending and loans on existing incomplete projects, such as the Genghis Khan Hotel. The bank thinks that incomplete structures are excellent collateral, apparently reflecting the traditional view of value on book value. For such construction, they are willing to lend for up to three years at some fixed spread over the Central Bank's lending rate.

The existing loans for construction did not include mortgages, so they have no formal foreclosure in process. Future loans would include mortgages and they think that foreclosure is viable. They are not confident about foreclosure in the case of occupied residential property. In any case, they would want additional collateral for construction lending. For loans for individual houses, they would look to guarantees form employers and character references. Currently, most of their lending is for trading activities between Russia and China.

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[12]See Stiglitz, "The Design of Financial Systems for the Newly Emerging Democracies of Eastern Europe. Also see Kraay. and Appendix II of this paper for a discussion of the industrial privatization in Mongolia.

[13]Refer to Appendix II of the IMF report by Milne, et. al.

The Mongol Cooperative Bank is the smallest bank, but the most private in its managerial attitudes. It is owned by the Cooperative sector and has only 600 Tugrik million is assets currently. It focuses on providing working capital to new small enterprises. The Cooperative Bank will lend up to T 300,000 for the construction of a house for a maximum term of three years. While they feel they could recover possession of pledged property, they prefer to require additional collateral and to look to potential commercial rents to recover on a construction loan.

The Bank is profitable currently, with net income of T 30 to 40 expected in 1992. However, this represents only about a 30 percent return on capital of T 120 million, which is not much more than their maximum rate on deposits (25 percent) and is deeply negative in real terms. At this point, none of the banks are successful in mobilizing Tugrik deposits, presumably because of the negative real rates of return and also doubts about the reliability of the banks. In fact, most major enterprises keep their foreign exchange holdings in foreign banks outside the country to ensure that they are not expropriated in current extreme shortage of foreign exchange.

Instead, most funding comes for the Central Bank, where loan applications are received, reviewed, and approved within the guidelines of overall credit creation. Apparently, this system is working satisfactorily currently, because there is relatively little demand for capital investments, as opposed to loans for trading activities and so cover operating losses.

There do not appear any ready sources of funding for long-term lending for housing. The deposit base is completely undeveloped and there is only the beginning of asset accumulation by insurance companies. There are no private pension funds currently and the government retirement account is deeply in deficit on a current cash basis. In this environment, mortgage credit will probably have to derive from long-term government loans to a specialized Housing Bank.

4.2 Introducing Finance into the Privatization Process

Since the government already owns the housing stock without any associated debt, it has several options for introducing financing into the privatization process. First, the provision of financing to tenant-purchasers need not involve any financial flows. If it wishes to offer financing, it can do so simply in the form of deferred payment plans, with or without interest. Alternatively, it can insist on all cash (and vouchers). Finally, it can originate formal loans through a commercial bank, funding those loans out of the general budget with the proceeds of the loans flowing back into the budget (although perhaps into a different place in the budget).

There are at least three considerations with respect to the desired approach. The first consideration is how much in real value the government wants to obtain for the housing. The provision of some kind of financing permits a household to pay more in total for its unit. The maximum amount can be obtained through very long-term financing with provisions for indexation for inflation.

The second consideration is simplicity, both for the sake of reducing administrative burden and for comprehension by the purchasers. There will be many other complexities demanding the time and energies of government officials and taxing the recordkeeping capacities of accounting offices. There also is an extremely low level of understanding about the nature of mortgages, interest rates, inflation, recording and release of liens, loan recovery enforcement procedures, and so on, on the part of officials as well as individual households.

A third consideration is the longer-term development of a viable housing fiance system. The privatization process would be neutral with respect to this if it provides no financing or it can be deleterious to this if it provides financing on terms that promote erroneous notions of what financing should be like. Alternatively, it can help promote sound principles of housing finance.

It should be possible to give all of these considerations significant weight in formulating the financing portion of the privatization strategy. A relatively simple form of multi-year payment scheme will permit the government to collect more for the units without causing undue complexity to administrators or purchasers. Moreover, if the scheme is properly specified, it can introduce to the public certain principles of mortgage finance.

4.2.1 A Specific Approach

One such scheme would involve the offer to finance up to half the cost of the apartments (before any deductions for free areas and other adjustments), up to a maximum of 90 percent of the net price after deductions and adjustments. In other words, if the fair market value is determined to be 300,000 T for a unit with 60 square meters of usable floor space, then 150,000 T of this could be financed. However, if the family has six members, the net price is only 150,000 T after a 5 square meter per person deduction. In this case, the maximum loan would be 90 percent of 150,000 T or 135,000 T. Any additional cash payment would go towards lowering this loan amount.

The term of the loans should be relatively short, both in order to avoid having to service many small loans and because longer terms may be too abstract to ordinary people. The maximum term should probably be only 10 years, with a lower interest rate applicable to shorter terms. A longer term could be considered if the government is determined to charge a higher price for the units, closer to replacement cost. But it seems likely that this is not a high priority, especially if the greater revenue would appear only in the distant future.

The issue of the interest rate is a particularly difficult one. Currently, all interest rates in the formal financial sector are very negative in real terms. Moreover, there is very little understanding of the nature and function of interest, especially in an inflationary environment. Until very recently, most lending was done at a low fixed rate (e.g., 1 to 5 percent) and loan rates were often less than deposit rates. However, some recognition of the effect of inflation on purchasing power and nominal asset values is probably appearing.

The recent history of inflation and the strong likelihood of more in the future calls for the introduction of some kind of inflation-related adjustment to any financing for privatization. However, the simple indexation for inflation is precluded by the likelihood of major swings in real wages, in the aggregate and especially for individual debtors.

A dual index mortgage design (with principal indexed to inflation and payments indexed to average wages) could be adopted, but there would remain a significant risk that amortization of the loan would not be complete within a reasonable term because of lagging real wages. While such an approach may be necessary and practicable in several years, it seems that the introduction of such a complex instrument in a situation where the real value of debt does not need to be preserved (i.e., the privatization process has a lot of arbitrary elements to it and does not involve private financial intermediation) is not necessary. Nor is it likely to be practicable when the consumer price index is subject to a variety of criticisms and non-price rationing is occurring.

A more attractive approach would be to set a relatively low stated interest rate and starting payment (e.g., 3 to 5 percent), but index the loan to the lesser of the cumulative change in the average wage in the civil service or the minimum wage, as set by the government. This would probably imply a decline in the real value of the payment over time, and, for those in the new private sector, may mean a decline in payment-to-income ratio over time. But it would introduce to Mongolia the notion of the nominal mortgage principal rising with wages and prices, without risking discrediting the indexing process through drastic variances in payment burden or extensions in loan term required by declines in real wages.

4.2.2 Underwriting Procedures

This approach leaves many questions with respect to the underwriting process for installment lending for privatization. The first question is whether there should be an underwriting process. In Hungary, state-owned units are being privatized with installment payments but without any underwriting. This does not pose a major problem, since most units are being sold at a 50 to 85 percent discount and a 3 percent fixed nominal interest rate is applied. If the real burden of installment payments in Mongolia are low enough, underwriting could be skipped there also.

A problem with trying to impose payment-to-income limitations is the difficulty of measuring anything other than formal sector income. There is sufficient evidence to conclude that most household derive 25 to 50 percent or more of household income from unreported sources. One approach to this problem, assuming that some form of underwriting is desired, is to permit a payment-to-reported income ratio of up to 40 percent if there is reasonable evidence that household expenditures are substantially higher than reported income.

Establishing the payment for a given loan size and term is relatively straightforward. It is calculated as if the loan were a fixed-rate loan at the stated interest rate for the stated term.

The payment is then recalculated periodically, based on the indexed remaining principal and the remaining term.

Normally, for an indexed loan, the choice of a period of indexation and payment revision is difficult. If the principal is adjusted more often than the payment, it is possible that the relative magnitude of the payment falls so sharply in between payment adjustments that the payment burden must rise in the future to ensure completion with the term of the loan.

For this type of loan, however, choice of period should not be a problem.

Given the high cost of servicing small loans, the presence of significant political and economic risks, and the desire to leave behind this initial phase of economic transition for more normal market-type financial intermediation, it makes some sense to impose a "yield-curve" on the interest rate structure on these loans. A sample structure might be:

1 to 3 years	2%
3 to 5 years	3%
5 to 7 years	4%
7 to 10 years	5%

The effective nominal rates each year would roughly equal these rates, plus the rate of change in the wage index used.

4.3 Benefits of Further Developing Housing Finance in Mongolia

It is not easy to create a system of financing the construction and purchase of new housing and the resale of existing homes. Many developing countries do not have viable systems and even developed countries must frequently adjust their systems to keep them working correctly. But most countries desire such a system because of the significant benefits, including:

- Housing construction is encouraged.
- Ownership of housing is easier.
- Households save more in order to pay back loans.
- Housing is a relatively safe basis for developing the banking and investment markets.

4.3.1 Sustainable Housing Finance

Mongolia needs all of these benefits of housing finance; a strong housing finance system would increase housing construction to help offset unemployment, ease access to formal housing instead of ghers, increase household saving, and hasten the sound development of a market-based financial sector. However, it must also carefully manage the financial resources it has. Most developing countries have found that their initial attempts at creating housing finance have ended as failures, with most of the funds being lost. The beneficiaries are those who borrow funds and do not pay them back or pay such little interest that there is not enough money to continue making loans (especially in situations of high inflation). Since these beneficiaries are those who could afford to build or buy a home, they are almost always relatively well-off to start with. Thus, if a housing bank fails, not only does lending stop, but the money has been spent on those least in need of charity.

Why do the housing banks of developing countries fail? The most common reasons arise from a single fact: they are set-up and controlled by the government. This usually creates an impossible situation. The government, especially a democratically elected one, has difficulty operating a financial institution on a commercial basis. Specifically, it is under political pressure to charge low interest rates and to not take strong measures to collect loans. In fact, politicians running for office have even promised to forgive loans if elected. In addition, the managers of the bank are not oriented to careful lending policies, to preventing corruption, and to efficient, low-cost operation of the institution. The situation is especially bad if the managers are part of the civil service, with the low wages involved or if the bank makes loans to enterprises that manufacture supplies for housing construction.

Another difficulty that governments face is accepting that housing is truly very expensive and even the wealthiest government cannot subsidize the cost of housing for many people. Despite this, many Western countries, including the U. S., as well as developing countries, have tried to subsidize the production or financing of housing on a large scale. Housing banks have often been the vehicle for these subsidies and have failed when the subsidy gets unsustainable.

There are at least two other common reasons for the failure of housing finance systems. First, there may be a weak legal or social basis for enforcing the repayment of loans. Sometimes the problem is that it takes several years of court proceedings to put even people who could pay, but do not, out of their house so it can be sold to recover the loan. Other times, there are social pressures against taking such a strong stand, even if it is simple on legal grounds. Unfortunately, experience has shown that many people will take advantage of weak enforcement of repayment.

The second reason is that the economies of developing countries are often subject to severe circumstances, including a falling standard of living and high inflation. Even a strong housing finance system will fail if it has not been carefully designed to withstand such severe shocks.

These difficulties can be overcome if enough care is taken. In fact, two Asian countries, India and Thailand, have created viable systems despite somewhat adverse circumstances. However, as has been discussed, Mongolia faces some special difficulties because of the current state of the financial markets, in addition to the precarious state of the economic situation.

4.3.2 A Proposal for a Housing Bank

Despite all of these difficulties, and because of the weaknesses of commercial banks, the Government of Mongolia may wish to create some kind of new institution to provide financing for housing. This is reasonable because, although most such institutions eventually fail, it is not always the case that doing nothing is better than such a failure. In fact, it is probably the case that most countries will not develop improved systems until they experience failure with a more expedient approach. For example, the United States has experienced two widespread failures of its housing finance system since 1930, both of which were very costly. Learning as much as possible from the successes and failures in other developing counties should further reduce the risks involved.

4.3.3 Recommendations

- Create an institution called the Mongolian Housing Bank with 100 percent government ownership if necessary, but open to equity investment by other institutions, including commercial banks and private companies, with the intent to privatize as soon as possible.

- Require that the institution be an independent economic entity, outside the civil service, with a Board of Directors representing at least the Central Bank, one commercial bank, and perhaps the Ministry of Trade and Industry, the Ministry of Housing and Construction, and the City of Ulaan Baator. The Governor of the Central Bank should be the Chairman of the Board until privatization, in order to maintain the proper development of the bank within the overall development of the financial system.

- Management and staff should be drawn from the private sector as much as possible and trained in the commercial operation of a housing finance institution. Senior staff should be rewarded for achieving dual targets of growth and loan repayment. A commercial bank could take on the management and development of the housing bank in return for part ownership.

- Funding would initially consist of the cash payments received from the purchasers of privatized flats. The installment payments due on those flats should be collected by the Bank and kept as funds available for lending.

- Three additional sources of funding should be pursued after some experience has been gained:

  a) the sale of special bonds backed by the bank and offering some protection from inflation,

  b) term deposits of 3 months or longer,

c) donor financing (for example, USAID Housing Guarantee Loan, World Bank, ADB)

- Beyond the installments for the flats, all loans should have some features that protect the bank from the effects of inflation and sharp changes in borrowers real incomes. The exact features would depend on the source of funds for the loans. Several options are briefly described in Annex A.

- The bank should be restricted in its investments to first mortgages on privately-owned housing, loans for the construction of housing, and inter-bank lending. Loans to industrial concerns in housing-related industries should not be permitted under any circumstances. No ownership of enterprises or housing should be permitted.

- No lending for housing construction should be permitted before technical assistance is provided on the risks and procedures for such lending.

- The development of the Mongolian Housing Bank must be made consistent with the development of the rest of the financial sector. It should not be favored or disfavored relative to the rest of the sector.

We suggested that the successful the Housing Development Finance Company of India should advise the staff on loan approval and recovery procedures, based on their experience in similar circumstances.

Our recommendations reflect the severe limitations of the current situation and thus are far from some ideal system. However, we view them as worthwhile steps towards the eventual development of a strong housing finance system in Mongolia.

5.0 A LEGAL INFRASTRUCTURE FOR REAL PROPERTY PRIVATIZATION IN MONGOLIA

5.1 Introduction

Mongolia is about to embark on a process of privatizing real property. Virtually all of that property is currently owned by the state. It appears that real property privatization will move forward on three fronts: (i) apartments will be sold to current tenants, (ii) state-owned land (other than land set aside for pasturage) will be made available for private ownership, and (iii) land used for cultivation may be made available for ownership by agricultural enterprises.[14] There is no legal infrastructure to accommodate privately owned real property. The purpose of this section is to outline the legal infrastructure needs. Since the privatization component which will have far and away the greatest impact on the largest number of citizens is the privatization of the existing housing stock, most of this discussion will be directed toward accommodating that activity. In the long run, however, the legal infrastructure discussed below will accommodate private property ownership generally.

As discussed in Section 2.1, Mongolia has already privatized numerous formerly state-owned small businesses by delivering shares of stock to citizens in exchange for vouchers which had been distributed by the government to each Mongolian citizen. Prior to privatization, the Baga Hural (the unicameral national legislature) had enacted a "Law on Economic Entities," which established certain basic business formats (i.e., sole proprietorship, cooperative, and company), and dealt with some fairly sophisticated concepts, such as limited liability. In translation, the entire law is about twenty pages in length.

The privatization of real property will affect directly the lives of many more people than did small enterprise privatization. And it will to a much greater extent affect their daily lives. For apartment dwellers, time will have to be devoted to the meeting the responsibilities of democratic control over their living environment. They will be confronted repeatedly with the evidence of the success or failure of their efforts on this front. Local authorities will have to struggle with the problem of supporting municipal government activities with ad valorem taxes, which means that they will be dependant on a functioning, up-to-date cadastre system, so that they know from whom to collect the taxes. They will also need an enforcement scheme, so that they know that their revenue stream is a reliable one.

Because its reach is so much broader, it will not be possible to establish a legal infrastructure for private real property within the compass of twenty pages (two hundred pages would be short), and it will probably not be possible to do it with a single legislative enactment. This will a be time-consuming, challenging process, the most difficult and important aspect of

[14]While agricultural enterprises were privatized as part of the small enterprises privatization program, the land on which those enterprises cultivate crops continues to be owned by the state.

which will be thorough, knowledgeable legislative debate which will hopefully prompt at least some broader public comment and debate.

5.2 Components of a Legal Infrastructure

There are five components to a legal infrastructure that would need to be in place immediately to accommodate a housing privatization program that would permit the initial owners to resell their units immediately: (i) a functioning cadastre system, (ii) a land transactions act, (iii) a condominium act, (iv) laws related to mortgage financing, and (v) landlord and tenant laws. It is not necessarily the case that each of these elements is reflected in a separate enactment. For example, it probably makes sense to treat land transactions, a cadastre (or recordation) system, and financing matters in a land transactions act.

As discussed in the Introduction, we have of necessity, attempted to prioritize attention to the tasks of privatization, including the legal components. Rapid progress is simply not possible on all fronts. In order to facilitate transition to a condominium association, we have focused first on the condominium act and the associated by-laws and regulations. The Mongolians have also begun on topics (ii) and (v) above and on a data base which will facilitate registration of title. However, It is important to continue to stress the importance of the entire legal framework, including bodies of law that generally exist outside the components discussed here, but relate to, and support, these components.

5.2.1 Cadastre System

While a private property system can exist without one, an efficient cadastre system is essential to facilitating the transfer of interests in real property. Without such a system, distortions are introduced into the alienation process which impair the realization of full value. For example, without a cadastre system, the pledging of multiple interests in real property becomes almost impossible, since no creditor can be certain of its priority position, except the very first creditor, who will insist on holding the deed. Also, if ad valorem taxes on real property are to be used to support municipal government activities, the taxing authorities must have a way to figure out who owns what property.

A cadastre system should reflect at least the following characteristics:

(i) It should be easy to use and to maintain through computerization,

(ii) It should be readily accessible through grantor, grantee and address indices, and

(iii) Recordation fees should be minimal.[15]

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[15]High recordation fees will encourage buyers and sellers, and mortgagees and mortgagors to enter into unrecorded transactions, which will quickly destroy the integrity and utility of the system. Viz. India, where mortgages are almost never recorded.

Discussions with officials in Ulaan Baator suggest that at least some parts of the city have been surveyed and that survey marks or bench marks have been installed. This process must be completed, and lot and block numbers assigned in all areas where land is to be privatized.

From a technical assistance standpoint, an expert in the establishment of cadastre systems should be retained to advise local governments how to proceed.

5.2.2 Land Transactions Act

Before any transactions beyond the initial conveyance from the state to the first owner can take place, a legal framework for conveyancing must be in place. The fundamental purpose of such a body of law is to assure the parties to a transaction that their intentions can in fact be carried out. Without that law, no buyer has a remedy against a defaulting seller (i.e., specific performance), and no seller has a remedy against a defaulting buyer (i.e., damages).

Normally, a land transactions act would rely on basic principles of law established elsewhere in the body of law of the enacting jurisdiction, for example, in a civil code. Such areas include contract, agency, subrogation, estoppel, fraud, misrepresentation, duress, coercion, mistake and bankruptcy law, among others. While Mongolia appears -- from statements made by an adviser to the Privatization Commission -- to have a civil code, until we have access either to a full translation or a detailed summary of its provisions, we do not know whether it establishes basic principles of contract or other law which would have a bearing on a land transaction act.

If it does not, at least some of those principles may have to be set out in a land transactions act. If such a step is necessary, the land transactions act will establish basic principles in many areas of the law of Mongolia. Since many of these fundamental principles implicate broadly important values in a society, the land transactions tail could end up wagging a very large dog.

For example, if it does not exist elsewhere, a land transactions act will have to set out standards for determining whether an individual has the capacity to enter into a contract, i.e., is he or she old enough, can a married woman enter into a contract without her husband's assent? Other questions include whether notions of community property are to be imported, whether parents are to be responsible for debts or other obligations incurred by their children, whether a husband who becomes obliged on a contract binds his wife, so that enforcement of that contract -- or the imposition of damages for its breach -- can reach his wife's assets, if indeed the legal system will recognize the concept of separate property for a wife.

While this enumeration barely even scratches the surface, it does serve to emphasize the extent to which the process of embodying these principles into law will implicate, in the broadest possible sense, the basic values of Mongolian society -- a society founded on an ancient, largely nomadic civilization.

The basic elements of a land transactions act include:

A. Contract formation, termination and cancellation.
B. General obligations and construction of an agreement to convey.
C. Contract performance.
D. Breach and repudiation of a contract to convey.
E. Remedies for breach.
F. Secured transactions.
    1. Validity of security agreement and the rights of the parties.
    2. Priority among conflicting security interests.
    3. Finance charges and usury.
    4. Default, cure, foreclosure and other remedies.
G. Recording and indexing of documents, and effect of recording.
H. Marketable title.
I. Curative provisions and limitations (e.g., adverse possession).
J. Liens and encumbrances.
K. Construction liens.

5.2.3 Condominium Act

The ownership of individual apartments in a single building brings into play principles unknown to traditional real estate law concepts. When apartment ownership began to become popular in the United States thirty or forty years ago, it quickly became apparent that a new body of law was necessary. New law was necessary not simply to accommodate new forms of real estate ownership but also to deal with the unique problems that arose when rental apartments were converted to individual ownership, to accommodate the special problems of the developer or converter of rental units into condominiums, and particularly, to address issues of how the building is to be governed -- how decisions are to be made -- by a large group of apartment owners all of whose interests and concerns may not be identical.

Another new element that the first generation of condominium laws had to confront was the ownership of common areas (hallways, elevators, storage areas, the land under and surrounding the building, its exterior walls, its roof, for example). Because the condominium failed or prospered based on whether sufficient money could be collected from apartment owners to keep the common areas properly repaired and maintained, the new laws established relatively fast and inexpensive ways to collect maintenance fees from owners.

Finally, condominium acts had certain "public law" implications. For example, the laws provided for the separate imposition of property taxes on each apartment, so that no owner was responsible for the taxes of any other owner. Local governments are forbidden from discriminating against the condominium form of ownership.

A condominium law should include the following elements:

A. The applicability of the law and its public law implications, i.e., separate taxation of each unit, protection from discriminatory land use and zoning laws, applicability of local ordinances and building codes.

B. The creation, alteration and termination of condominiums, including their establishment of boundaries between units, the sufficiency of the legal description, the content of a condominium declaration, the allocation of interests in the common areas, the allocation of expenses for common area maintenance, and the rights of secured lenders.

C. The management of a condominium, including the powers of the owners' association, the responsibilities of board members and officers, the relationship between the association and the developer or converter (in Mongolia's case, the state) of the project, the content of association by-laws, the upkeep of the project, meetings of the association, voting, liability of the association, insurance, assessments of unit owners for common expenses, and the enforcement of liens for common area expenses.

D. The protection of condominium buyers, including requirements for disclosure of information, special rights in situations where buildings are being converted from rental to ownership, buyers' rights in certain circumstances to cancel a purchase contract, resales of units, warranties of quality, the enforcement of, and the statute of limitations applicable to, those warranties.

E. The administration and registration of condominiums, including provisions for the establishment of an administrative agency to regulate the making of disclosures to buyers, to supervise sales, and to regulate the precompletion sale of units, so as to facilitate financing of construction and rehabilitation costs by the developer or converter.

5.2.4 A Landlord/Tenant Relations Act

The State Privatization Commission advised us that there already exists in the civil code and elsewhere in Mongolian law something resembling a law dealing with the relationships between landlords and tenants. Presumably, this body of law arose out of the necessity to regulate the relationship between the state as landlord and its citizens as tenants. The SPC also said that the law contained eviction procedures, but that they were little used.

As was noted, not all of the currently state-owned apartments will be converted into condominiums. Units currently occupied by families whose income is below the poverty standard will be permitted to continue to live in their units, which the state will continue to own.

Since the government, like any other unit owner in a condominium project, will have to contribute its proportionate share to the cost of maintaining and repairing the building, it will have to collect at least some rent from these below-the-poverty-line tenants. Also, the government will encourage the construction, by private developers, of rental housing projects. Both of these circumstances require the adoption of a landlord/tenant relations law the primary function of which is to balance the right of the landlord to collect rent against the tenant's right to get what he or she pays for (i.e., the tenants promise to pay rent is enforceable only if the landlord maintains a habitable dwelling).

The important elements of a landlord/tenant relations law include:

A. Formation of the relationship, including the basic elements of a lease, need for a writing, distinction from other relationships, security deposits and various types of tenancy.

B. Rights and duties during a tenancy, including the landlord's right of entry, the covenant of quiet enjoyment, the landlord's duty to maintain and to repair the premises, the landlord's right to collect rent, when rent is due, various tenant remedies, including the right to repair the premises and deduct the cost of the repairs from rent, the implied warranty of habitability, assignment and subletting, lease renewal and extension, changing the terms of a tenancy, the landlord's liability for personal injury and property damage, and the tenant's liability for property damage.

C. Termination of the tenancy, including abandonment, surrender of the premises, breach of lease covenants, legal proceeding to collect rent and to evict tenants, "self help" eviction, retaliatory eviction, lockout of tenant, and enforcing a judgment of eviction.

5.3 In Summary: A Question of Process

Unlike most of the former communist world, Mongolia does not have a cultural history of private property; it is not a problem of reviving a disused cadastre system, or dusting off and updating a legal system that makes private real property ownership mean something. *Development of the legal framework must essentially start from scratch.*

At the level of devising a legal system, these problems may appear more theoretical than real. But at the level of getting the owners of 400 units of housing in a single building to work together as a whole, to hire competent people to manage and maintain the building, to collect fees from owners so that the manager can be paid, the elevator fixed, the hallways painted, the roof replaced every eight years, to accommodate to the fact that some of the units will continued to be owned by the state and to be lived in by renters, whose interests may be very different from those of the owners, it presents a very real set of problems. These problems will be vastly exacerbated by the extent to which the current state-owned stock is in poor condition.[16]

In summary, as noted in Section 1.0, as an alternative to immediate privatization, we have recommended that the State Privatization Commission consider a pilot program involving a limited number of buildings This would provide an opportunity to work closely with potential owners and to test various approaches to problems of governance, collection of maintenance fees, establishment of reserve funds, and all of the myriad of problems associated with condominium ownership and operation. At the same time, it would permit technical advisors to work in an orderly fashion, with Mongolian lawyers, to erect the legal infrastructure outlined above.

[16]Our preliminary inspections suggest that at least moderate problems impact most of the stock. In any event, the difficulties of privatization are greatly compounded by problems of deferred maintenance.

6.0 PROGRESS WITH THE PRIVATIZATION

The Government plans to begin the privatization early in 1993. In the meantime a number of critical decisions have to be taken and actions implemented:

— increase the rents to establish a level playing field between renters and owners;

— establish the essential legal framework for the transfer of ownership, including making it possible to have some form of co-ownership of the buildings;

— begin the publicity campaign to stress the benefits as well as responsibilities of ownership (an outline of an information campaign is shown in Annex 7);

— undertake the survey that will provide the basis for establishing the relative property values;

— design the privatization program in a management and administrative sense, and clearly establish implementation responsibilities;

— most important of all, decide on the "deal" to be offered to the households who might privatize.

To help the State and Ulaan Baator Privatization Commissions to make the necessary decisions, we have organized a training program. The training plan is described in Annex 6. Some of the training was carried out on the Abt team's last trip to Mongolia: workshops were held on home ownership options, housing privatization policy, valuation and computer systems. We are also providing assistance with the information systems that will be required to carry out the privatization. Information systems needs are outlined in Annex 8. USAID has provided 6 computers to the Housing Company, which has administrative responsibility to execute the privatization program.

Probably the most important activity that will help the Commissions to make the key decisions and design the program is the study tour that will take place in January. The top decision makers will visit a number of people at the World Bank and AID who have direct experience of privatizing housing in other countries, including China, Hungary, and a number of other East European countries. The group will also visit some privatized public housing in the Washington area, and some condominiums there to gain a better understanding of that mode of ownership. Finally the group will then discuss the above decisions with Abt staff in the light of the experience gained in the study tour.

The Abt team will return to Mongolia in March to assist in the preparation and initiation of the housing privatization program.

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ANNEX 1

CONDITION OF THE HOUSING STOCK

CONDITION OF THE HOUSING STOCK

The purpose of this section is to determine the degree of maintenance that needs to be performed either before or after privatization. A determination is made of the costs involved, including present expenditures on maintenance as well as a potential target for future maintenance operations. A description is included of how the management is organized with a suggestion that future operations will be more decentralized. Finally, a discussion of materials procurement, distribution, and shortages is included.

1. Inspection Procedure

The First Deputy Mayor of Ulaan Baator is responsible for two divisions: one that provides for new housing, and one that manages existing housing. Thirteen Housing Authorities operating under the guidance of The Housing Company are responsible for the day to day management and maintenance of the State owned housing stock. The Authority also makes recommendations to the Company about major capital improvements.

The entire housing stock is inspected twice each year by a team made up of 5 to 10 inspectors and tenant representatives. Inspections are performed in the spring after the harsh winter freeze, and in the fall prior to the heating season. Each inspection commission is headed by an engineer and is provided with a check list for reviewing normal maintenance needs. The team also identifies serious and/or emergency conditions requiring more extensive repair. Upon completion, one copy goes to the Housing Authority and one copy to the Housing Company. Each Authority must complete its inspection within 21 days.

The Chief Engineer of the Housing Company reviews the inspection forms, sends a team of specialists to inspect in detail problem areas that are serious, and prioritizes and schedules the buildings in greatest need of repair.

The capital repair budget for the four years 1986 - 1989 shows expenditures of 18 million tgs for 81 buildings or 135,600 m^2.

86-89	4,513,450 tgs/yr	20 buildings/yr	33,900 m^2/yr
1990	5,156,400 tgs	19 buildings	24,400 m^2
1991	7,903,300 tgs	12 buildings	12,400 m^2
1992	12,654,300 tgs (approx)	8 buildings	13,043 m^2

The Housing Company provides final inspection after repairs are complete.

2. Routine Maintenance

The new owners of the apartments will have to set aside about T 100 per month for routine maintenance. We used Authority Number 2's annual operating expense report to make this estimate as follows:

Item		Tugriks	
Salaries		2,800,000	
Electricity		663,000	
Heat		4,640,000	
Water		1,820,000	
	sub-total H.E.W.	7,123,000	
Equipment for Workers		50,400	
Transportation		250,000	
Trash		686,000	
Communications		100,000	
Cleaning Supplies		230,000	
Repairs		1,700,000	Subcontract
		1,150,000	material
Income Tax		378,000	
	Total annual expenses	14,497,000	
	Less H.E.W.	-7,123,000	
	Less Capital Project	-1,700,000	
	Normal Maintenance Budget (1992 Tugriks)	5,674,000	

$\frac{5{,}674{,}000 \text{ tgs}}{4{,}700 \text{ units}}$ = 1,207 tgs/unit/year or 100 tgs/month

3. Capital Repair

Major renovations were made to 12 buildings (with 495 flats) in 1991 at a cost of T 7.9 million. The work consisted of repairs to exterior walls, roof, electric lines, hot/cold water pipes/fixtures, heating pipes and radiators, painting, floor covering, and window glass. The Chief Engineer identified an accumulated backlog of 137 buildings in need of capital repair:

Buildings that should be abandoned: Terrible condition - foundation and wall cracks; not worth saving.

Buildings requiring too much money to save: These have no earthquake protection, require foundation underpinning & wall reinforcement.

Buildings requiring major overhaul: These require similar work to that shown above at 1992 prices of approximately 1,581,800 tugriks per building.

Buildings estimated to need less extensive overhaul: These can be estimated at ½ the above budget in 1992 tugriks or 800,000 tgs per building. These might be the only candidates for capital repair prior to privatization.

4. Management Efficiency

There is some evidence that the Housing Authorities are overstaffed. The table below compares Ulaan Baator's and Boston's public housing.

	Boston Housing Authority	Ulaan Baator Housing Company
Number of Units	14,000	47,800
Total operations staff	600	2,900
Units/employee	23	16.5
Units/maintenance staff	70	48*

* Based on Authority 2

The cost of operating the Boston Housing Authority usually runs 66 percent above the income. The difference is subsidized 2/3 by the federal government and 1/3 by the State of Massachusetts. In addition the streets and walks, the water and sewer and electric lines are maintained by the City of Boston.

ANNEX 2

BASIC DATA ON HOUSING AUTHORITY NUMBER 2

BASIC DATA ON HOUSING AUTHORITY NUMBER 2

4,700 units

1-bedroom - 1,293
2-bedroom - 2,138
3-bedroom - 1,222
4-bedroom - 47

89 apartment buildings

11 9-story, with elevators (22 elevators)
78 5-story without elevators

143,500 square meters of living space

20,000 residents

186 employees:

1	chairman
1	economist
1	chief engineer
1	chief accountant
1	electrical engineer
1	secreatry/typist
1	personnel management
1	civil engineer
1	material technician
1	finance officer (teller)
1	construction material supply manager
2	sanitation engineers
2	sewerage managers
40	plumbers
6	plumbers on call for special services
55	maintenance workers (each responsible for cleaning entryways and corridors; 700 square meters in high-rise, 560 square meters in low-rise)
9	elevator tecnicians (for the 22 elevators in 11 buildings)
7	electricians (2 of which on 24 hour call at all times)
4	electric meter readers
12	general repair persons (painters, carpinters, decoraters, chimney cleaners)
5	parts supply/manufacturing, mostly plumbing fixtures
9	heating technicians (for 3 central heating systems)

9	inspectors (controlling use and care of apartment; managing trash collection)
9	maintenance of public toilets (not located in the buildings, but at cinema, bus terminal, public square)
12	grounds maintenance workers, outdoor, landscape, playground
3	dispatchers (to coordinate and send repair personnel)

If need more elevator help, call on the UB City elevator company.

Contract with CCUP for trash collection.

Other contracts with other companies for use of trucks and cars.

Annual Expenses

Item	tugriks
Salaries (for above personnel)	2,800,000
Electricity	663,000
Heat	4,640,000
Water	1,820,000
Equipment for workers (uniforms, masks, gloves, helmuts, boots, protective clothing)	50,400
Transportation (cars, trucks from other companies, mostly to carry materials)	250,000
Trash collection	686,000
Communications (radio, tv, phones)	100,000
Cleaning supplies	230,000
Repairs	2,850,000
Income tax	378,000

Total Annual Expenses	14,497,000

Monthly Payments by Tenants

Item (cost basis)	tugriks for 5 person family in a 3-room, 30 square meter unit	
Rent (3 tugriks per square meter of living space)	90	
Drinking water (4.50 tugriks per person per month)	22.50	
Hot water (1.60 tugriks per person per month)	8	
Other water (5.40 tugriks per person per month)	27	
Trash collection (3 tugriks per person per month)	15	
Heat winter - 7 months (4.50 tugriks per square meter per month); May and September (22.25 tugriks per square meter per month); summer (no charge)		90
Electricity (.50 tugriks per kilowatt, metered) (estimated here at 160 kw per month) (28% of receipts collected for electricity goes to the Authority; 72% goes to the State electric company)	80	
		322.50

Thus, sample family pays 332.50 tugriks per month for rent and utilities x 12 months = 3,990 tugriks per year x 4,700 units in these buildings = 18,753,000 tugriks income to the Authority. It is less, however, not only because this is a sample family, but also because 72% of electricity payments are not retained as receipts to the Authority.

Authority also receives rent from the shops in the buildings. These rents are negotiated, and the better producing ones pay higher rents, including the US$ stores. These figures were unavailable, but these

Shop rents + unit rents =	16,975,000 tugriks per year
of which "profit" is	2,478,000 tugriks per year

of which payments

to the State	1,210,000 tugriks per year
to the Company	250,000 tugriks per year
to the Authority	1,018,000 tugriks per year

leaving 14,497,000 tugriks per year
for the total annual expenses, as per the table above.

In all of this, there is no accounting for the Authority offices; they "own" it, but they do pay the Ulaan Baator city government for the .08 hectares of land at 450,000 tugriks per hectare = 36,000 tugriks.