The Institute for Urban Economics

OVERVIEW OF LEGISLATION ON HOUSING AND UTILITY SECTOR IN RUSSIAN FEDERATION

Tariff Reform in the Russian Federation

Under the Soviet system, municipal enterprises providing communal services operated on a cost-reimbursable basis. Investments were funded separately. Cost was divided into two parts: base costs and profit. Base costs covered regular expenses. In addition, certain classes of expenses, such as extra contributions to the employee funds for vacations or training and other "add-ons," were covered by "profit." Profit was set by municipal officials as a percentage of base costs, often in the absence of any analysis. These Soviet accounting rules are still in force and have a profound impact on the operations of utilities. Utilities cannot include most investment spending—including interest expense—in base costs, and the share of profits that can be used for investment is strictly limited, as is the maximum profit rate.

It is important to distinguish between two possible cost bases that could be used for regulatory purposes. Under one, the regulations determine tariffs for monopoly communal service firms, particularly water and district heat companies, as the cost of goods (or services) produced (or sold) by these enterprises. Thus, for a water utility it is the cost of a unit of water delivered to the boundary of the customer (e.g., connection to the internal network of a multifamily building). The regulation of tariffs for communal services for Russian households is based on an alternative approach. It differs from the standard western tariff regulation of utility monopolies in three important ways:

- The tariff may include not only the tariff for the services of the utility enterprise, but also the cost of works and services of other organizations engaged in the service delivery (in case of water supply, the cost of maintaining internal building nets, water meters in buildings or apartments, etc.).
- The tariff for services to the households may cover only a portion of the cost of service delivery, with the remainder covered by other sources: the municipal budget (subsidies for the difference between full costs and the tariffs) or higher tariffs for other consumers (cross-subsidization).
- Tariffs for the households typically regulate not just the cost of a service, but also a normative volume of service consumption in cases where metering equipment is unavailable; thus the payment rate for the service equals the value of the regulated tariff multiplied by the regulated normative consumption rate. Metering for residential use of water and district heat, even at the building level, is extremely rare.

In the first days of the transition, the federal government transferred to municipalities the ownership of state housing (mostly of state enterprises), municipal housing, and the communal service assets associated with it. In practice this meant that municipalities became the owners of the great majority of district heat and water-sewerage service enterprises. (As discussed below, some large facilities that co-generate electricity and heat are regulated by the Subjects of the Federation, that is, the regional governments.) The main regulatory document issued in September 1993 on reforming the prices of housing and communal services empowered local administrations to establish tariffs for housing and communal services. It also called for the development of a methodology for the determination of economically reasonable rates and

tariffs.[1] A 1996 Government Resolution confirmed that households should pay the full costs of these services by 2003 but again failed to address the structure for setting tariffs. Several subsequent regulations continued this pattern.

It wasn't until 2001 that a regulation was issued that actually addressed the setting of tariffs at the municipal level.[2] It spoke of the need for tariffs to be substantiated by the production and investment programs of the regulated enterprises. For the first time, it declared the need for developing procedures linking tariff regulation at the municipal and regional levels, and established that the tariff structure should correspond to the system of contractual relations in the housing and communal service sector.

At the end of 2002, the determination of tariffs for municipal communal services was influenced by the federal, regional, and municipal levels of government, because the production of these services involves inputs that have prices regulated by the federal and regional authorities. The effective legislation assigns each level its own regulatory powers. More specifically, the distribution of responsibilities is as follows:

I. *At the federal level:*

- approving the federal standards of the cost of housing and communal services that are used in computing the federal contribution to locally paid housing allowances that subsidize communal service payments;
- establishing tariffs for the electricity and gas delivered to the wholesale market by all participants in this market; and
- establishing limits for fuel and energy consumption by organizations financed by the federal budget.

II. *At the regional (Subject of the Federation) level:*

- regulating tariffs for the electricity, gas, and heat procured on the wholesale market from enterprises of the fuel and energy complex (FEC), for all consumer groups;
- establishing regional prices and tariffs for the electricity and heat produced by large cogeneration plants operating in the region sold on the retail market;
- establishing tariffs for the electricity and heat, as well as water supply and wastewater collection, for private enterprises producing these goods and services for sale in the retail market; and
- exercising control over compliance with the existing regulatory legal acts of local governments.

III. *At the municipal level:*

- regulating prices and tariffs for water and heat for municipal enterprises;
- establishing normative rates for the consumption of housing and communal services; and
- establishing rates for households' payments for communal services.

The above listing reveals multiple overlapping authorities. Prominent among these is that the cognizant regulatory agency in the area of heat and water supply depends on the type of owner. Private entities are regulated at the regional level even if they provide services only within a

[1] Resolution of the RF Council of Ministers, *On Transition to a New System of Payments for Housing and Communal Services, and Procedures for Granting Compensations (Subsidies) to Citizens for Housing and Communal Services Payments.* (No. 935 as of September 22, 1993).

[2] RF Government Resolution No. 797 of November 17, 2001, *On the Subprogram "Reform and Modernization of the Housing and Communal Service Complex in the Russian Federation" of the Federal Targeted Program "Zhilishche" for 2002–2010.*

municipality. This creates serious, sometimes irresolvable, problems in attracting private businesses for management of municipal communal infrastructure.

It is important to note that the existing legislation does give some direction to the tariff-setting process by stating that municipalities should establish

> rates and tariffs for the housing and communal services (except tariffs for electricity and gas) subject to the implementation of cost-reduction measures as a result of unjustified expenditures revealed through expert examination of the tariffs for goods, works, and services counted in their price. The decision to review the rates and tariffs for the housing and communal services should be preceded by an obligatory expert examination of the economic feasibility of the tariffs for goods, works, and services counted in the price of respective services.[3]

This statement and the assignment of tariff-setting authority to local governments constitute the entire legislative base.

In addition to these laws and regulations, three methodological documents have been issued by the national government.

1. *Methods for planning, counting and calculating the self-cost of the housing and communal services* (hereinafter – Methods) <***9***>.
2. *Guidelines for forming economically feasible tariffs for the housing and communal services* (hereinafter – Guidelines) <***10***>.
3. *Methodological recommendations on the financial substantiation of the prices for water and sewerage* (hereinafter – Methodological Recommendations for Water) <***11***>.
4. *Methodological recommendations on the financial substantiation of the prices for heat and heat supply* (hereinafter – Methodological Recommendations for Heat) <***12***>.

The first two comprehensive documents are based on the concept of an economically feasible tariff for a housing or communal service (EFT), which is understood as a fee charged for maintenance or repairs of housing (including capital repairs) or the delivery of a utility service ensuring minimum cost recovery necessary for an expanded reproduction with account for the owner's program for the development of the facilities subject to compliance with the service quality standards. The EFT entails the identification of the production cost, i.e. the self-cost, and the profit required for normal reproduction. It is recommended to calculate expense items based on normative indicators that adjust the current costs to make them more rational, rather than on the actual data for the preceding period.

The Methodological Recommendations for Water pursue similar goals, defining self-cost based on the adopted production and investment programs, effective norms and standards for material, labor, and money costs with regard to the reported data of the organizations for the preceding period. The price of a unit of service is defined as a fraction of the sum of funds and the planned production volume.

According to the Methods, the self-cost of services is projected based on the data characterizing efficient use of fixed assets, materials, energy and labor resources subject to compliance with the minimum state standards for the service quality.

Despite that all the above documents declare the principle of the priority of financing available for the implementation of an enterprise's production and investment programs, the calculation of the EFT is reduced to calculation of the self-cost and profit based on a certain profitability

[3] RF Government Resolution No. 707 as of June 18, 1996, *On Reorganizing the System of Payments for Housing and Communal Services.*

standard. The main attention is given to item-by-item calculation of the cost of service production, with each item budgeted according to the unit cost standards.

Stated otherwise, these methods presume normative cost-accounting. On the one hand, this approach is appropriate for production processes involving similar or recurring operations, such as water supply, wastewater collection or heat supply. On the other hand, this approach imposed very high requirements to the definition of standards which should take into account the current state of fixed assets, technologies used, organizational arrangements and qualification of the staff. Moreover, the standards-setting process is not just a determination of some values, but an instrument of motivation. In other words, the standards are designated to address the issues of stimulating cost reduction, improving labor efficiency and quality of the product, etc. However, experience proves that the existing standards fail to address these tasks.

Evidently, it is impossible to abandon the standard-based method in many aspects of the tariff calculation, but it would be unreasonable to give them exclusive attention. This method may be efficient if the standards are periodically reviewed to capture changes in the technological and other production factors.

The mechanism for calculating planned profit required for the implementation of the production and investment programs is described ambiguously in both the Methods and the Guidelines. On the one hand, they speak about an absolute sum of the profit, while on the other for no evident reason propose to calculate planned profitability rate.

Despite the correctness of the interpretation of many provisions on the application of self-cost calculations, the mechanism for calculating planned profit, and others, these documents:

- ignore the distinction between constant and variable costs in the self-cost calculation;
- neither document makes it possible to calculate a two-rate tariff for a given service.

Overall, one can say that practically all methodological recommendations reduce the tariff rate calculation to base-costs, disregarding or merely declaring the need to take into account the development goals of the regulated enterprises. These recommendations say nothing about a system of tariff regulation at the municipal level, tariff regulation procedures, etc.

While these methodologies are not binding for local governments, they have gained broad acceptance because of the opportunity they offer to begin to fill the regulatory vacuum.

Analysis of regulatory and legal basis of the transition to a new system of payment for housing and utility services.

Before adoption of the Law "On Foundations of the Federal Housing Policy", of December 24, 1992 (hereinafter - the Law "On Foundations ..."), payment for housing and utility services was regulated mainly by the norms set by the RSFSR Housing Code of July 24, 1983. The procedure of payment for use of residential space in state[4] and communal housing relied on state subsidies for expenses on maintaining state and communal housing, which greatly exceeded payments made by population. The state was spending huge amounts on subsidies to housing and utility sector, with very low return. Housing and utility payments made by the population could not compensate these expenses. Rent payments were collected in accordance with the Decrees of All-Soviet Central Executive Committee and Soviet of People Commissars of RSFSR "On Housing Payments in Cities and Worker's Settlements" of May 14, 1928, and "On Housing Policy" of January 4, 1928, which set the rate of rent payments at RUR 0.132 for 1 square meter of residential floor area, and for buildings with improved comfort conditions - at RUR 0.165 for 1 square meter (i.e. 25% higher). These rates did not change for over 60 years and amounted to about 2% of a household income (4% together with utility payments). In 1992, residents' payments covered only 1% of maintenance and repair costs of state housing, and only 8% of utility services costs. This method of payment for use of housing was not in line with the principles of the country's transition to market economy.

Principles of the new system of payment for housing and utility services.

With the adoption of the Law "On Foundations ..." the procedure of compensating the expenses on housing stock maintenance was changed. Pursuant to Article 15 of the Law "On Foundations ...", payment for housing and utility services under a rent agreement is set in the amount covering the cost of maintenance and repair, as well as utilities. Thus, federal law declares the principle of full coverage of costs of maintenance and repair of housing and utility services with payments of residents, who occupy residential space in state and communal housing under social rent agreements[5]. Transition to the new system of housing and utility payments is aimed at compensation of the actual cost of housing and utility services by consumers and implies simultaneous introduction of targeted social assistance to families, depending on their income. Thus, in 1992, it was declared that **the goal of housing and utility payment reform is the transition to full coverage of costs by residents' payments with simultaneous social protection of low-income families**.

Pursuant to Paragraph 2 of the Resolution of the Supreme Soviet of the Russian Federation "On Enactment of the Law of the Russian Federation "On Foundations of Federal Housing Policy"" of December 24, 1992, previously adopted legislative acts of the Russian Federation and subjects of the Russian Federation can be applied as long as they do not contradict the Law "On Foundations ...". Therefore, the use of provisions of the Housing Code of RSFSR was limited and the Code occupied a less important position in the hierarchy of legal acts regulating the procedure of housing and utility payments.

Legislators assumed that introduction of full payment for housing and utility services by the population with simultaneous social protection of population would result in significant decrease in budget expenses, as the need to provide subsidies to housing and utility enterprises would be

[4] At that time, "municipal" type of housing was not yet introduced. Absolute majority of residential buildings and 100% of apartment buildings belonged to the state housing stock (Art 5 of RSFSR Housing Code).

[5] Later, the Government of the Russian Federation applied the same principle to owners of housing.

eliminated and budget expenses would only be associated with compensation of benefits and allowances provided to citizens.

Terms and stages of transition.

Article 15 of the Law "On Foundations ..." stated that the transition to the new system of payment for housing and utility services should be done in stages within 5 years, i.e. from 1998 all budget subsidies to housing and utility enterprises should have been terminated, while consumers should have paid full cost of services. The transition should be done in stages, and the stages and the order of transition to the new system of housing and utility payments is determined by the Government of the Russian Federation together with authorities of the subjects of the Russian Federation.

The principle of full coverage of the costs of maintenance and repair of housing and utility services by residents' payments, established by the federal law, is further regulated by the Resolutions of the Government of the Russian Federation, which describe in detail the procedure for implementation of the new payment system and set forth additional social guarantees for the population.

On the grounds of Article 15 of the Law "On Foundations ...", the Resolution #935 of the Government of the Russian Federation of September 22, 1993 "On Transition to New System of Payment for Housing and Utility Services and Procedure for Providing Compensation (Allowances) to Citizens for Housing and Utility Payments" (Paragraph 1) sets the terms of stage-by-stage transition to the new system.

In addition to Resolution #935, another Resolution of the Soviet of Ministers of the Russian Federation (#1329, of December 23, 1993) "On Supplementing the Decree #935 of the Government of the Russian Federation, of September 22, 1993" authorized executive authorities of the subjects of the Russian Federation to establish the level of residents' payments for maintenance and repair of housing and utility services as percentage of cost, for each year and each region (city), depending on the current financial situation and possibility of providing compensation (allowances) to citizens for housing and utility payments from the budgets of the subjects of the Russian Federation, with the goal of reaching the 100% level of residents' payments by 1998.

In 1994 - 1995, tariffs for housing and utility services were growing at such a quick rate that they were no longer lagging behind the inflation rate. In these years, the share of housing and utility costs covered by the population increased from 2 - 3 % to 20 - 40 %[6]. In 1995, real income of population fell by 13%. As a result, politicians reconsidered their approach to the reform of housing and utility payments and extended the deadline for transition of housing and utility sector to full self-sufficiency.

Federal Law # 9-FZ, of January 12, 1996, "On Introduction of Changes and Amendments to the Law of the Russian Federation "On Foundations of Federal Housing Policy" has changed the initially established five-year term of transition to the new system to a ten-year term. Thus, pursuant to federal law, the deadline for transition to full coverage of costs of maintenance and repair of housing and utility services by payments of residents occupying residential space in state and municipal housing under social rent agreements was moved to 2003.

[6] According to data of Gosstroy of Russia, in 2002, the share of residents' payments amounts to 52.3% of housing and utility costs.

Following the State Duma, in 1996, the Government of Russia decided not to set a unified maximum level of residents' payments for housing and utility services. Paragraph 6 of the Government Resolution # 707, of June 18, 1996, recommends that executive authorities of the subjects of the Russian Federation set the level of residents' payments for housing and utility services as percentage of housing and utility costs for each year of the transitional period. Such regulation of terms of stage-by-stage transition to the new payment system should have been performed on the basis of suggestions of local self-governments, depending on the current financial situation. Due to the fact that Paragraph 7 of this Resolution authorizes local self-governments to set tariffs for housing and utility services, the level of residents' payments, established by executive authorities of the subjects of the Russian Federation, can be used only for inter-budgetary relations between region and municipalities.

Timeframe for the reform of housing and utility payments (1997-2003) was fixed by the Concept of Housing and Utility Sector Reform, approved by Presidential Decree # 425, of April 28, 1997, "On Housing and Utility Sector Reform in the Russian Federation". However, at the new stage, the Concept placed the main focus not on raising the tariffs for housing and utility services, but on lowering the costs of service providers. The Concept indicated that crisis should be resolved by way of changing the system of financing, i.e. by moving from budget subsidizing to full coverage of housing and utility costs by consumers, while providing at the same time social assistance to low-income families and economic incentives for improving the quality of services. In other words, the Concept suggested sharp reduction of budget expenditures (first of all, the expenses of the state) and corresponding increase of expenses of the population.

In 1999, the State Duma once again decided to move the deadline for transition to full payment for housing and utility services. Pursuant to Federal Law # 113-FZ, of June 17, 1999, "On Introduction of Changes and Amendments to the Law of the Russian Federation "On Foundations of Federal Housing Policy", the transition to the new system of payment for housing and utility services shall be performed stage by stage within 15 years, i.e. by 2008.

This Federal Law added the following provision to Article 15: "During the period of stage-by-stage transition to the new system of payment for housing and utility services, the Government of the Russian Federation shall continue to observe the procedure for providing subsidies (transfers) to budgets of the subjects of the Russian Federation for maintenance and repair of housing and facilities of the housing and utility sector in the amount not covered by residents' payments". Thus, the state has declared for the first time its obligation to compensate a part of expenses of regional budgets, which are used to cover the losses of housing management, housing maintenance, repair, construction, utility and specialized organizations, resulting from state regulation of prices for housing and utility services.

RF Government Resolution #877, of August 2, 1999, "On Improving the System of Payment for Housing and Utility Services and Measures of Social Protection of Population" (Part 2, Paragraph 8) authorizes local self-governments, during the period of transition, to set the maximum allowable share of household expenditures for housing and utility payments in total family income, as well as amount of residents' payments for housing and utility services provided. At the same time, the Government recommends that, for the purpose of improving social protection of low-income population groups, local self-governments set the amount of payment for housing and utility services within the limits of the federal standard of maximum allowable share of household expenditures for housing and utility payments in total family income, per person. Thus, the Government has consented to the fact that actual terms of transition to full coverage of housing and utility costs will be determined at municipal level.

Distribution of authority on setting the rates of housing and utility payments for the population.

Pursuant to the Resolution # 935 (Paragraph 5), local administrations are authorized to approve norms of consumption for housing and utility services, as well as rates and tariffs for housing and utility services. This authority is determined by the terms and levels of residents' payments as percentage of housing and utility costs, established by the Resolution.

Later, Presidential Decree #221, of February 28, 1995, "On Measures for Bringing Order into State Regulation of Prices (Tariffs)" authorized the Government of the Russian Federation to determine and approve the lists of goods, works and services, prices (tariffs) for which are subject to state regulation by the Government of the Russian Federation, federal bodies of executive power and bodies of executive power of the subjects of the Russian Federation. Pursuant to this Decree, the Government has approved the Resolution #239 of March 7, 1995, which contains the list of goods, works and services, prices (tariffs) for which are subject to state regulation by bodies of executive power of the subjects of the Russian Federation. This list includes "payment for housing and utility services by the population", as well as "water supply and waste water services" as a separate item.

However, Federal Law #154-FZ, of August 28, 1995, "On General Principles of Organization of Local Self-Government in the Russian Federation", adopted later, established that prices and tariffs for products (services) of enterprises, agencies and organizations, which are part of the municipal property, shall be regulated by local self-governments (Article 31). Therefore, as absolute majority of housing and utility enterprises are part of municipal property, the authority of setting rates of housing and utility payments remained primarily with local self-governments. Furthermore, the authority of local self-government to approve norms of consumption of housing and utility services, rates and tariffs for housing and utility services (except for electricity and gas) was confirmed by the Resolutions of the Russian Government #707 (Paragraph 7), of June 18, 1996, and #887 (Paragraphs 7, 8 and 9) of August 2, 1999; this authority was applied not only to municipal enterprises and agencies, but also to housing and utility service providers with different form of ownership.

Ensuring social protection of citizens in connection with payment for housing and utility services.

Article 15 of the Law "On Foundations ..." (as amended on December 24, 1992) states that bodies of local self-government, local administration provide compensations (allowances) to citizens, ensuring payment for housing within the limits of social standard of housing floor area and norms of consumption of utility services, taking into account total family income, existing benefits and approved budget. Thus, federal law indicates that assistance provided to the family for payment of housing and utility services should be based only on the amount of total family income.

Law "On Foundations ..." introduces the concept of social norm of housing floor area. The norm is the amount of floor area of housing assigned to one person, which determines the limits for housing and utilities compensations (allowances) (Article 1). Article 11 indicated that social norm of housing floor area is equivalent to the minimum size of housing provided to the citizens, which is established by bodies of state power of the subjects of the Russian Federation. This approach was later duplicated in a number of resolutions of the Government of the Russian Federation, regulating issues of payment for housing and utility services and provision of housing allowances.

Five years later, in 1997, the Resolution of the Government of the Russian Federation #621, of May 26, 1997, "On Federal Standards of Transition to New System of Payment for Housing and Utility Services", has set the federal standard for social norm of housing floor area, which is being used for interbudgetary relations. This standard, adopted currently in the majority of regions of Russia, amounts to 18 square meters of general floor area of housing per one member of a family of three or more, 42 square meters - for a family of 2 persons and 33 square meters - for a person living alone.

The Resolution #935 has authorized local administrations to set the share of maximum allowable household expenditures for housing and utility payments in total family income, based on the maximum level of such expenses, which was established as percentage of total family income (10 - for 1994, 15 - for 1995, 20 - for 1998). The citizens were eligible for compensation, if the amount of their expenses for housing and utility services, provided at residential space occupied by them (within the limits of social norm), with the account for existing benefits, exceeded the maximum allowable share of household expenditures for housing and utility payments in total family income, set for a certain period.

The Soviet of Ministers has established compulsory compensations (allowances) only for citizens occupying residential space in municipal and communal housing. For citizens renting housing, members of cooperative housing, as well as citizens who own their housing, there was only a *possibility* of receiving such compensations. In 1999 (after adoption of Federal Law # 113-FZ, of June 17, 1999), the owners and tenants of housing got equal rights to compensations (allowances).

Federal Law #9-FZ, of January 12, 1996, has introduced an addition to the Law "On Foundations ..." and changed cardinally the principles of providing compensations (allowances) for housing and utility payments. Starting January 1, 1996, household expenses for housing and utility payments should not exceed half of minimum wage established by federal law, if the total family income per person does not exceed the established minimum subsistence level. Thus, legislators abandoned the method of differentiating the amounts of actual payments of all allowance recipients on the basis of total family income, and established a *unified* amount of payment (equal to half of minimum wage) for a considerable number of citizens.

Resolutions of the Government of the Russian Federation #707, of June 18, 1996 "On Improving the System of Payment for Housing and Utility Services" and # 887, of August 2, 1999, "On Improving the System of Payment for Housing and Utility Services and Measures for Social Protection of Population" have fixed and elaborated on both principles of allowance provision.

The second principle (basis), as mentioned above, implies that a considerable part of the population has to pay for housing and utility services *at the same price*, equal to half of minimum wage, regardless of the established rates of housing and utility payments and total family income. This equalization of the allowance amount for citizens, whose incomes may differ substantially, means elimination of the principle of providing assistance to citizens for housing and utility payments based on their total family income. Moreover, the second principle of allowance provision implies either sharp reduction (10 times or more) of the allowance amount or termination of allowance provision if the total per capita household income exceeds minimum wage by 1 Rouble. This presents the evidence of the fact that the ways of ensuring social guarantees of citizens in the housing sector are imperfect and unfair.

Privileges for rent and utility rates.

Privileges for rent and utility rates are a legacy of the Soviet system of supporting the population. In the 1920s, local Soviets were allowed to reduce rent and utility rates paid by families with

many children by 5% to 15%. However, such privileges were not universal. Second, they were recommended, but their introduction was not obligatory. Third, they were insignificant and could be applied only to families with many children, which were the poorest ones, as a rule. It should be pointed out that such privileges are still in effect in some cities, such as Novgorod and Vladimir.

In their current form, reduced rent and utility rates were introduced in 1975, when, on the occasion of the 30th anniversary of the victory in the Great Patriotic War, the CPSU Central Committee and the USSR Council of Ministers introduced a 50-percent reduction of rent and utility rates for disabled war veterans of the first and second groups and families of servicemen killed in action by their joint Resolution No. 304, On the Additional Privileges for Great Patriotic War Veterans and Families of Killed Servicemen, of April 18, 1975. Later, in the period between that year and 1991, several more resolutions were adopted. They provided for reduced rent and utility rates for war veterans and other similar groups of citizens, as well as for some other groups, such as specialists who lived and worked in rural areas and people working in hospitals for lepers located in rural areas.

A huge number of privileges were introduced in Russia in the post-Soviet time. During that period, privileges were provided not only for services to the fatherland to Heroes of Russia and war veterans, to families with many children, disabled people and other similar groups, but they were also provided to people of particular occupations, such as customs officers, militiamen, prosecutors, army officers, judges and others. More then ten *new* laws providing for reduction of rent and utility rates for particular groups of citizens in 1991 through 2002, and more than 30 additions were introduced in them during the same period. Moreover, the privileges provided in accordance with Soviet laws and resolutions are still in place. In many Russian cities, local laws regulating social insurance and safety net matters contain provisions taken directly from Soviet legislation or provisions that refer to them.

Thus, during the years of reform of the housing and utilities sector, the measures aimed at the reduction of municipal spending on the housing sector were implemented simultaneously with decisions that increased pressures on the federal budget. Moreover, the federal sources of finance determined by legislation can hardly compensate the budget for the provision of privileges, while financing of the implementation of the most costly law - the law on Veterans - is entrusted to governments of the subjects of the Russian Federation, which, in their term, are unable to fulfill such financial obligations.

In addition, many Russian city and regional governments have introduced local privileges to certain groups of citizens by their decisions (privileges to honored citizens, participants in operations in Chechnya, single mothers, people affected by natural disasters, etc.). As a result, more than 40% of Russians are now paying reduced rent and utility rates, according to the State Statistics Committee of the Russian Federation (Goskomstat).

The current system of supporting particular professional rather then social groups, alongside with the absence of a system for compensating business entities for subsidized rates, is destroying the housing and utilities sector of the Russian economy. Even if budgets of higher level provide compensation for subsidized rates, the funds allotted for the purpose never reach service provides. Most often, they disappear in local budgets.

In 1996, for the first time in Russian history, Resolution of the Government of the Russian Federation No. 245 of March 6, 1996 introduced subsidized rent and utility rates for judges of the Constitutional Court of the Russian Federation and ranked members of its staff. In addition, Resolution of the Government of the Russian Federation No. 1210 of October 14, 1996 introduced the same privileges for judges of the Supreme Court of the Russian Federation and the Supreme Arbitration Court of the Russian Federation and members of their staff. The

resolutions provides for full payment of rent and utilities by the above categories and compensation for such payments upon the submission of appropriate payment-confirmation documents at the place of work. In 1998, the application of these rules was extended to two more categories: judges, prosecutors and their staff members.

Such procedures for subsidizing housing-maintenance and utility services does not infringe on the rights of people entitled to privileges, but it reduces the volume of non-payments to housing-maintenance and utility enterprises. Provision of compensation from budgets of particular organizations can be regarded as the first step taken at the federal level in order to bring the provision of subsidies for housing-maintenance and utility services.

However, such procedure does not make it possible to come closer to the introduction of targeted support to those people who actually need it. It's quite obvious that poverty can hardly be attributed to particular groups of citizens entitled to reduced rates. There are poor young families, pensioners and disabled people. There are strong people in good health who are temporary unemployed, the may be poor representatives of particular occupational groups who have many dependents in their families. That's why it is not particular professional and social groups who must be supported but rather people of a particular family-income level.

Main Directions for the Improvement of Federal legislation Regulating payment for Housing and Utility Services.

The bases for the federal housing policy were established by the Federal Law on the Bases of the Federal Housing Policy more than ten years ago. Though the law has been frequently amended since its adoption, it still fails to make the government housing policy any more transparent, clear and consistent. During the same period, Russia's Civil Code was adopted, development of the Housing Code began and certain provisions of the existing housing legislation were amended. In addition, new problems were encountered in the process of reforming Russia's housing and utilities sector. Their resolution also requires legislative action.

All this requires that new amendments and additions be introduced into the Law on the Bases of the Federal Housing Policy. Since 1999, the Russian government has repeatedly made various amendment proposals to the State Duma. In late 2002, the State Duma passed the draft law submitted by the government in the first reading. The aim of the bill is to introduce the principles of systematic revision of rates with account taken of changes in personal incomes, introduction of targeted social support of particular families instead of the subsidizing of monopolies and balancing of the state's obligations relating to payments for housing and utilities.

The proposed bill streamlines the provisions of Articles 15, 18 and 19 of the law and introduces a number of new definitions reflecting changes in the housing and utilities sector introduced in accordance with the sub-program named the "Reform and Modernization of the Housing and Utilities Complex of the Russian Federation and implemented within the Zhilishche (Housing) Federal Purpose-Oriented Program for 2002 through 2010 (Approved by Resolution of the Russian Federation Government No. 797 of November 17, 2001). The bill also excludes the provision for the division of powers relating to regulation of payments for housing and utilities between the federal level, subjects of the Russian Federation and municipal formations. The time and procedures for the transition to a new system of payment for housing and utilities shall be established by subjects of the Russian Federation in accordance with decisions of the Government of the Russian Federation.

It should be remembered that, since the adoption of the Conception of the Reform of the Housing and Utilities Complex in the Russian Federation (Decree of the President of the Russian Federation No. 425), the Russian government has not changed its opinion about the time of introduction of non-subsidized rates of payment for housing and utilities (2003). Thus, municipal

formation will get a legal right to establish housing and utility rates at a level guaranteeing complete cost recovery.

The law past in the first reading provides for the provision of targeted housing subsidies to families depending exclusively on their income and its share used for payment for housing and utilities. The proposed version of the bill contains no provision requiring that all citizens whose average monthly income is lower then subsistence minimum in a respective subject of the Russian Federation can pay only 0.5 of the minimum monthly wage for housing-maintenance and utility services. In other words, the new law provides for the abolition of the notorious "second basis". According to the bill, the principles of the housing subsidy provision must conform to the Regulations for the Provision of Subsidies for payment for Housing and Utilities approved by the Government of the Russian Federation.

The law approved in the first reading provides for significant changes in the system of the provision of subsidies for payment for housing and utilities to particular group of Russians. Earlier, the Russian government asked law makers to abolish reduced rates in their current form and introduce targeted subsidies instead of them, but the proposal was not supported by law makers. According to the law passed by the State Duma in the first reading, most privileged groups will retain their current privileges and their amounts. At the same time, the law defines sources of financing such privileges (subsidized rates) more precisely: part of them must be financed from the federal budget, while the other part must be financed from budgets of subjects of the Russian Federation. Moreover, the law contains a provision allowing subjects of the Russian Federation to refuse to provide some privileges if their budgets can not afford them. This provision can come into effect only in 2005. However, its possible efficiency is already questioned by many.

Though the new version of the law contains a number of positive improvements, the most important of which is the abolition of the "second basis" for the provision of subsidies, it is mostly a product of compromise which is unable to resolve the main problem - optimization and reduction of government obligations to subsidize housing and utility rates for different social and occupational groups accounting for 40% of Russia's population.

The reform of the system supporting the population's payments for housing and utility services is now the most important task from the viewpoint of both financial stabilization of the housing and utilities sector and social justice. The subprogram titled "Reform and modernization of the Housing and Utilities Complex of the Russian Federation" (which is part of the Zhilishche (Housing) Federal Purpose-Oriented Program for 2002 through 2010) has established that "the main idea of the economic reform in the housing and utility sector is the transfer of the right of the disposal of budgetary resources that are currently allotted to subsidize the sector from the municipal enterprises to citizens who are the persons most interested in the effective use of such funds". The same document provides for the introduction of a system of citizens' personal social security accounts. The use of such accounts will promote citizens' self-organization in the housing sector and development of the market for professional housing-maintenance service market, it will also increase the transparency of the use of funds and increase social orientation of the budgetary policy.

Experimental provision of targeted housing subsidies using citizens' personal accounts, which began in some Russian regions in 2002, was the first step towards the establishment of such system. Given the preservation of subsidies extending to all the population of Russia and privileges enjoyed by a significant part of Russians, it was impossible to transfer all the funds concerned to personal accounts as of the start of 2003. The experiment began after the adoption of Resolution of the Government of the Russian Federation No. 490, "On the Experimental Application of the Economic Model of the Reform of the Housing and Utilities Sector", of July 1, 2002. In the development of that resolution, Russia's State Committee for Construction (Gosstroi) developed the Procedure for the Performance of the Experiment

Aimed at Targeted Social Support of the Population in the Payment for Housing and Utility Services with the Use of Personal Social Accounts and approved it on September 6, 2002.

According to the Procedure, the personal social account is construed as a bank account to which subsidies used by citizens for payment for housing and utility services are transferred. The main purpose of a citizens' personal social accounts is to serve as instruments for citizens' settlements with service providers using budgetary funds transferred into them.

In addition to housing subsidies, other government funds intended for the housing and utilities sector may be transferred to such accounts. For instance, regional and municipal privileges can already be expressed in money terms, while respective amounts can already be transferred to personal social accounts on the condition that citizens enjoying privileges pay for housing and utility services in accordance with the established rates. This will require amendment of Russia's local laws and regulatory documents regulating the provision of such privileges.

Conclusions

Thus, having reviewed the initial goals of the reform of payment for housing and utility services, stated in the Law "On Foundations ..." of 1992, as well as intermediate goals, described in later legislative acts and governmental resolutions, issued over the decade, we can arrive at the following conclusions:

1. The goal of the housing and utility payments reform is the transition to full coverage of costs by residents' payments with simultaneous social protection of low-income families. This goal has not changed and is still being pursued by the legislative and executive authorities of the Russian Federation.
2. The terms of transition to the new system of housing and utility payments have been repeatedly moved to later dates. The legislators and the Government cannot reach unity of opinion either on the necessity of full transition to the new system as soon as possible, or on the methods of such transition.
3. Due to uncertainty of legislative authorities regarding the terms and stages of transition to the new system and their ultimate refusal to set the stages of transition in federal laws, the key decisions on actual terms of transition are being made at the municipal level and responsibility for these decisions falls on local self-governments.
4. Initially declared principle of clear and direct correlation between the social assistance provided to a family for housing and utility payments and total family income was eliminated, when the second principle of allowance provision was introduced, under which the amount of allowance depends on minimum subsistence level and minimum wage. As a result, the principles of social justice in providing social assistance to population were undermined.
5. During the years of the reform of the system of payment for housing and utilities, simultaneously with measures aimed at cancellation of subsidies to the housing and utilities sector and reduction of municipal government spending on that sector, legislative decisions were made to introduce reduced housing and utility rates to particular groups of citizens. Such decisions significantly increased pressures on the federal and municipal budgets.

Legal Framework for the Development of Competition in the Housing Sector

In the period preceding the reforms the housing and communal service sector was characterized by the rigid state regulation of all housing relations and the predominance of state ownership.

The distinctive features of this system are:

- ? state monopoly in housing maintenance and utility services, with the loss-bearing activities of respective organizations strongly subsidized by the state;
- ? deep subsidizing of the initially loss-bearing operations of the housing and utility companies;
- ? the rights of housing owners were practically no different from the rights of tenants in the state housing stockownership rights;
- ? state enterprises were assigned the function of providing housing to their employees and maintaining this housing.

The preconditions for housing and communal service sector reforms were created by the law *On Ownership in the Russian Federation* <*18*>, which eliminated the quantity and value restrictions on the citizens' rights to own property, including residential premises. Ownership was also granted to members of housing and housing-construction cooperatives who have paid for their units in full.

Pursuant to resolution of the RF Supreme Soviet as of December 27, 1991, No. 3020-1 (<19>), some state properties were conveyed into ownership of municipalities (except cities in raion jurisdiction) and raions (except raions in cities). The properties conveyed to local governments included housing and utility facilities:

- ? residential and non-residential stock;
- ? municipal engineering infrastructure;
- ? enterprises engaged in the operation, maintenance, and repairs of these properties.

From that time the responsibility for organizing management of the municipal housing stock was placed with the local governments. Divestiture of the state and departmental housing stock was most active in mid-90ies. The share of state property in the housing and communal service sector decreased during this period from 42 to 5 percent. Additions to the municipal housing stock confronted local governments with the alternative: to create new municipal agencies for maintaining this stock or to attract private businesses on a competitive basis.

The law, *On Privatization of the Housing Stock in the Russian Federation* (<***13***>), permits the privatization of residential premises. Pursuant to this law, owners of privatized premises in the state or municipal housing stock are co-owners and users of internal engineering equipment and common areas in the buildings. Thus privatization of residential premises has lead to a situation when one real estate object (a residential building) may have several owners who enjoy equal rights under the RF Constitution. The privatization law identified two types of properties in a multifamily residential building: residential and non-residential premises in the ownership of private individuals and legal entities, and the common property. The law, *On Homeowners' Associations* (<***14***>), classifies common property as property serving more than one owner: stairways, landings, elevators, elevators and other shafts, corridors, roofs, crawling spaces and basements, loan-bearing and non-load-bearing structures, as well as mechanical, electrical, sanitary or other equipment outside or within residential premises serving more than one unit. Individual units are managed by their owners. The common property is managed on the basis of the decisions of the general meeting of unit owners.

The law, *On Homeowners' Associations,* created the legal framework for the owners' participation in the management of the common property. It was intended to promote the transition to an object-based management of multifamily buildings and, subsequently, promote the demand for various housing maintenance services. However, the process has been very slow, and municipalities have retained their monopoly for the procurement of housing services, which is a major obstacle to the development of a competitive environment.

The regulatory framework currently in effect in Russia (see <***2***>, <3>, <***4***>, and <***20***> at the end of the book) envisages a three-level system of management for the multifamily stock:

- ? owners of the residential building;
- ? management company;
- ? contractors for the delivery of goods, works, and services required for the management function.

From the above it follows that competition in the housing stock is possible both for the management of multifamily buildings, and for the delivery of products and services.

The formation of an economically efficient management system in the housing sector starts with the structuring of relations between property owners and management companies. The effective law permits management of the property to be organized in the following manner:

- ? by conveyance into economic jurisdiction;
- ? by conveyance into operative management;
- ? under a contract of trust management ;
- ? under a contract for the delivery of property management services for a consideration.

The right of economic jurisdiction and the right of operative management are special types of real rights not found in any other legal system. These rights are granted to legal entities for an undefined term and include possession, use, and disposition of the owner's property. An enterprise having economic jurisdiction over a property may possess, dispose, and use the property at its own discretion. The right to possess, use and dispose of the property conveyed into economic jurisdiction or operative management may not be restricted by a contract and is regulated solely by the Civil Code.

The property conveyed under the right of economic jurisdiction or operative management is withdrawn from the physical possession of the conveying owner, and is place on the balance sheet of the holder. Thus the owner may no longer exercise the rights associated with the possession and use (and, to a large extent, disposition) of the property. Importantly, enterprises holding the property under the right of economic jurisdiction are liable for their debts at the expense of this property, but do not answer for the debts incurred by the owner, because the property id treated as the "allocated property".

The existence of legal entities which are not owners of their property but which may act as independent participants of economic transactions with it is the direct consequence of the transitional status of the economy and the heritage of the "state" economy, of which the said types of legal entities are an example.

Evidently, at the present phase the legislation adopted for the period hinders further development of an efficient system for management of the housing stock. They do not allow the owner to manage the housing stock to the extent desired by the owner, and block the development of competition in this area.

Under a contract of trust management the trustee exercises the owner's rights with respect to the property to the extent provided for by the law or contract. The trustee has no ownership right to

the property and acts in the interests of the owner (or the beneficiary indicated by the owner), though acting in his own name.

Trust management of the property may be established by any owner. The contract of trust management is a fixed-term contract and may be signed for a term not exceeding 5 years. By the general rule, upon the expiry of the contract the property should be returned to the owner.

It should be noted that the property conveyed into trust management is segregated from any other property of the conveying owner, as well as the property of the trust manager. For this purpose, the property id recorded in a special balance sheet and records. Moreover, settlements associated with the trust management of the property are made through a separate bank account.

These features make a contract of trust management preferable to contracts of economic jurisdiction or operative management. Nevertheless, this contract has several defects which limit its usefulness.

Pursuant to the Civil Code, a trust manager may be an individual entrepreneur or a for-profit company, but not a unitary enterprise. Therefore, it appears impossible to form equal conditions for the management of the housing stock by organizations of different ownership form.

The act of conveying a property into trust management should be executed in accordance with the rules for the sale/purchase of real estate. In particular, it is necessary to obtain an inventory of the property, an independent auditor's report on the composition and value of the property and an inventory of all debts. In addition, one should bear in mind that transactions with real estate are subject to the state registration.

Also, it should be taken into account that debts under the obligations arising in connection with the trust management of the property are settled at the expense of the property, which may result in the loss of the property by its owner.

It is thus obvious that practical use of a contract of trust management faces severe difficulties which do not allow for realizing the advantages of this type of contract.

Under a contract for the delivery of services the contractor undertakes the obligation to perform specified actions in the interest of the client or a third party – beneficiary. Municipal procurement orders for the housing and communal services and contracts for management of the housing stock are characteristic examples of this type of contract.

A municipal procurement contract has several advantages as compared to economic jurisdiction or operative management, and certain advantages as compared to a contract of trust management. A municipal procurement contract enables the owner to decide at its own discretion what portion of the management activity should be assigned to the management company. Being a fixed-term contract, a municipal procurement contract can create efficiency incentives for the management company. It may be concluded with an entity of any ownership form, including municipal unitary enterprises and institutions.

At the same time, a municipal procurement contract has several defects which make it inapplicable for the delivery of housing and communal services. In accordance with the RF Budget Code <***23***>, a municipal procurement order is an agreement between a local government and a contractor for the performance of works (delivery of services) financed out of the local budget. Judging by this definition, one may conclude that use if the term "municipal procurement order" with respect to the housing and communal services delivered to the households is incorrect. These services are funded by two sources – the budget and the population, and the share in the cost coverage of the latter is growing steadily. It is of course possible to segregate the housing and communal services financed by the budget from the total volume of services, and form a procurement order for this portion of the services. However, making a contract for these sums would be legally incorrect because the obligation to finance these services out of the budget arises by force of the laws and implementing acts. However, a

municipal procurement order would be appropriate, for example, with respect to urban environment services, because the services are financed by the budget. Again, the delivery of housing and communal services is a different case.

One form of a service delivery contract is the so-called management contract, which is used by some cities to attract private companies to the management of the housing stock on a competitive basis.

In this contract the owner has the right to define the list of functions assigned to the management company. For example, the owner may assign the management company with the keeping of the inventory of the property, recording the property off-balance.

The contract can take into account all conditions required for the efficient performance of the management company, without restricting the initiative of the latter. A single format of the contract may be used for all housing owners, including owners (natural persons) of individual premises. The only difference may lie in the right of the management company to conclude naim contracts.

The federal regulatory acts promoting competition for the housing maintenance services urge local governments to reorganize the sector by segregating the management and maintenance functions. However, the implementation of this theoretically correct approach into practice has, regretfully, failed to create a competitive environment for contracted maintenance and repair works.

Moreover, the competition for contracted services is negatively affected by the tax benefits provided for by the effective law, in accordance to which households' payments for housing services are exempted from the value-added tax (VAT). The exempt applies to payments to the management company only, while contracted services for maintenance and repairs of the housing stock are subject to VAT. Thus the tax law encourages the merger of management and maintenance functions, at the same time hindering the development of competition for contracted services. At present the entire sum of the VAT collected in a jurisdiction is transferred to the federal budget, and local administrations regard the search for legal ways of avoiding this tax as one of their main tasks. Placing the management and maintenance functions with one entity is one of such ways.

In view of the above, this report analysis the impact on the competition for management and maintenance of multifamily buildings of the segregation of management and maintenance functions, and of the conveyance of the housing stock into municipal ownership with the subsequent segregation of its management and maintenance functions by the municipalities.

Overview of legal pre-requisites for the Establishment and Activities of Condominium associations

One of the objectives of the housing and real estate policy proclaimed by the RF government in the early 90-ies of the XXth century was to transfer the management of the major bulk of the housing stock including multifamily buildings to private homeowners.

As a result of free privatization of housing initiated by the federal Privatization Law (*On Privatization of Housing in the Russian Federation,* #1541-1, issued on 07/04/91), the structure of the housing stock in the Russian Federation has crucially changed. To date, private homeowners occupy 64 percent of the housing stock, 40 percent of which are units in multifamily buildings.

The massive home privatization in Russia has given rise to a situation when practically all multifamily buildings in the country are now occupied by more than one or even many homeowners. The ownership in housing implies the free right of an owner to manage its own property that is to make decisions on its maintenance, repair and use. Moreover, the RF Civil Code provides property owners not only with the right but also with the burden of maintaining the property (Art. 210, *Burden of Maintaining Property*). Therefore, today the housing sector reform is expected not just to boost the privatization process in the sector but also help private owners become real managers of their property.

However, today in Russia, as in the early 90-ies, most of the multifamily stock is still managed by municipalities. The unwillingness of residents to become participants of the housing policy making process as well as to assume responsibility for maintenance and management of the property they live in is rather favorable for municipalities, which continue to ignore the right of homeowners to participate in the common property management, keep using administrative mechanisms of economic management, holding a monopoly on delivery of utility, property maintenance and renovation services, and impede the creation of necessary economic and administrative preconditions for expansion of other models of property management. In an attempt to instigate the involvement of private homeowners into the property management from above the federal government issued a law welcoming the creation of associations of homeowners as a new model of property management.

Condominium as a single property complex.

The Housing Policy Fundamentals law issued by the RF government on December 24, 1992 (*On Fundamentals of the Federal Housing Policy*, #4218-1, hereinafter referred to as the Fundamentals Law) stipulates that unit owners in multifamily buildings are considered co-owners of common elements in their buildings, that is “elements designed to service more than one homeowner including staircases and hallways; elevators, elevator and other wells; corridors, roofs, attics and basements; fencing, bearing and non-bearing structures, mechanical, electric, sanitary and other equipment installed outside or inside a building and servicing more than one units; adjacent land plots within the established boundaries including landscaping elements and improvements located on them; as well as other objects designated to serve a single real property complex” (Art. 8). The Fundamentals law was the first in the Russian law making practice that used the term “condominium”. The 1997 edition of the law interpreted this term as a single complex of real property including units and common elements. The law also defined that common property in condominium is held in share ownership of homeowners, which cannot be alienated apart from their ownership to units (Art. 8, It. 2). These provisions were later fixed in

the RF Civil Code (Article 29, It. 1 and 2)[7], and the Homeowners' Associations Law, (*On Associations of Homeowners*, # 72-FZ, issued on 06/15/96, Articles 1 and 7).

The Homeowners' Associations Law (hereinafter referred to as the HA Law) gives an extended definition of the term "condominium": a real property complex including a land plot within the established boundaries and a building and other property objects located on it, some elements of which (units) are used for accommodation or other purposes and belong to homeowners, and some elements (common elements) are used as a common property in share ownership of homeowners" (Article 1).

Today, most difficulties in condominium registration are met when it is necessary to define the legal status of a condominium land. The HA Law (Articles 1, 5, 8) treats a condominium land as a common property of homeowners, and states that a person buying an apartment in a multifamily building simultaneously acquires a share in common elements and land belonging to a condominium. Later, the provisions of the HA Law on land rights of condominium members were confirmed by the Presidential decree # 485 (*On Guarantying the Right of Property Owners to Acquire Ownership to Land under their Property*, issued on 05/16/97) and the RF Government resolution #1223 (On Approval of Regulations for Establishing the Size and Boundaries of Condominium Land Plots, issued on 09/26/97).

However, neither the HA Law, nor other legislative statutes issued have clear provisions obliging local governments to treat condominium land plots as common property of homeowners, no matter whether there is or is not a registered association of them. Until 2001 this vagueness of the law was widely used by local land administrators as a ground not to recognize the homeowners' right to hold a condominium land in ownership, which was in fact contrary to the HA Law provisions. However, the situation did not change in favor of homeowners' associations even after the adoption of the Land Code. Russian cities set about to develop State Cadaster formation procedures, but most programs neither took into account the interests of both existing and future condominium associations nor aimed at formation of condominiums as unified property complexes.

Achievement of homeowners' consensus on condominium management

Unit owners in multifamily buildings have to use housing and utility services collectively. Therefore, in multifamily buildings, where residential and non-residential elements belong to multiple owners, a consensus of all homeowners on terms and methods of the property management is required.

The Fundamentals Law in its 1992 version made no difference between the terms "condominium" and "association of homeowners" thus considering the registration of an association of homeowners as an only possible way of management of property held in common share ownership. In particular, the Law stipulated that "construction, maintenance and renovation of multifamily houses, apartments and other residential units constituting a condominium should be regulated by contracts" concluded between homeowners (Article 8). The RF Civil Code (Part I, Article 291 issued in 1994) also failed to suggest homeowners mechanisms for reconciling their interests in order "to ensure the exploitation of a multiapartment building, the use of the apartments and their common property" other than registration of an association of home (unit) owners.

The HA Law was the first that proclaimed the right of homeowners in multifamily buildings to create associations by their free will and suggested several property management models for

[7] Unlike the Fundamentals Law, the Civil Code (Art. 290) does not treat adjacent land plots as a property held in common share ownership of unit owners.

management of condominium property. Under this law, condominium homeowners are eligible to decide themselves which of the suggested models suits them best. The law (Articles 20 and 21) suggests three property management models:

1) direct management of the property by all homeowners - for condominiums having no more than four units and a limited (from two to four) number of homeowners;
2) delegation of the responsibility to manage the condominium property to a state or a municipal property management company;
3) registration of an association of homeowners that may either manage the condominium property itself or delegate this responsibility to a contracted property manager.

In view of the enactment of the HA Law, Article 8 of the Fundamentals Law was corrected in 1997 to read: "homeowners … *may* form an association of homeowners". From this moment on, the formation of homeowners' associations (HOA) is no longer treated as a single way for reaching a consensus between homeowners on their property management.

Still, notwithstanding provisions according to which homeowners are considered eligible rather than obliged to choose a property management model the HA Law at the same time requires to impose a fine on those who fail to do that within six months (Article 20). This penalty can be applied only to condominiums where more than 50 percent of units are held in private ownership. Still, the Law fails to specify who and how should apply this sanction in practice[8], and in addition local governments have no practice to monitor changes in the rate of owner-occupied units in multifamily buildings. Consequently, it is hardly possible to cite at least one case of imposing this penalty in practice.

For better understanding of how unit owners in condominiums may come to a property management consensus it is important to understand how the law regulates the problem of condominium membership. Under the HA Law (Articles 32 and 49) the membership in an association of homeowners was obligatory for all unit owners. In 1998 the RF Constitutional Court declared this requirement contradictory to the RF Constitution[9] thus permitting homeowners to stay apart of an association of homeowners and thus not to participate in collective management of their common property. Practically, the RF Constitutional Court recognizes the prevalence of a private freedom of choice over joint interests of other homeowners. However, the collective mode of consumption of housing and utility services in multifamily buildings makes it impossible to leave a particular homeowner without them. So, by refusing to participate in the joint management of the property a homeowner, in fact, infringes rights and interests of other homeowners in the building.

Worth noting is the fact that Russia is a single country in the world that legalized this prevalence. Obligatory registration of homeowners' associations in multifamily buildings is a legitimate practice in many countries including Norway, Denmark, Germany, Netherlands, Switzerland, Poland, Hungary, Czech Republic, Kazakhstan and Uzbekistan. In Slovakia, Romania, Bulgaria< Estonia, Latvia, Lithuania, Belarus and Moldova associations are created on a voluntary basis. But all countries are common in requiring the obligatory membership of all homeowners in an association as soon as it is created in a particular building except Russia.

Encouragement of HOA formation.

The effective law suggests a series of incentives intended to create "a favorable environment" for the formation and operation of associations of homeowners. Yet in 1992, the Fundamentals Law

[8] Until July 2002, this was the responsibility of the State Housing Inspection, but on 12/30/01it was repealed by the federal law #196-FZ.
[9] Decree of the RF Constitutional Court #10-P as of 04/03/98.

stipulated that the main advantage of HOAs was an opportunity "to control costs and service prices and select maintenance and renovation service providers".

The HA Law also permits HOAs to be autonomous in planning their cost and revenue budgets, regulating membership fees, and contracting out management and maintenance services to any type of provider. HOAs are also allowed to hold some units in a condominium in common property and sell or lease them out in order to derive an income (Article 29).

Of particular importance is the provision about eligibility of condominiums to receive "grants, money reimbursements and subsidies" (Article 19). The HA Law guarantees the right of condominium homeowners and tenants to enjoy the social protection provided by effective state and local programs of social safety. Specifically, this social protection implies "the transfer of state and municipal subsidies to HOAs in order to help them finance their operating, maintenance and capital repair costs, purchase some types of communal services and compensate losses from providing discounted services to eligible population groups". In other words, in event of the creation of a HOA and allowing it to manage a building, this HOA will be considered eligible to receive all types of grants, subsidies and benefits that are envisaged by current laws and regulations. However, the Law fails to regulate who, in particular, should be a recipient of this financial aid – an association, a management company or a provider of maintenance or utility services – leaving these decisions at the discretion of authorities that provide this assistance.

When reviewing provisions of the HA Law ensuring the social protection to condominium homeowners and tenants it is also worthy to note that these guarantees were later supported by RF Government resolutions (#707 from 07/18/1996, and #887 from 08/02/1999) regulating rent and housing allowance payment procedures.

Creation of HOAs in new construction.

One of the chapters of the HA Law specifically regulates the creation of HOAs in new construction. This chapter was created in response to the need of many Russian municipalities to find a management model for buildings constructed at the expense of private investors and sold to private owners. Typically cities are reluctant to take on buildings in which they have no ownership for management. As a result, frequently such buildings are left "to the mercy of fate", that is, their occupants are left without housing and utility services, and the buildings themselves begin rapidly lose their value right after the commissioning of them.

The HA Law suggests to solve this problem by permitting the registration of a HOA as a legal entity both after and prior to the commissioning of a building and registration of a condominium, just at any stage of construction (Chapter 6, Article 48). So, the Law makes it possible for investors to register a HOA in advance and thus ensure the immediate transfer of it after the completion of construction to the HOA for management. The Law makes also easier the registration procedure for such HOAs requiring from developers just to submit an application, a building permit and a draft charter of a HOA (Article 48).