Transition Period of Reforming Shared Construction Participation System in Housing Construction of the Russian Federation: Factors and Risks

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Abstract. The article deals with the issue of emerging risks during the transition period of the ongoing reform in shared construction participation system (SCP system) effective as of 2017. Peculiarities and stages of the transition period in the reform of the SCP system, which is to be replaced in several stages with construction project funding based on escrow, are looked into. It is inferred that the issue has been given sufficient light in scientific publications due to its social and economic relevance, however the issue of detecting and preventing risks during the transition period has not been cleared out enough. The current condition of the Russian construction industry is investigated by means of analysis of statistics data. Major groups of factors, defining current state of the industry, are outlined, as well as analyzed in different aspects (legal, economic, infrastructure). Critical analysis of negative factors of development of construction industry is made; and it confirms possibility of a significant increase in the number of ‘defrauded co-investors’ which contradicts the reform in question. The authors justify the need to identify and delineate risks, develop appropriate measures to reduce them at all stages of the reform in the field of shared construction. Risks and measures to eliminate or minimize risks are identified in accordance with the reform stages. The consequences of realization of risks, which mostly lead to emergence of problem real estate objects and to an increase in the number of “defrauded co-investors”, are identified. Most important measures are outlined, most significant of them being related to increasing transparency and disclosure of the information base associated with the registry of defrauded co-investors. The conclusion is made about necessity to coordinate risk management measures and requirement to create an information base in form of a distributed registry, which will ensure disclosure and transparency, as well as increase confidence of all the interested parties in the ongoing reform.

At present, in the Russian housing construction sector, a reform of the ‘shared construction participation’ is being implemented. ‘Shared construction participation’ made it possible to fund the construction of apartment buildings under shared construction participation agreements (SCP agreements) directly from individuals, which led to the Russian phenomenon of “defrauded co-investors”. The essence of the reform lies in gradual abandonment of SCP agreements and transition to the accepted worldwide system of financing housing construction through construction project funding. The Ministry of Construction of Russia expects that the industry will be able to completely switch over to the system of project funding by 2020-2022. The need to reform the industry was voiced by Russian President Vladimir Putin on October 25, 2017 at a meeting with members of the Government. The first stage (effective as of 01.07.2018) tightened standards for real estate developers in the market of shared construction, one of the measures being introduction of mandatory requirements to transfer funds to the Compensation Fund of shared construction. Effective as of 01.07.2019, the second stage declares mandatory to use escrow accounts for co-investors with simultaneous credit financing of developers as part of construction project funding. These stages can be viewed as a transitional period.
to a civilized project funding, which involves using sales contracts. Thus, during the transition period, SCP agreements remain within the framework of project funding without removing risks of ‘defrauded co-investors’. Only at the third stage of reforming the system of shared construction (2020-2022), upon complete transition to sales contracts, the problem of ‘defrauded co-investors’ can be solved. Consequently, due to its high social and economic significance, the problem under consideration will remain at the center of attention of politicians, experts and the public until SCP agreements are completely eliminated, which requires total completion of the reform and full transition to sales contracts.

Both professional and scientific communities have been researching the issues of transition of the Russian housing construction industry to project funding as well as identifying measures to solve the problem of defrauded real estate investors. Searching ways to reduce risk of emergence of defrauded co-investors in the transition period of the reform should be considered the priority area of research in this field. This determines the relevance of this study in scientific and practical applications.

In Russian scientific papers, these problems are researched systematically and at length. For instance, in a number of scientific sources, results of studies of the Russian and foreign models of housing construction under contemporary conditions show “the need to develop and refine existing approaches aimed at improving housing conditions in the country” [1,2,3,4,5]. When analyzing the legal support of the shared construction system in housing construction, researchers, as a rule, note the ambiguity in assessment of consequences of the cancellation of the shared construction system without weighing out its positive and negative aspects [6,7,8,9,10]. The causes of the ‘defrauded real estate investors’ and ways to eliminate this problem are being studied in detail [11,12]. Thus, the authors note that strategically “the attention of the legislator is aimed at preventing emergence of defrauded co-investors. But the problem in the industry is much wider, it has a systemic nature and needs an appropriate approach to the solution,” which implies using various tactics of risk management to prevent fraudulent schemes at every stage of the housing reform [11]. The scientific community notes the relevance of introducing project funding and studies proper strategies to carry out that introduction, however, recommendations for its implementation, as a rule, do not take into account the risks of emergence of new defrauded co-investors, which may further lead to their growth and increase in the number of problem (incomplete) construction projects.

A detailed analysis of research on the issues under consideration shows that the risk analysis of emergence of defrauded co-investors under conditions of the transition period of the reform is not given due attention. This, in turn, does not allow managing the risks of shared construction at the stage of their prevention and puts the solution of this problem in manual control mode. This happened, for instance, with ‘defrauded real estate investors’ during implementation of such housing projects as ‘SU-155’, ‘Urban Group’ and other incomplete real estate objects.

The information base for the study of the problem in question was made up by technical literature, data from the websites of the federal authorities and statistical collections.

The article is aimed to identify risks based on an analysis of the factors identified during the transition period of the reform of the shared construction, and to develop measures for their prevention and control.

Analysis of the results of the ongoing reform of the shared construction system revealed both negative and positive aspects (Fig. 1).
### Positive Factors
- Creating a package of regulatory documents in the field of control, financing and judicial practice for the period of the reform of the share construction system
- Growing demand for new buildings (growth of SCP agreements)
- Creation of banking infrastructure and new financial products for developers (as part of project funding)

### Negative Factors
- The growing number of defrauded real estate investors
- Slow-paced transition of developers to project funding
- Raised prices for new buildings

**Figure 1.** The factors identified during transition period for the reform of the shared construction participation system.

The positive factors of the transition period include:

1. Legislative innovations that ensure transition from the system of funding housing construction through shared construction participation agreement to construction project funding. At the end of December 2018, a list of instructions of the President of Russia was published, which determined the vector of development of the housing construction market for 2019, as well as legislative innovations in authority, financial and judicial activities [15].

2. Growth in 2016 of registered SCP agreements, which implies guaranteed population demand for new buildings. Thus, according to the Rosreestr, over the 8 months of 2018 in the Russian Federation 450 472 SCP agreements were registered, which is 6.4% more than in 2017 (423,457 people), and 2.3% more than in 2016 (440 356 people) [16].

3. Creation of banking infrastructure and development of new banking products for developers in a changing market model.

   In 2019, the Bank of Russia plans to authorize 97 banks. Under the new legislation, they will be the only authority to draw citizens’ funds to escrow accounts when buying housing under construction. In April 2018, in the framework of project funding, PJSC Sberbank used escrow accounts for the first time in Russia to conduct a home funding transaction. In November 2018, in 11 regions, complex pilot projects were launched with the aim of working out project margin management schemes for developers on account of balance of sales and loan servicing costs. A line of banking products with a floating interest rate has been created, which will depend on the speed and amount of money transferred to escrow accounts. With the active flow of funds to escrow accounts (approximately 50%), the rate can reach 6-7% compared to the average market rate of 12%. “Today, practice shows that there are loans with an interest rate of 3.5%, that is, the level of funds on escrow accounts is about 70%, and the maximum interest rate at which loans are given is 9%. That is, all the rates are lower than the market rates,” [17].

   Despite the positive results of the housing reform, there are still some negative risk factors. These include the following:

1. An increase in number of defrauded co-investors. Comparing the statistics over the last two years, it can be clearly seen that, despite the fact that the reform of ‘shared construction participation’ is moving alongside the parameters set by the Russian government, the number of defrauded real estate investors has not decreased, but, on the contrary, has increased. At the same time, data coming
from different sources is contradictory and incomparable, which indicates lack of a unified accounting base and data manipulation in the interests of stakeholders, as well as impossibility of accurate forecast and prompt reaction to risk factors. According to the Ministry of Construction of Russia, at the end of 2017, there were 830 problem objects in 72 regions of the Federation, and the number of defrauded real estate investors in these objects reached 86 thousand people. At the end of 2018, the number of ‘defrauded co-investors’, according to various experts, increased, but the figures given are significantly different one from another. Thus, according to the head of the Working Group of the Presidium of the United Russia General Council for defrauded real estate investors, State Duma deputy Alexander Yakubovsky, 1,200 construction projects are considered problematic in the Russian Federation, and the number of defrauded citizens reaches 180,000, and it is increasing annually by 30,000-50,000. Deputy Prime Minister Vitaly Mutko states an even bigger figure: 200,000 families are defrauded, and, he notes, this figure excludes troubled housing projects of the Urban Group and SU-155, which are in a high degree of completion. According to the data of the Investigation Committee, there are, actually, about 900 problem real estate objects of shared construction and tens of thousands of real estate investors in Russia (table 1).

Table 1. Number of Problem Real Estate Objects and Defrauded Co-investors.

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018* |
|------|------|------|------|------|------|------|------|------|-------|
|      | Number of problem real estate objects, in units. | 697 | 1000 | 964 | 847 | 577 | 510 | >800 | 830 |
|      | Number of ‘defrauded co-investors’, in thousand people | 66 | 84 | 95 | 80 | 47,5 | 42,5 | 100 | 86 |

2. Slow-paced transition of developers to project funding. According to the Bank of Russia, in March 2019, a total of 500 applications for project financing were filed in 11 authorized banks. This is due to the fact that over the last three years, developers have been engaged in creating “a backlog of permits for the construction of apartment buildings”, which allowed them to continue the construction and funding of real estate objects under the old conditions according to the usual SCP agreement schemes. Most (30.1%) permits (by floor area of residential premises) were issued in 2018. This will certainly have a negative impact on the industry as a whole and will lead to a new wave of uncompleted real estate objects and ‘defrauded co-investors’ (table 2) [16].

Table 2. Issued Permits for Housing construction in Russia annually over the period 2012-2019.

| Year of issued permits | Houses | Housing units | Total volume of floor area |
|-----------------------|--------|---------------|---------------------------|
|                       | Units  | %             | Units                     | %             | m^2   | %    |
| Before 2012           | 429    | 2,8%          | 35617                     | 1,3%          | 2201101 | 1,7% |
| 2012                  | 307    | 2,0%          | 33728                     | 1,3%          | 1858213 | 1,4% |
| 2013                  | 584    | 3,8%          | 83961                     | 3,1%          | 4387496 | 3,3% |
| 2014                  | 1472   | 9,6%          | 235569                    | 8,8%          | 11261978 | 8,5% |
| 2015                  | 1690   | 11,0%         | 273756                    | 10,2%         | 13669662 | 10,3 |
| 2016                  | 3863   | 25,2%         | 622553                    | 23,2%         | 30059902 | 22,7 |
| 2017                  | 3198   | 20,8%         | 596174                    | 22,2%         | 28926781 | 21,9 |
Thus, the developers have secured quite a load of work by the old schemes of the SCP agreements for a total amount of more than 130 million square meters of residential development. More than 3000 developers continue to use the currently dominant method of funding which is direct investment of housing through SCP agreements.

3. Raised prices for new buildings. According to experts, at the beginning of 2019 there was a sharp jump in prices for mass-market new buildings. According to Rosreestr, “in February, the number of registrations shared construction participation agreements for residential real estate in Moscow also increased by 29%, compared to February last year, compared to January this year — by 34%.” At the same time, the rise in the cost of construction is due to corruption schemes, which in 2017 “were revealed within 54 regions, in 2016 within 50 regions. Signs of collusion in tenders in 2017 were revealed during more than 400 open auctions in electronic form, in 2016 during 140 auctions. The sum of the total initial maximum contract prices for the last year is more than 38.6 billion rubles, in 2016 it made up 6.8 billion rubles. In 2017, the Federal Antimonopoly Service of Russia initiated 146 cases of anti-competitive agreements in the course of construction and repair works of buildings and structures, as well as in the construction and maintenance of roads”. Abandoning shared construction system with transition to project funding will lead, according to experts and heads of relevant departments, to a small increase in housing, but “on the other hand, this eliminates all the risks that our citizens today have, giving money to the developer”.

The transition period is a combination of the risks of the previous stage related to existing ‘defrauded co-investors’ and the risks of emergence of new ‘defrauded co-investors’ that may arise under conditions of project funding based on escrow accounts opened in authorized banks, but on the basis of SCP agreements.

In accordance with the accepted international methodology of risk management, we identified the risks of a transition period, which allowed us to consider the consequences and identify measures to prevent occurrence of risk events (Table 3) [18].

Table 3. List of Risks in Transition Period, Consequences and Measure to be taken.

| Risks                                                                 | Consequences                                | Measures                                                                 |
|----------------------------------------------------------------------|----------------------------------------------|--------------------------------------------------------------------------|
| 1.1. Non-execution of instructions of the President of Russia on abandoning SCP system funding. | Increase in the number of problem real estate objects and the number of defrauded real estate investors. Increased social tension, increased budget expenditure. | - Inclusion of a separate statement about absence (reduction) of problem real estate objects in the national project ‘Housing and urban environment’  
- Increasing responsibility of governors and rating them in accordance with completion of the shared construction targets set by the President of the Russian Federation. |
| 1.2. Unreliability and incompleteness of data in the registry of defrauded real estate investors | Growth in the number of ‘unaccounted’ problem real estate objects and ‘defrauded co-investors’ | - Development and implementation of refined criteria for assigning buyers to the category of ‘defrauded co-investors’  
- Entering problem real estate objects into the register in accordance with a number of problem apartment buildings, not with a number of problem real estate objects (residential complexes)  
- Clarification of the concept of a ‘problem real estate object’ (if its construction is postponed for more than a year) |
1.3. Lack of resources to complete projects

- Freezing the completion of ‘problem real estate objects’

Risks as of 01.07.2019

1.4. Complicated bankruptcy procedure for the developer

- Increased cost of project completion

- Development of clear regulations at both federal and regional levels to make a decision regarding completion of the problem real estate object (funds, transfer of land sites, etc.)

2.1. Increased cost of housing

- Falling demand for housing, reduced volume of construction.

- Application of advanced technologies and materials in construction

- Reduction of the time for the courts to consider cases of declaring a problem developer as bankrupt and transferring the object for completion to another developer

2.2. Non-transparent operation of the developer

- Construction becomes more time-consuming, with increased construction costs, bankruptcy of the developer. Updating the registry of problem real estate objects.

2.3. Banks’ lack of expertise on construction technology

- Unqualified assessment of the developer’s activities, which may result in partial or complete non-execution of the construction project

2.4. Bankruptcy of authorized banks

- Loss of funds by co-investors in escrow accounts. Emergence and spread of the category of ‘defrauded co-investors’

2.5. Legislative "loopholes" enabling to bypass project funding

- Actual emergence of bypass schemes that can lead to negative situations in the construction industry and emergence of fraudulent schemes

Thus, according to the results of the analysis, it can be concluded that there are risks of appearance of defrauded co-investors during the period of reforming the shared construction participation system. This is facilitated by such negative factors identified in the process of the reform as distrust of developers, an unreliable information base, and price manipulation. To minimize negative factors, it is sufficient to ensure informational openness of data based on the decentralized registry technology and legally ensure strict and complete execution of government orders as part of project management.
It is worth noting that the transition period for the reform adjusts the housing construction industry to complete replacement of SCP agreements with project funding based on purchase and sale agreements. As a result, investment risks will be eliminated; and the problem of defrauded co-investors will be resolved.

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