
The Reform of the Housing System and the Current State of the Mortgage System in Russia (Summary)

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Introduction

Following the increase in its oil and gas exports, the Russian economy has accumulated significant surpluses in both the international balance of payments and central government finances; with the emergence of surplus money in the financial market, the real-estate market has also expanded, mainly in Moscow. At the same time, contributions to securities investments and real-estate investment funds have intensified and residential mortgages have become the focus of attention. In February 2005, a group including Deputy Chairman of the Central Bank of Russia Gennady Melikyan, President of the Russian Banks Association Garegin Tosunyan, State Duma Deputy Anatoly Aksakov and Deputy Head of the Federal Financial Markets Service Vladimir Gusakov visited Japan to participate in the Seminar on Investment, Finance and the Real-Estate Market in Russia, which was held at the Nippon Keidanren and which featured an introduction to the housing finance situation in Russia. This article provides an

overview of reforms in the housing system and the current state of the mortgage system in Russia.

1. The Progress of and Problems Concerning the Reforms of Housing System

(1) The progress of reforms of the housing system: The most important reform of Russia's housing system was the privatization of housing ownership in 1991. In 1992, the privatization of housing ownership spread under the presidential decree that gave each person privatization checks worth 10,000 rubles in order to enable them to purchase a house. In 1996, under the Basic Law on Housing Policy, the principles of housing ownership and management, and communal services were regulated; this was the basic law regulating the Russian housing system until the end of 2004. In 1998, the Mortgage (Mortgage Collateral) Law was enacted, while in 2001, the Law on State Registration of Land Ownership and Transactions was enacted, putting in

place the legislative foundations for the sale and lease of housing and residential land. Furthermore, under the Legal Code on Land of June 2003, residential land was included in the scope of property transactions, while the provision of finance by means of the securitization of mortgage loan-assets was legally prescribed in the Mortgage Securities Law of November 2003.

- (2) **Housing policy in the 2004 Presidential Message.** On 26th May 2004, in his annual message to the Federal Parliament, President Putin presented a detailed housing policy. Firstly, he stated that a housing finance system would be established that would enable people to repay loans from their future income and permit those in the middle-income bracket to use long-term mortgages. Sharing in housing construction, housing savings, the registration of real-estate titles, credit information and greater efficiency in the mortgage securities market are also necessary. Secondly, the monopoly in the construction market is to be eliminated, along with fees for administrative procedures and the excess profits made by those in the construction industry; in addition, the use of land and the promotion of housing construction by local authorities is to be established, permission procedures streamlined, and the time and costs required for constructing communal facilities reduced. Thirdly, housing ownership is to be guaranteed, with market transactions being made more transparent and the costs of these being reduced. Finally, public housing is to be provided to low-income brackets and measures to support young families are necessary.
- (3) **The Federal Government's housing policy:** At a Federal Government Cabinet meeting on 8th June 2004, Minister for Industry and Energy Viktor Khristenko reported on "Measures Concerning the Expansion of Housing Construction and the Housing Market in Russia", proposing that comprehensive bills relating to housing be formulated. The first of these was intended to enact the Legal Code on Urban Construction, which would promote the provision of housing and generate demand for housing through the provision of a considerable quantity of housing. The second was to focus on the creation and expansion of a housing mortgage system, while the third was intended to improve the public housing system.
- (4) **Reforms of communal services:** In addition to the caretaking and repair of multi-storey collective housing, one of the problems relating to housing in Russia is that of communal services, such as the provision of electricity, heat, water and sewerage services, as well as the disposal of waste. With regard to such communal services, local authorities (city and town administrations) owned and operated facilities, but the provision of these services has been made difficult by price rises and an endless stream of problems, such as accidents caused by decrepit facilities, power cuts, reductions or stoppages in supply, and a failure to pay the charges for these services. Russia's communal services sector is large in scale, encompassing more than 4 million employees working for more than 52,000 companies, and it forms a part of the Russian housing

market. At the Cabinet meeting on 28th October 2004, Mr. Khristenko proposed measures to promote market-orientated economic reforms in the communal services sector.

2. The Enactment and Consolidation of Housing Legislation

The majority of the 27 bills concerning housing reforms submitted to the State Duma by the Federal Government in June 2004 were promulgated at the end of December, following parliamentary discussion of them. The contents of the main laws are outlined as follows:

- (1) **Legal Code on Housing:** This was promulgated on 29th December 2004 (Federal Law No.188-FZ) and entered into force on 1st March 2005. It abolished the old Legal Code on Housing of the RSFSR of 1983, as well as stipulating that free housing would cease to be provided in Russia after 2007 and prescribing market-oriented economic reforms of Russia's housing system.
- (2) **Legal Code on Urban Construction:** This was promulgated on 29th December 2004 (Federal Law No.190-FZ) and entered into force on 10th January 2005. It promotes the involvement of construction businesses in housing construction and the use of new land for housing, in order to form a housing market.
- (3) **Law on the Sharing in Construction of Collective Housing:** This was promulgated on 30th December 2004 (Federal Law No.214-FZ) and entered into force on 1st April 2005. This law includes prescriptions regarding the collection and use of money contributed by individuals and companies sharing in the construction of multistorey collective housing, sectional ownership of collective housing and the responsibilities of sectional owners; it also stipulates that owners had no obligation to live in the sections of collective housing that they owned.
- (4) **Law on Housing Savings Cooperatives:** This was promulgated on 30th December 2004 (Federal Law No.215-FZ) and entered into force 90 days later, on 1st April 2005. It regulates housing savings cooperatives that collect and use money in order to construct and acquire houses for residential purposes; it differs from the **Law on the Sharing in Construction of Collective Housing** in that members of the cooperative construct and acquire houses for residential purposes.
- (5) **Law on Credit Records:** This was promulgated on 30th December 2004 (Federal Law No.218-FZ) and will enter into force on 1st June 2005. Under this law, financial institutions are obliged to provide loan information to the Credit Records Bureau, which can only be used with the consent of the borrower (i.e. the debtor). Financial institutions will be obliged to provide credit information from 1st September 2005.

3. The Housing Market and Communal Services in Russia

- (1) **Russia has a number of types of housing:** Housing in Russia is classified into a number of types: independent houses, apartments and collective housing (condominiums). Comprehensive housing assets in Russia are defined as housing reserves, which consist of

privately owned housing reserves, state-owned housing reserves and local authority-owned housing reserves.

(2) The composition of the Russian housing market:

The housing market has expanded since the beginning of privatization in 1991, but its history is still short and there is little experience of it. Housing market transactions are complicated and the sale of a house takes quite a long time. There are many parties involved in the transaction, such as realtors (estate agents) and mortgage agencies. The housing market is divided into the market for newly built housing and the secondary market for preexisting housing and there are local authority housing markets, regional markets and national markets. In addition, there are three sectors: the general housing sector, the luxury housing sector and the *dacha* (holiday home) sector.

(3) The characteristics and scale of the Russian housing market

i) The characteristics of the Russian housing market: Characteristics of the Russian housing market in 2003 include the fact that the average per capita area of housing is quite small, 27.5% of households occupy prefabricated houses or homes that are decrepit or have fallen into disrepair, and about 65% of the total area of housing is occupied by homes that are over 30 years old and are decrepit or have fallen into disrepair. With regard to demand for housing, there is strong demand for improvements to housing, with 55% of the total area of existing housing said to need improvement, so it is anticipated that demand for newly built houses will lead to an expansion in the housing market.

ii) The scale of Russia's construction industry: With regard to the market scale of Russia's construction industry, total investment in fixed capital in 2005 is estimated at 3.1 – 3.2 trillion rubles; about 55% of the market is accounted for by subcontracted construction work, 12% by communal services, 2-3% by construction and 0.5% by the construction materials industry. The total area of completed housing in 2003 was 36.26 million square meters, which was 7.2% higher than the previous year, but less than in the period 1993-95. The total area of completed housing is predicted to rise to 39 million square meters in 2004 and 42-47 million square meters in 2005.

(4) The scale of the communal services market: The scale of the communal services market is said to be about 800 billion rubles annually, with services provided to residents worth around 650 billion rubles (81%), figure which is rising each year. As of August 2004, the percentage contributed by residents was no more than around 65% on average throughout Russia. The price of communal services per square meter of residence was 33.7 rubles, compared with 29.5 rubles at the end of 2003. The rise in the cost of communal services in 2004 can be attributed to rises in distribution costs and the prices of fuel oil, coal and electricity.

4. The Current State of the Mortgage System

(1) The Home Mortgage Lending Agency (HMLA):

The HMLA, which was established in September 1997, is wholly owned by the Federal Government; its main function is to issue corporate bonds on the securities market and use the money it gathers through this to purchase loans-assets from lending banks (refinancing), thereby providing banks with long-term funds. As of the beginning of 2005, the standard conditions for refinancing were a fixed annual interest rate of 15%, a lending period of 1-27 years, a lending limit of 30-70% of the price of the house, and monthly repayments equivalent to not more than 50% of the borrower's monthly income. As a long-term financing mechanism using proper mortgage securities has yet to be created, the HMLA, the liabilities of which are guaranteed by the Federal Government, is a quasi-governmental financial institution supplying finance to housing mortgage lending banks.

(2) The National Association of Participants in the Mortgage Market (NAUIR):

The NAUIR was established in January 2004 and is cooperating with the policy of expanding the housing market formulated by the Ministry of Industry and Energy and its Construction and Communal Services Agency. Its main functions are the creation of uniform rules to govern the housing mortgage market, the formulation of plans and draft legislation relating to housing policy, the harmonization of the interests of participants in the mortgage market, the propagation of a housing mortgage system and the cultivation of experts. The organizations making up the membership of the NAUIR are the Russian Banks Association, the All-Russia Insurers' Union, the International Association of House Construction Funds and Mortgage Lending, National Association of Participants of the Stock Market, the Professional Association of Registrars, Transfer Agents and Depositories, the Russian Guild of Realtors, the Russian Society of Appraisers and the Russian Union of Industrialists and Entrepreneurs. The NAUIR is chaired by Vladimir Ponomarev, former Deputy Chairman of Gosstroi (State Committee on Construction and Housing) and Viktor Khristenko has been appointed its honorary chairman.

(3) The National Bureau of Credit History, Ltd. (NBKI):

This was established on 30th March 2005 and has as its founding members 15 banks and groups, including the Russian Banks Association, Vneshtorgbank (Bank for Foreign Trade), Alpha-Bank, Petrocommerz Bank, Gazprombank, Rosbank, Citibank and Trans Union International Inc. (USA). The NBKI is a vital infrastructure element in the banking service market and will promote the expansion of the personal loan market. At its inaugural meeting, the NBKI's charter was endorsed and 15 directors were elected, with Andrei Suchkov, Vice-President of Vneshtorgbank, being elected as chairman and Alexander Vikulin, general director of the National Credit Information Bureau (advisor to the Russian Banks Association) being elected general director. The international company TransUnion Crif Decision Solutions LLC was approved

as the NBKI's strategic technology partner.

(4) Housing mortgage markets in each region

i) Barriers to market entry: In addition to selecting the financing organization and experts, and initial investment such as refurbishing existing facilities and renting (or buying) an office, there are economic impediments to entering the mortgage market in Russia, in the form of low ability to make payments on the part of the Russian people and a lack of long-term funds on the part of banks. Furthermore, it is difficult to evaluate credit risks due to a lack of information about the borrower's income. The biggest problem for lending banks is the fact that the regulations concerning the compulsory seizure of the mortgage by means of a court order are inadequate.

ii) Regional housing mortgage markets: As of the end of September 2004, total housing mortgage borrowing was 13.9 billion rubles (36% of which was borrowed in rubles, with a further 64% being borrowed in foreign currency), with foreign currency borrowing accounting for an abnormally large share. The national share of the Central Federal District, which includes Moscow, was 16% of ruble borrowing and as much as 80% of foreign

currency borrowing; the shares of the other federal districts were as follows: Volga Federal District (32% of ruble borrowing and 3.2% of foreign currency borrowing), Urals Federal District (22.6% and 3.5%), Siberian Federal District (19.9% and 4.9%), Southern Federal District (4.4% and 1.2%), Northwestern Federal District (2.2% and 6.2%) and Far Eastern Federal District (3.2% and 1.2%). Russia's housing loan market is concentrated in the Central Federal District, mainly centered on Moscow, but the markets in the Volga, Urals and Siberian federal districts are also quite large, while those in the Southern, Northwestern and Far Eastern federal districts are small.

Conclusion

The reforms of Russia's housing system began in around 2002 and many new laws came into effect in 2005, but housing loans are still in their infancy and mortgage securities are not yet in widespread use. Housing mortgages account for just 1.5% of the total value of personal loans and there are pronounced regional disparities. In the future, it will be necessary to investigate trends in the real estate market and securities market, including the real estate investment funds in Russia.