

**INSTITUTE FOR URBAN ECONOMICS**



**ANALYTICAL REPORT**

**HOUSING AND URBAN PLANNING POLICIES IN RUSSIAN CITIES: WEAK SUPPORT**

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## **HOUSING AND URBAN PLANNING POLICIES IN RUSSIAN CITIES: WEAK SUPPORT**

Russian cities currently feel the utmost need both for improving the affordability of housing and upgrading its quality, enhancing the beautification of the urban environment. Achieving the housing policy objectives necessitates a considerable update of urban planning policy which is currently characterized by minimum urban planning regulations and inadequate enforcement of those in place. Urban development and land use regulation remain a source of ‘administrative rent’ and appear to be unable to ensure a transparent legal framework for developers, while abusing them by high administrative barriers.

This article reviews housing and urban planning policies both at federal and local levels and analyzes case studies of inconsistencies in implementation of housing and urban planning policies in Russian cities, including one on the new phenomenon of the spontaneous and illegal development of so called “loft housing” in central districts of major cities. The paper concludes by setting out proposals on how to streamline housing and urban planning policies both for improving the affordability of housing and the quality of urban environment and avoiding potential negative externalities.

Keywords: housing policy, urban planning policy, urban environment, loft

## **Introduction**

Russian cities have been substantially influenced by the legacy of the Soviet centrally planned economy. Monotonous concrete-slab developments in residential areas with inadequate access to social infrastructure, along with dilapidated and obsolete individual residential developments, and abandoned industrial areas, create a typical scene of the middle zone of an urban settlement. Post-Soviet development of housing and residential construction markets, regrettably, worsened the problem of the inherited substandard urban environment.

As a result, Russian cities currently confront the utmost need for improving the affordability of housing and upgrading its quality and enhancing the attractiveness and wholesomeness of the urban environment, developing public spaces, expanding the diversity of housing tenure forms for different categories of citizens, assuring transportation links between urban areas, and increasing the opportunities for leisure and public activities.

By now, the basic legal framework regarding housing and urban planning sectors has been developed in Russia and the main goals and objectives of housing and urban planning policies identified. Yet, in the absence of effective instruments, real changes may not be realized in practice.

Relevant experience gained by developed countries shows the interrelation between the instruments of housing and urban planning policies which enable the effective attainment of the goals set.

The aim of this article is to review the current state of housing and urban planning policies in Russia, practices of reconciling the goals, objectives and instruments of the foregoing policies, and to set forth proposals on how to streamline housing and urban planning policies with a view to improving the affordability of housing and upgrading the quality of urban environment.

The analysis of inconsistencies of housing and urban planning policies is enhanced with four cases reflecting various aspects of housing and urban development issues.

## **1. An Overview of the Housing Sector in the Russian Federation**

As of 2016, the size of the entire housing stock in the Russian Federation is reported to be 64.9 million dwelling units (apartments and single-family houses) with the total floor space of 3.65 billion sq. m.

Housing availability is estimated at 438 dwelling units per 1,000 persons, close to the EU average. The average floor space per capita, however, stands at 24.9 sq. m, which is only half of that reported EU countries. Housing needs remain a major problem – according to sociologic surveys, around 40-60 percent of households report to need improved housing conditions.

According to Rosstat, more than 30 percent of the total population lives in apartment buildings (ABs) in need of capital repairs. Yet, with the current pace of capital repairs of ABs the situation shows signs of worsening.

Most of the Russian housing stock is privately owned thanks to a generous privatization program in the post-Soviet period. Indeed, private dwellings account for about 90.5 percent of the total housing stock floor space. As of 2016, households owned nearly 87.2 percent of all the private housing defined by square meters. The state owned 3.5 percent and municipal governments 5.6 percent. Experts estimate that, aside from the rental housing owned by public authorities and legal entities (3.5 percent), there also exist nearly 10 percent of individually-owned dwellings which are rented out, mainly, on an informal basis, that is, without paying taxes. Inadequate development of the rental sector may be explained by a weak legislative framework which is incapable of protecting both parties to a rental agreement, and low investment attractiveness of the construction of rental ABs because of their long pay-back period and some other factors.

According to data for 2016, ABs dominate Russia's housing stock – they account for over 67 percent of the national housing stock floor space. In urban areas, ABs make up 81 percent of the total housing stock; in major cities even more – 85 percent with the highest share of 98 percent reported for Moscow. Russia's ABs mostly form 'condominiums' with common equity ownership of common areas.

Transition to a market economy necessitated the development of a new legal framework for the urban planning processes. This has taken place at a rather slow pace and somewhat separately from the development of housing policy. Not until the adoption of the Urban Planning Code of the Russian

Federation in 2004 were time limits set for all municipalities design and adopt their land use and development rules.

At present most municipalities have adopted both general plans identifying local long-term urban planning priorities and land use and development rules.

Despite formal setting of a legal framework for urban planning regulation, Russian cities in practice witness a somewhat spontaneous process of urban development, which respond primarily to investment interests of large developers with access to administrative resources, rather than to public interests. Nearly always when investor interests mismatch the public ones, i.e., established in urban planning documents, the latter is being amended accordingly. A study done in 2012 (Kosareva et al. 2015) found that the longer land use and development rules remain effective, the larger the number of amendments introduced therein. Indeed, land use and development rules approved 2–3 years ago were amended only once a year, while those adopted 7–10 years ago have seen, on average, two amendments per year. Apparently investors became more efficient in navigating the system over time.

Implementation of construction projects still involves a large number of excessive administrative barriers which impede market access to new actors and restrain competition. A ‘seller’s market’ model operating in residential construction generates high housing prices and hinders the introduction of innovative technologies and novel designs.

From the early 2000s with the beginning of sustained economic growth, the rates of housing construction showed an upward trend - the largest amount of new housing was built in 2015 (85.3 million sq. m (or 1.1 million housing units) which was almost tree-fold increase compared to 2000.

Private investment fueled the sustained development of self-built housing construction<sup>1</sup> which witnessed a more than four-fold increase by the end of 2000s, accounting for over 40 percent of the total number of housing units constructed. The rest 60% of new housing units accounts for the supply of professional developpers who construct mainly (about 95%) apartment buildings.

Housing construction in Russia is mainly financed by individuals – future homebuyers make large advance payments from their own resources. Developers of apartment buildings use the funds of

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<sup>1</sup> Self-built housing construction of single family houses is direct construction by a person or family on their own land plot, with an outside workforce hired to perform several types of work.

individuals and shift the major risks of non completion and low quality to them. Use of loan financing by developers is discouraged due to the lack of interest on the part of both banks and developers.

Still, due to strong income growth and relatively weak urban planning restrictions implied on housing construction the housing price-to-income ratio<sup>2</sup> stood at 3.4 (years) in 2016 against 5 in 2000. The proportion of households who can afford buying a standart flat<sup>3</sup> using mortgage showed also substantial improvement rising to 35.3 percent in 2016 up from 17.7 percent in 2007.

## **2. Interrelation between housing and urban planning policies**

To set the stage for the analysis of the Russian case, we present here an overview of housing and urban planning policies and selected aspects of their implementation.

*Housing policy* may be defined as a goal-setting process carried out by government for the entire system which includes institutes of ownership, disposal, and use of dwellings, financing and implementation of residential development projects, housing maintenance and management. The state also intervenes in the foregoing housing relations to achieve the housing objectives defined by legislation. Housing policy aims to support the development of emerging market relations and/or rectify the failures of the already developed market.

*Urban planning policy* implies a goal-setting and related processes defined by government for the entire system of urban planning pertaining to the development of newly urbanized areas or areas being redeveloped. This covers and includes planning and regulation procedures for land use development, and the use of land plots for public areas. State intervention is also needed to achieve objectives defined in legislation.

In implementing both housing and urban planning policy the state relies on regional and municipal authorities to develop legislative regulations and other normative legal regulation, and to use budget-, tax- and administrative instruments.

Compared with housing policy urban planning policy tends to be more technocratic in nature and evolves with an eye to a wide variety of requirements for land development. Goals of urban planning policy, hence, cannot in all cases be defined in general terms, but rather must be identified on the basis of

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<sup>2</sup> In Russia this indicator is calculated using average (rather than median) incomes and prices.

<sup>3</sup> Conforming to floor space per capita standards – 18 sq. meters per capita.

the analysis of the entire body of rules and restrictions on land development given a specific areas attributes.

To achieve their goals, housing and urban planning policies must be properly reconciled with each other, which means consistency between the relevant goals, objectives, and implementation instruments.

Subject to the stage of economic development, the main goals of housing policy, in general terms, may be as set forth below:

Goal 1.1: ensuring the access to affordable housing for people with low- and moderate incomes who the housing market appears to be unable to offer an adequate solution (provided that the market meets the housing demand on the part of most individuals).

Goal 1.2: creating and developing housing and residential construction markets and the housing finance market in order to improve the affordability of housing for most people.

Goal 1.3: providing a 'roof over the head' for large groups of population, ensuring partial 'legalization' of informal residential developments and providing the access to basic services to dwellers thereof, and providing housing to categorically eligible social groups of the population, typically to public employees.

The main goals of urban planning policy, dependent on the stage of development, may be described as follows:

Goal 2.1: ensuring a high quality urban environment and comfortable living conditions.

Goal 2.2: ensuring conditions for maximum housing construction volumes to meet the demand on the part of every consumer group (state, corporations, households).

Goal 2.3: addressing the problem of 'informal' and scattered developments.

The first typological goals (goals 1.1 and 2.1) – first priority goals –tend to be adopted mostly in developed market economies, i.e., those with sufficiently high level of housing availability. Housing needs, in this regard, not only focus on housing but also extend to the quality of environment, and this determines the priorities of housing and urban planning policies.

The second set of goals (goals 1.2 and 2.2) – second priority goals – tend to be adopted mostly in economies in transition and in emerging economies where housing availability remains inadequate to most individuals. For this reason, creation and development of housing markets, residential construction

markets and housing finance markets, with the purpose of improving the affordability of housing for most people, are given priority. In this connection, either explicitly or implicitly, there is a rather *weak urban planning policy in place - with few mandatory requirements and weak supervision of compliance with them* – in order to facilitate the increase in volumes of housing construction.

The third set of goals (goals 1.3 and 2.3) – third priority goals – are high on the agenda in developing economies with unsatisfactory housing availability, a high proportion of informal dwellings, and scattered residential developments at large. In these countries, housing policy is likely to focus on provision of a ‘roof over the head’ for large categories of population. Informal residential developments, which the authorities largely ignore for the time being, allow large groups of population to satisfy their housing needs, at least in part, though the problem of ‘informal residential developments’ remains high on the agenda in the countries (De Soto 2004; UN-Habitat 2009, UN-Habitat, 2003). Urban planning policy therein tends to be not only weak but also patchy.

The choice of particular goals to be set for housing or urban planning policies is predetermined by the level of economic development in the country and the current living standards, including housing availability level (See Table 1).

**Table 1. Main goals of housing and urban planning policies in countries with different levels of economic development**

Priority	Main goal of housing policy	Main goal of urban planning policy	Countries with housing and urban planning oriented towards the attainment of the goals	GDP per capita (in current prices, USD per capita)	Housing availability (dwelling units per 1,000 persons)
1.	Goal 1.1	Goal 2.1	USA	51,704	420 <sup>4</sup>
			Great Britain	38,811	430 <sup>5</sup>

<sup>4</sup> As of the end of 2013. <http://www.hofinet.com/countries/context.aspx?regionId=6&id=175>  
<sup>5</sup> As of the end of 2011. <http://www.hofinet.com/countries/context.aspx?regionID=3&id=90>

			Netherlands	46,010	430 <sup>6</sup>
2.	Goal 1.2	Goal 2.2	Poland	13,333	370 <sup>7</sup>
			Czech Republic	19,680	380 <sup>8</sup>
3.	Goal 1.3	Goal 2.3	India	1,547	250 <sup>9</sup>

Municipalities in countries with developed housing markets which focus on the 1<sup>st</sup> priority goals typically adopt a rather *stringent urban planning policy* with a large number of urban planning regulations. In this case, municipalities strictly supervise the implementation of the regulations in order to ensure high standards for the quality of urban environment and to maintain the value of housing assets. The policy may cause an increase in prices in the housing market and make a purchase or rent of dwellings unaffordable for a minor part of individuals (Malpezzi 1996). In this connection, the countries implement the programs aimed to make housing more affordable for people with low or moderate incomes. This, naturally, entails additional public expenses. Yet, in the context of strong public for a high quality of urban environment, the additional expenses may be deemed reasonable. Moreover positive externalities associated with the improved quality of urban environment help enhance the quality of human capital, reduce the required public expenses related to public health care, development of transport infrastructure, social assistance, and crime prevention.

In these countries, hence, urban planning instruments also focus on development of the affordable housing sector, which also includes social housing provided to individuals by local governments and non-profits on non-market terms in volumes sufficient to satisfy the demand of local communities (Gurran et al., 2008).

Most developed economies boast an extensive practice of applying urban planning instruments in reaching housing policy goals. In Great Britain and Netherlands, specifically, inclusion of the requirements for construction of social housing in urban planning documents serves as the basis for provision of budget subsidies. The requirement for the proportion of affordable dwellings in new

<sup>5</sup> As of the end of 2011. <http://www.hofinet.com/countries/context.aspx?regionID=3&id=174>

<sup>6</sup> As of the end of 2012. <http://www.hofinet.com/countries/context.aspx?regionID=3&id=119>

<sup>7</sup> As of the end of 2013. <http://www.hofinet.com/countries/context.aspx?regionID=3&id=134>

<sup>8</sup> As of the end of 2008. [http://www.bmwf.gv.at/Wirtschaftspolitik/Wohnungspolitik/Documents/housing\\_statistics\\_in\\_the\\_european\\_union\\_2010.pdf](http://www.bmwf.gv.at/Wirtschaftspolitik/Wohnungspolitik/Documents/housing_statistics_in_the_european_union_2010.pdf)

<sup>9</sup> As of the end of 2011. <http://www.hofinet.com/countries/context.aspx?regionID=7&id=75>

construction projects which, normally, accounts for 10-15 percent of the latter, is used in several U.S. cities. Compliance with the requirements tends to be encouraged via various bonuses (e.g. residential density bonus, reduction in the amount of payments related to construction of infrastructure required by a project, etc.).

In countries where urban planning laws strictly and explicitly define the rules, compliance with which ensures approval of construction projects and the issuance of construction permits, the requirements for affordable housing is integrated in the laws. With these regulations in place, the price of land (as a function of development opportunities) is being determined by land use and development rules. Efficient administration helps minimize the uncertainty for a developer since the process for obtaining a construction permit takes up little time.

Other systems of urban planning regulations involve negotiations within construction permit issuing process to ensure that the project conforms with regulations and guidelines. This review process takes up more time than the one outlined above but it assesses more thoroughly the possible public benefits that could be obtained from a particular construction project, and determine the conditions upon which the benefits may be achievable.

A number of European countries, as well as Australia, embrace a third approach which implies the elaboration of a detailed development plan for a particular area (in case of new area development). Under this approach land use and development regulations are established with due account for developers' proposals. The approach is referred to as master urban planning.

Along with the general regulation of housing and urban planning relations, the current goals of housing and urban planning policies always take into account traditional institutions, cultural preferences of different social groups, and also particular priorities associated with the life cycle stage of expect occupants. In particular, developed countries adopting social-democratic and corporatist models of housing policy (Hoekstra 2003) tend to use more stringent urban planning regulations while the housing policy aims to facilitate housing provision to wider groups of the population, including the households with median income and slightly-above-median income.

### **3. Inconsistencies in implementation of urban planning and housing policies in Russian cities**

Nowadays three key pieces of legislation set the priorities and goals of state housing policy:

1. Decree No. 600 of the President of the Russian Federation ‘On Measures for Provision of Affordable and Comfortable Housing to the Citizens of the Russian Federation and on Improvement of the Quality of Housing and Utility Services’ adopted in 2012;
2. Concept of Long-Term Social and Economic Development of the Russian Federation till 2020;
3. State Program of the Russian Federation ‘Provision of Affordable and Comfortable Housing and Utility Services to the Citizens of the Russian Federation’<sup>10</sup>.

The Concept (no.2) sets the following strategic goal of the state housing policy for a period to 2020 – to create a comfortable living environment in order to meet housing needs and to ensure high a quality of life in general. Giving such weight to living conditions is rather innovative for Russia.

Nevertheless, the current strategic documents on housing policy are not really focused on a particular type of housing policy, as described in the prior section. The priorities set only partially are related to goals 1.1 and 1.2 and even, to some extent, goal 1.3. Also, these policies reflect the urban planning policy goals 2.1 and 2.2. Additionally, the modernized set of the policy priorities is not yet supported by implementation mechanisms and economic incentives. Specifically, management ‘signals’ from the federal level mainly follow the ‘old pattern’ and only seek to encourage growth in housing construction volumes.

Inadequate coordination between urban planning and housing policies not only leads to inconsistent decisions in the process of goal setting and the allocation of resources for policy implementation, but it also provokes a number of problems typical for the current development of the Russian cities. The following subsections discuss the problems associated with the policy aimed at increasing the supply of affordable housing, the development of a market of non-residential premises used as a living space (hereinafter referred to as ‘loft’ apartments).

### ***3.1. Assessment of the balance between urban planning and housing policies in selected Russian cities***

Common to the three problems just listed is the extent to which housing and planning policies support each other. To explore the degree of consistency between the two an empirical analysis of the

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<sup>10</sup> RF Government Resolution #2227-p endorsed on November 30, 2012

balance between urban planning and housing policies in municipal planning documents was carried out through case studies of the cities of Perm, Yekaterinburg, Belgorod, and Moscow.

Both Perm and Yekaterinburg have populations exceeding one million people and demonstrate moderate population increases. Belgorod was selected as an example of a city with on-going active policy to promote the extensive development of self-provided housing construction outside the city's limits. The choice of Moscow was accounted for by its strong economy and growing population with wider opportunities for applying various vehicles for implementation of balanced urban planning and housing policies.

The review focused on the following main locally developed documents related to urban planning and housing policies<sup>11</sup>:

- 1) Program of social and economic development;
- 2) Strategic master plan;
- 3) General plan;
- 4) Land use and development rules;
- 5) Comprehensive action plan for implementation of the General plan;
- 6) Urban design standards;
- 7) Programs on housing provision and availability of housing and utility services;
- 8) Programs on resettlement from dilapidated and unsafe dwellings.

The review undertaken of urban planning documents sought to identify the provisions that concern possible policy priorities of urban planning policy:

- 1) spatial development concept: extensive development through physical expansion on new vacant areas for new residential developments vs. intensive development which encompasses improvements within the limits of already built-up areas;
- 2) housing supply and urban environment: the focus is on the quality of urban environment vs. quantity indicators in respect of new housing construction; and
- 3) a spatially differentiated quality of urban environment: the focus on formation of diverse living environments vs. that of uniform standards to be applied across the jurisdiction.

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<sup>11</sup> Not all the documents from the list could be in effect in each of the cities as of the time of the review.

The review undertaken of housing policy documents sought to identify the housing policy priorities. These could include:

- 1) affordable housing provision (with regard to all categories of households with particular levels of income, e.g. low-income households);
- 2) resettlement of residents from dwellings considered to be unsafe for living (mitigation of social tensions in certain communities of a city);
- 3) provision of various options for housing improvements to all groups of population: cooperatives, rental housing or homeownership; and
- 4) support of private initiatives by individuals for self-provision of housing.

In assessing the degree of consistency or inconsistency between the planning and housing documents we relied on the procedures as described that follow:

- 1) identifying a total number of provisions in approved urban planning and housing documents that set priorities for each area;
- 2) identifying the urban planning provisions reflected in housing policy documents and vice versa (in absolute and relative terms).

The findings of the review are presented in Table 2.

**Tab. 2. Assessment of the degree of consistency between the documents related to urban planning and housing policies applied in selected cities**

Indicator	Degree of consistency across the cities			
	Perm	Yekaterin- burg	Belgorod	Moscow
Coverage of urban planning issues in housing policy documents				
Total number of provisions in approved urban planning documents setting the priorities of urban planning policy, including:	11	8	7	8
<i>Number of provisions reflected in housing policy documents</i>	5	1	2	3
Proportion of urban planning provisions				

reflected in housing policy documents, in percentage terms	45%	12.5%	28%	37.5%
<b>Coverage of housing issues in urban planning policy documents</b>				
<b>Total number of provisions in approved housing documents setting the priorities of housing policy, including:</b>				
	9	4	6	4
<i>Number of provisions reflected in urban planning policy documents</i>				
	1	1	2	1
<b>Proportion of housing provisions reflected in urban planning policy documents, in percentage terms</b>				
	11%	25%	33%	25%

The table shows a weak interrelation between the documents related to urban planning and housing policies and indicates the prevalence of urban planning policy priorities over the housing policy ones.

### ***3.2. Review of implementation of the program ‘Housing for the Russian Family’ aimed at increasing the supply of affordable housing***

The program ‘Housing for the Russian Family’<sup>12</sup> (hereinafter, the Program) was launched in 2014. The Program envisages the construction of 25 million square meters of economy-class housing over the period till the end of 2017. The dwellings are to be sold to eligible individuals from certain social categories at a fixed price below the market value (80 percent of the market value as established in each participating jurisdiction, but not exceeding 35 thousand rubles per square meter<sup>13</sup>).

The Program is an attempt to promote the construction of affordable housing for priority categories of individuals who appear to be unable to purchase dwellings on market terms and need to have their

<sup>12</sup> Decree of the Government of the Russian Federation “On Certain Issues of Implementation of a Program ‘Housing for the Russian Family’ Within the Framework of the State Program “Provision of Affordable and Comfortable Housing and Utility Services to the Citizens of the Russian Federation” (No. 404, adopted on May 5, 2014.

<sup>13</sup> The average housing price per square meter in the 3<sup>rd</sup> quarter of 2015 accounted 51.7 thousand rubles.

housing conditions improved. The Program does not provide for direct financing of economy-class projects from budget funds.

Taking into account the implementation practices of similar programs in developed countries, the Program envisages the opportunity for carrying out projects that include a component giving the developer the right to sell some units on market terms. This principle of cross-subsidizing allows a developer to prepare a project (with market- and non-market components) that should bring acceptable overall profit margin.

The following measures were designed to encourage the participation of private investors in the Program:

- provision of land plots, owned by the state and municipalities, to developers on privileged terms;
- purchase of utilities infrastructure built up by developers (paying back the infrastructure costs)<sup>14</sup>;
- provision of soft loans to developers for construction of economy-class dwellings<sup>15</sup>;
- provision of soft mortgage loans to eligible individuals<sup>16</sup>; creation and maintenance of a register of the buyers of economy-class dwellings with a view to mitigating the risk of inadequate demand.

A financial feasibility study was carried out to shape the Program's terms and conditions under the Program. The effective share of economy-class housing in residential construction projects as required for getting the necessary financial rate of return at 15 percent per annum with due account for different options for cost sharing between a developer, a utility provider and the authorities was estimated.

The estimates, specifically, give grounds to conclude that the construction of dwellings intended for fixed-price sale may avoid losses provided that the projects involve free-of-charge connection to the utilities infrastructure. To "breakeven" 83 percent of all the dwellings in a project need to be sold at the fixed price, and 17 percent – at market price. An acceptable total rate of return estimated at 15 percent can be achieved when an 89 percent return is obtained from the sale of dwellings at market price. The

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<sup>14</sup>Program on financing the purchase of utility facilities was approved by the decision of a supervisory board of Agency for Housing Mortgage Lending (also referred as AHML) in 2014.

[http://www.ahml.ru/common/img/uploaded/files/grs/Programma\\_po\\_finansirovaniu\\_vykupa\\_obektov\\_ITO\\_05\\_12.12.2014.pdf](http://www.ahml.ru/common/img/uploaded/files/grs/Programma_po_finansirovaniu_vykupa_obektov_ITO_05_12.12.2014.pdf)

<sup>15</sup> Program on Promoting the Provision of Loans for Construction and Purchase of Housing (a program 'Stimul') was approved by the protocol of the Board of Directors of Agency for Housing Mortgage Lending available on a web site at [http://www.afhc.ru/program\\_stimul/Progr\\_STIMUL\\_red8.pdf](http://www.afhc.ru/program_stimul/Progr_STIMUL_red8.pdf)

<sup>16</sup> Social standard of AHML (special terms of residential mortgage lending to eligible individuals from social categories), available on the web site of AHML at [http://www.ahml.ru/common/img/uploaded/files/participants/standards/forms/Arh\\_15.01.01/pril9\\_soc\\_st.pdf](http://www.ahml.ru/common/img/uploaded/files/participants/standards/forms/Arh_15.01.01/pril9_soc_st.pdf)

estimates have also indicate that there was practically no risk of insufficient demand for economy-class housing under the Program.

However, it stands to reason that the Program is unlikely to conform to all its planned volumes and deadlines. As of the end of October 2015, in the 60 regions selected 259 construction projects with floor space of economy-class dwellings estimated at 14 million sq. m.<sup>17</sup> were in the Program. However only 1,007 construction permits for Program units with the total floor space of 4.8 million sq. m, including 2.9 sq. m. of economy-class dwellings had been issued<sup>18</sup>. This represents only 11.6 percent of the target volume under the Program.

A broader review of experience, undertaken as part of this analysis, provides grounds to conclude :

1. As a result of inadequate urban planning regulations adopted in participating cities, only outlying land plots were provided under the Program. This fell short of expectations on the part of developers and utility companies because of high costs for construction of utilities infrastructure.
2. Main basic conditions of the Program which should have motivated developers, state authorities, local governments, and utility companies, failed to do so. Economic and organizational principles underlying the Program could not overcome the institutional relations (informal commitments and payments, and expectations of abnormally high rates of return) that pertain to residential construction in most cities and regions.

### ***3.3. Development of a loft apartment market: evidence of weak urban planning policy***

Nowadays Russia's major cities face the development of so-called 'loft apartments', a market segment which has emerged in the past few years and has developed momentum in the context of current housing and urban planning policies and their enforcement.

Loft apartments are non-residential premises in multistory buildings used as living units. During 2012-2017 this segment was actively developed and began to compete with ordinary apartments. Figure 1 presents the dynamics of supply in housing market of newly constructed units (ordinary apartments in ABs) and of that in loft apartment market in Moscow. From 2012 to 2015 the market supply of lofts in

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<sup>17</sup> Report on the progress of the Project implementation as of October 1, 2015, is available on a web-site of Agency for Housing Construction Finance. [http://www.afhc.ru/\\_state\\_program\\_providing\\_housing/program\\_results/otch\\_011015.pdf](http://www.afhc.ru/_state_program_providing_housing/program_results/otch_011015.pdf)

<sup>18</sup> Ibid

Moscow rose from 104.4 thousand square meters up to 687 thousand square meters, that is, a nearly seven-fold increase, while the supply of ordinary apartments grew only 1.6 times. During this period, lofts were in fact replacing ordinary apartments. Indeed, in the 2<sup>nd</sup> quarter of 2012, lofts offered for sale accounted for 11 percent of the total apartments offered for sale, but in the 2<sup>th</sup> quarter of 2015 they already accounted for 33 percent.

The average price of a square meter of loft apartments exceeded that of regular apartments in residential apartment buildings over the whole period from 2013 to 2017 (Fig. 2). As of the end of 2015, the foregoing gap made up nearly 60-70 %. It is explained by the location of loft apartments comparing with ordinary ones.

By the end of 2014, the average price per square meter of floor space of a loft apartment appeared to be about 15 percent below the average price per square meter of an ordinary apartment of the same quality in the similar location. This gap is more drastic in the most expensive city districts in particular – for the South-West District of Moscow it amount about 40 percent (Fig. 3). These price advantages ensured that loft apartments' sales outpace the competition with residential dwellings.

Loft apartments are built mainly in city's central areas and, therefore, in relatively more expensive locations. The remarkable fact is that it is 'expensive' loft apartments that are built for the most part while exactly in central areas the land plots for residential development appear to be almost non-existent. Construction of residential apartment buildings, within the framework of comprehensive territorial development, is shifted to peripheral areas (in 'cheap' suburban areas). Meanwhile, the cost of regular apartments in peripheral areas is less than that of loft apartments in central areas (Fig.3). As one would expect, location is affecting prices. But other factors are also at work in determining the relative attractiveness of loft apartments.

One factor is that future maintenance costs to be incurred by loft apartment owners are considerably higher than those of regular apartment owners. Maintenance costs include utility charges, payments for management company services, and also property and land taxes. By expert estimates, for example, the average maintenance costs in the Central Administrative District of Moscow make up 150 rubles per a square meter of residential dwellings, while for loft apartments, the average maintenance cost

ranges from 180 to 190 rubles per a square meter<sup>19</sup>.

The Table 3 shows the average utility charges for loft apartments (loft aps) and regular apartments (regular aps).

**Table 3. Utility charges for loft apartments vs utility bills for regular apartments<sup>20</sup>**

Utility Service	Loft aps	Regular aps	Ratio of utility charges for loft aps to those for regular aps
Electricity supply, RUR/kWt*hour	3,83	2,81	1.36
Water supply, RUR/cub. m	29,91	26,75	1.12
Sanitation, RUR/cub. m	20,53	19	1.08
Heat supply, RUR/Gcal	1 800	1 440,5	1.25

Owners of loft apartments are also forced to pay for additional services such as on-site security, consierge services, cleaning of premises, parking area, and so on. Loft apartment owners hire a property management company for maintenance of the building, repair of common-use property, and also negotiates the cost of utility services at its own discretion. In aggregate, as compared with utility bills of regular apartments those charged in respect of loft owners may cost twice as much and even more.

Loft apartments are taxed at higher rates than residential dwellings. The following housing privileges cannot be applied to loft apartments since these are qualified as non-residential premises:

- Personal property tax deductions;
- Property-related tax deductions for purchasers of residential dwellings.

In addition to high recurring expenses the owners of loft apartments have no right to register as officially living in Moscow because the units are in buildings zoned for non-residential use<sup>21</sup>. While this

<sup>19</sup> URL: <http://realty.rbc.ru/experts/12/02/2015/562949993979952.shtml>

<sup>20</sup> URL: <http://www.garant.ru/article/567202/>

<sup>21</sup> Pursuant to Cl. 26.1 of Order 'On Approval of Administrative Procedures on Provision of a Public Service on Registration of Citizens of the Russian Federation by the Federal Migration Service at a Place of Temporary Residence and at a Place of Permanent Residence within the Russian Federation (Order #288 issued on September 11<sup>th</sup>, 2012) "a citizen shall furnish to the persons responsible for registration ... a document serving as a ground for occupying the dwelling (statement of a person (persons) who provided the dwelling to the citizen, an agreement, a certificate of state registration of rights (title to the residential unit), a court decision recognizing the

does not deprive them of constitutional rights in social sector, access to services require travel to other jurisdictions.

Similar problems emerge on the legal status of loft apartment buildings. Housing law of the Russian Federation, particularly Housing Code of the Russian Federation, applies two definitions – both suggesting the use of a building for dwelling purposes – an ‘apartment building’ and a ‘residential building’. Town planning legislation defines an ‘apartment building’ as a type of building for dwelling purposes, and, additionally, introduces another type of dwelling - a ‘terraced house’ (or a row house).

Any other types of buildings for dwelling purposes are not identified by the Russian laws as housing. Therefore, non-residential buildings with loft apartments, in legal terms, cannot be qualified as apartment buildings, residential buildings, or terraced houses.

The lack of legal regulation for buildings with loft apartments is caused by legal gaps in regulation addressing the construction and design of the buildings. Because there are no special requirements in either the construction or town planning regulations, the design and construction procedures for loft buildings simply relied on regulations adopted for non-residential buildings. In short, buildings with loft apartments designed for dwelling purposes are built in areas not intended for residential development. No resolution of these legal problems was available by the end of 2016.<sup>22</sup>

It is not infrequent for buildings with loft apartments intended for permanent residence to be located in recreational zones. According to Article 35 of Town Planning Code, a recreational zone may include areas within the boundaries of the territories occupied by municipal forests, squares, parks, municipal gardens, ponds, lakes, water reservoirs beaches, foreshores of common-use water bodies, and other territories being used and designed for recreation activities, tourism, physical training exercises and sports activities. Taking advantage of the foregoing Article, developers loft apartment buildings as tourist

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right to use the dwelling or other document, or its duly certified copy, serving to confirm the right to use the dwelling)’.

<sup>22</sup> In this regard, Article 35 of the Town Planning Code of the Russian Federation (hereinafter, TPC RF) regulates the types and the composition of territorial zones: ‘as a result of land use zoning there may be determined residential zones, public and business zones, industrial zones, engineering and transport infrastructure zones, recreational zones and other types of territorial zones’.

Residential zones, therefore, may include single-family houses, low-rise buildings, mid-rise buildings, high-rise buildings. Residential zones allow for location of detached, in-built and attached social and utility facilities, public health facilities, pre-schools, primary schools and secondary education facilities, religious buildings, parking areas, garages, and objects related to dwellings of persons and not having adverse environmental effects. Residential zones may also encompass the territories intended for horticulture and dacha activities.

The erection of buildings with loft apartments in residential areas, hence, fails to meet the legislative requirements designed to regulate town planning activities since the buildings under consideration are neither qualified as a dwelling unit nor as a social facility.

facilities, e.g. as apart-hotels. They then either sell premises in the building or transfer a share of ownership rights to the building to the purchasing household.

The situation for loft apartments is getting worse because the housing law fails to explicitly prohibit the use of non-residential premises by persons as a living space and also to impose sanctions for using non-residential premises as a living space. Such prohibition is not articulated in housing laws per se, though, in some way, it has been defined in related laws such as the Law on Sanitary and Epidemiological Well-Being of the Population. In practice, however, the relevant regulatory bodies fail to apply the foregoing law.

The situation also creates conflicts between the two groups of owners in one building: owners who use apartments as living space and owners who use them for entrepreneurial activities (e.g. rent out the apartments as office space). The situation becomes especially urgent if the non-residential premises intended for different purposes share the same floor. Technically, the owners of loft apartments who rent them out as office space appear to be law-abiding persons since they use the apartments in accordance with their legal status as a 'non-residential premise'. Yet, such a law-abiding attitude, in practice, may infringe on the interest of the owners who use their loft apartments as a living space because it is not uncommon that engineering systems of a building with loft apartments (and even engineering systems of 'blocks' of apartments) are not designed for their actual use as non-residential premises (office space). At the same time, infringement on the interests of those owners who use the apartments as office space also takes place because of 'weak' engineering systems. Indeed these owners appear to be considerably deprived of the benefits they may expect to gain through a purchase of non-residential premises. A review of judicial practice provides the evidence of a substantial number of claims filed in connection with disputes between the owners who use their loft apartments as a place of permanent residence and the owners who use their loft apartments as office space<sup>23</sup>.

There also exists problem with conversion of loft premises to dwellings. Usually loft premises located in multi-use buildings may fall short of meeting the requirements as envisaged by the provisions of the housing and town planning laws since the apartments were designed in line with the requirements to non-residential premises and non-residential buildings.

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<sup>23</sup> See, e.g., appeal ruling of the Moscow City Court (# 11-14206/13, issued on May 28<sup>th</sup>, 2013); Judicial decision of the Ninth Arbitration Court of Appeal (# 09AII-32741/12, issued on November 25<sup>th</sup>, 2012).

Therefore, developers take advantage of the situation by way of reducing the cost of their construction projects, building up loft buildings in place of apartment buildings, and passing off the former as dwellings almost equal to regular apartments in apartment buildings. Presumably, the various factors discussed in the last few paragraphs, with all the attendant uncertainty purchase of a loft carries, push loft prices down.

Fast supply-side growth of loft apartments may be accounted for not only by their attractive prices. Developers also respond to a understandable need of large numbers of households to live in central urban areas of the city. But the existing urban planning documents hardly provide any possibility for housing construction in central locations because most land plots suitable for residential development are in areas zoned for public, business or industry. No wonder that a considerable share of supply of loft apartments falls on Moscow's Central Administrative District though the difference in price per square meter of floor space between a loft and an ordinary apartment there is at its lowest.

So, developers currently consider loft apartment construction projects to be economically attractive because the legislation remains patchy:

- a) technical specifications for construction projects for non-residential buildings where loft apartments are located are less strict than those designed for ordinary apartments which include higher requirements for ventilation, sound insulation, fire protection etc.;
- b) there is no need for changing the permitted land use that was originally designated for a commercial construction project; such a change would require amending land use and development rules;
- c) Russian law does not oblige a developer to provide social infrastructure on a site where non-residential buildings with loft apartments are being built, whereas a residential construction project would certainly require that;
- d) current urban development legislation does not provide 'fine tuning' of urban planning regulations for specific situation.

The development of the loft apartment market, as an illegal segment of the real estate market, reveals the absence of clearly defined and feasible urban planning policy setting priorities for urban development and functional use of urban areas. This leads to 'spontaneous' urban development as a result of inconsistent decisions on the part of private investors.

#### 4. Conclusion and outlook

The current stage of Russia's economic development as well as that of development of the key market institutions over the transition period necessitate conceptualization of the goals and instruments of the housing and urban planning policy. The on-going implementation of the current urban planning policy focused on maximizing newly built square meters of housing has fallen short of reaching even the planned standards of per-capita floor space<sup>24</sup>. This may exacerbate the mismatch between the amount of investment in new construction projects to be carried out in new areas and the amount of investment mobilized for housing rehabilitation projects and modernization and capital repairs of the existing housing stock<sup>25</sup>. In turn this could cause the loss of consistent spatial organization of urban areas, the deterioration in urban environment quality and growing housing affordability problems.

The situation requires that state regulation be streamlined in order to overcome the shortcomings of the housing market, especially as it relates to improving the efficiency of the affordable housing supply encouragement policy. This necessitates that effective urban planning regulation be formed to clearly and comprehensively define the requirements and limitations to the use of land plots and that the regulations be enforced.

The good news is that the basic preconditions for focusing national housing and urban planning policies on first priority goals are in place.

Our analysis provides evidence to suggest that *the main goal of the new housing policy* should focus on enhancing the quality of housing provision to citizens with different income levels and with different needs (instead of the existing goal of just increasing the number of square meters of housing construction). To achieve this goal the following *main strategic priorities of the housing policy* are:

1) provide institutionalized opportunities for improvement of housing conditions of various groups of population; expand and differentiate measures for the development of different options to help satisfy housing needs of individuals with due account for their income, the stage of a life cycle, and the

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<sup>24</sup> As established by the Concept of Long-Term Social and Economic Development of the Russian Federation till 2020 approved by the Order of the Government of the Russian Federation (No. 1662-p, dated November 17, 2008), the standards of per-capita floor space should have been 25-27 square meters by 2015. However, actual per-capita floor space, according to Rosstat, was 23.7 sq. m per person as of January 1, 2015. With current rates of growth of per-capita floor space values it may not exceed 26 sq. m per capita by 2020 – a target standard per-capita floor space within the range of 28-35 sq. m was established by the Concept of Long-Term Social and Economic Development of the Russian Federation till 2020.

<sup>25</sup> By authors' estimates, in 2012 the accumulated deficit of current investments required for rehabilitation of the housing stock and utilities infrastructure was estimated at 22.6 trillion rubles which represents 36 percent of GDP.

place of residence. Differentiation includes encouraging the development of economy class dwellings, and the development of rental housing based on schemes of commercial, non-commercial and social tenancy, as well as the development of housing cooperatives and other housing options (in place of the priority for improving housing conditions of households solely through the purchase of own dwellings);

2) improve the quality of the urban environment primarily through rehabilitation, modernization and improvement of dilapidated and obsolete residential areas, capital repairs of apartment buildings, organization of effective housing and utilities infrastructure and housing stock management (instead of a priority for increasing the volumes of housing construction focused on development of new (greenfield) areas).

Achieving these goals necessitates a considerable update of urban planning policy which is currently characterized by minimum urban planning regulations and inadequate enforcement of those in place.

Thus, the implementation of the new housing policy requires:

1) reconciling the goals and priorities of the urban planning policy with the goals and priorities of the new housing strategy;

2) using a wider variety of instruments for urban planning and regulation in Russian cities with a view to attaining the goals and meeting the priorities;

3) strengthening the supervision of compliance with the requirements of urban planning and regulation.

Though the suggested model itself may seem comprehensible, the mechanisms for its practical implementation are likely to be rather complex because they necessitate drastic changes in the existing public and administrative relations in the domains of land use and development. They also require the introduction of novel instruments for urban planning and regulation.

To ensure the attainment of the goal of the new housing policy may require that *the goal of urban planning* policy should be defined as the balanced functional and spatial development of urban areas. This implies the creation of a comfortable living environment, improved quality of urban environment, reasonable volumes and forms of new residential developments, as well as renovation, modernization of the existing residential areas.

*Main priorities of urban planning policy*, effective in terms of implementation of the priorities of the new housing strategy, will likely include:

1) creation of a comprehensive system of urban planning and regulation in order to take into account the priorities of housing policy;

2) priority be given to renovation of residential areas with dilapidated and obsolete dwellings, reorganization of industrial zones and other inadequately used urban areas<sup>26</sup>, and enhancement of a greater availability of social and commercial facilities in peripheral areas of cities;

3) encouragement of increased density of residential developments in central areas and provisions to constrain residential density in peripheral areas, in particular to the number of stories in high-rise buildings built in those areas;

4) introduction of novel instruments for urban planning regulation to facilitate the development of various market segments (including rental dwellings and housing cooperatives) and the construction of economy class dwellings that are affordable for purchase or lease.

Urban design and planning for each urban settlement could substantially change the demand for housing construction, facilitate the development and modernization of infrastructure, improve the quality of housing provision to individuals and enhance urban environment by reducing the mismatch between the volumes of new residential developments and the volumes of renovation of residential areas<sup>27</sup>.

Additionally, the legal procedures for the direct regulation of housing characteristics varying with the location of a dwelling should be applied. Among other things, this would require that contents of housing policy documents be extended (via the introduction of the relevant provisions on differentiation of dwellings according to quality standards), and, at the same time, be adjusted for conformity with land use and development regulations. These changes will affect the terms of tenders for awarding developers rights for construction or comprehensive development of urban areas.

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<sup>26</sup> For example, industrial zones cover a substantial part of Moscow (16 percent of the total urban area), Yakaterinburg (40 percent of the total urban area), and St-Petersburg (13 percent of the total urban area). Besides, industrial zones are often used for purposes other than intended, or they are used less intensively than other urban areas. For instance, the total number of people employed in industrial zones of Moscow is estimated to be 13 times below, on a per hectare basis, than that reported in respect of the Central Administrative District of Moscow.

<sup>27</sup> By authors' estimates, in 73 Russian cities with a population of above 250 thousand persons a potential volume of housing construction under the projects of further development of built-up areas with dilapidated, unsafe, and obsolete housing stock, makes up 262 million sq. m.

The differentiation of the goals and priorities could vary for different types of Russian regions considering the development of their housing markets, housing construction and housing affordability (Kosareva et al. 2015, 87 – 103).

For developed regional economies the first-priority goals (1.1 and 2.1) should be set. The goals may be attained inasmuch as a developed economy has revenue sources to finance goods as urban environment and affordable housing. Yet, revenue allocation to finance the attainment of these goals should conform with a strict and well-coordinated state policy because state participation is essential for proper redistribution of revenues. However it should be noted that even in most developed regions outside the boundaries of metropolitan agglomerations a fair number of old industrial towns, among them single-industry towns exist. The revenue sources of those municipalities may not be adequate to finance improvements of the urban environment. The second-priority goals (1.2 and 2.2) may suit such towns.

For the less developed regions the attainment of the first-priority goals may become possible only in the long run because a developing economy initially lacks sufficient revenue sources for financing the goods such as urban environment and affordable housing. Second-priority goals, hence, may fit such regions. To maximize the volumes of housing construction it is necessary to reasonably relax the requirements of urban planning policy but only as these pertain to characteristics of urban environment. Yet, there is no need for giving up the priority of a ‘compact development’ since an extensive (sprawl) development of these urban areas would cost much more than an intensive one.

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