How will changes in legislation affect the real estate market?

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Abstract. The Real Estate market is heavily influenced by internal and external factors. These factors address the negative impact on the level of market stability. In many cases, market fluctuations were largely due to the changing legislation. This makes grow demands in the housing market (the primary market) on the one hand but on the other provides a significant boost leading to high price levels of square meters. Today many people get possession of real estate due to mostly by mortgage loans and shared construction preferring house-buying at the primary market cause of lower prices especially if you buy it at the start of building construction. Recently taking into account the land fraud from the construction companies and as a result revising of shared construction of making contracts is under consideration of laws regulating and other types of financing for housing construction. The transition to the new financing for housing construction system means convergence toward project financing. The real estate development will need to be financed by the Bank. That approach was expected to reduce risks for builders and owners (consumers). In the advanced world this scheme is used for a long time and allows essentially simplifying the mechanism for attracting funds for construction and reducing a need for dedicated financial resources from various-level budgets for the finalization of housing projects.

1. Introduction

In the current worldwide economic crisis in our country there has been a significant decline in investment activity in the real estate market. The modern real estate market is very sensitive to economic and political changes, including changes in legislation.

The forecast, which today give experts in the field of housing, is very ambiguous. According to experts, growth, as well as decline is possible subject to all factors affecting the real estate market, and they may not be interconnected.

From an economic point of view, the housing market is primarily influenced by supply and demand, and internal factors can have an impact on the change of these two categories in different directions. [3]

In the context of the economic crisis, there is always a drop in demand and a corresponding drop in real estate prices, however, in conditions of simple economic instability, the opposite effect can occur – that is, the threat of a future crisis spurs demand and increases the share of property transactions, such a situation was observed in 2014-2015.

In addition, the growth of inflation can also lead either to a reduction in investment activity, or Vice versa to provoke an increased, and sometimes even an excessive demand for real estate – as an investment investment.
Adjustments in legislation can also lead to changes in the real estate market. So by July 1, 2019 it is planned to abandon the conclusion of contracts of shared construction (DDU) and gradually move to new schemes for the acquisition of housing under construction. The transition includes measures that include the gradual replacement of equity construction by Bank lending and other sources of financing.

In the context of the economic crisis, there is always a drop in demand and a corresponding drop in real estate prices, however, in conditions of simple economic instability, the opposite effect can occur – that is, the threat of a future crisis spurs demand. Now the sale of new buildings, about 80%, is carried out through the conclusion of the DDU contract, such a scheme provides for the construction of housing at the expense of shareholders. That is, individuals, which is associated with a certain degree of risk associated, including the risk of bankruptcy of the construction company and not the completion of construction. [2]

This scheme has its drawbacks and pitfalls. In accordance with the Law 214-Federal Low "On participation in the shared construction of apartment buildings" the contract must contain various characteristics of the construction object, the deadlines for the delivery of the object and a detailed technical description, as well as, importantly, the duration of the contract. Very often, construction companies interpret the law in their favor or try to circumvent it. For example, the contract may be unclear spelled out responsibility for failure to deliver the object in operation, in particular, who should pay the costs and pay the penalty. In this case, the contract may include a condition according to which the company is liable only in case of its own fault and not the fault of the developer, or the list of force majeure circumstances may be expanded.

Another DDU contract’s pitfall is the quality of work. In accordance with the agreement spells out the conditions for the removal of deficiencies, inconsistencies and so on. In such cases, some developers include a clause in the DDU contracts that the permit for commissioning is equivalent to confirming the compliance of the object with the project documentation. It turns out that in this way the company disclaims responsibility for poor quality work.

This is only a small number of difficulties that shareholders may face and in most cases they are all solvable and do not have serious consequences.

More problems that are serious arise in cases where the market is an unscrupulous company-developer, whose purpose is not initially to bring the construction to the completion stage, or when the company does not count on its strength and as a result is forced to declare bankruptcy. Такая картина является более серьезной, и, к сожалению, встречается довольно часто.

Thus, according to experts of the Rating Agency of the construction complex (RASK), in 2018, 150 developers were at different stages of bankruptcy throughout the country. It is almost 2 % more than in 2017, and only developers who sell housing under the 214-Federal Law regulating shared construction were taken into account, the reason for this situation was the tightening of rules for working with shareholders. [5]

2. Materials and methods

The Problem of investment in real estate is today very relevant and research in this area, as well as the development of measures regulating the problem of housing, devoted a lot of scientific articles and analytical materials. Moreover, the problem of choosing the method of financing housing construction is typical not only for the Russian market, but also for many European countries.

For example, in the works of the authors of the London school of Economics, we consider approaches to ensuring the availability of real estate ownership, through equity or equity ownership, as well as the impact of the global economic crisis on the behavior of developers and consumers. These and a number of other authors in their works propose to develop appropriate measures aimed at the
formation of appropriate methods of forecasting demand in accordance with the dynamics of changes in the needs of different groups in quality and affordable housing.

In the Russian authors’ works of the analysis of problems and measures of their regulation in the field of economic and legal field of housing construction is carried out. So, in the work of Egorova E. V., Pakhomova O. Y. we are talking about the viability of shared construction in the new economic environment and developing alternative solutions to housing Finance. [6]

In the work of Morozova L., Karimov T., Baeva D., Kuchina E. the analysis of funding sources is carried out, the differences of the Russian practice of housing financing from the used foreign system, the gradual transition from the existing model of financing to less risky project financing are considered. [9]

In addition, many authors are talking about the analysis of the advantages and disadvantages of the system of shared construction. In particular the impact of various economic and legal factors on the growth of fraudulent transactions in housing construction, especially in shared construction.

В данной статье на основе проведенного сравнительного анализа особенностей и механизма осуществления жилищного строительства предлагаются пути решения существующих проблем, дана оценка последствий на рынке жилья после вступления в силу внесенных изменений в действующее законодательство.

3. Results

According to the Federal Service for State Registration, Cadastre and Cartography, the number of transactions with the participation in the joint construction for the purchase of apartments in new buildings in the whole country in October 2016 amounted to 168.7 thousand, while in October 2015, their number amounted to 148.8 thousand transactions. The number of transactions in 2018 increased by an average of 13.3% compared to 2017. The reason for this growth, many experts call the low level of prices of apartments at the stage of the pit, an average of 25-30% than in the finished house. In addition, the increase in the share of such transactions is associated with a gradual decrease in Bank rates, the launch of new projects on the market, and the simplification of approval procedures. [4]

However, against the General background of the growth of transactions with the help of DDU schemes, the number of defrauded investors increased.

Therefore, at the end of 2018, developers recognized as bankrupt, could not complete the construction of 3.6 million square meters of housing in the whole country, which corresponds to almost half of the volume of new buildings in Moscow alone. According to credit-rating company of building complex, the number of potential bankrupts may grow to 7.8 million square meters. This situation is associated with the departure of small and medium-sized developers from the market.

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Based on the Rating Agency of the construction complex report in 2018, about 150 developers were at different stages of bankruptcy throughout the country, which is 2% higher than in 2017. Moreover, the companies operating based on 214- Federal Law were taken into account in the preparation of the report. The most difficult situation arose at 111 developers recognized insolvent – total of 3.6 million square meters under construction. [3]

In such a situation, if a company-Builder does not comply with the requirements of the legislation, this may result in the denial of Federal registration service in the registration of DDU transactions. Today problems of this nature have arisen in more than 100 companies in Russia as a whole. Nevertheless, if in case of refusal of registration of DDU the main share of risk bears more the Builder, than the shareholder (as without the corresponding conclusion of the contract he has no right and is not obliged to transfer money of construction company). In case if you made a deal with the problem Builder, risk of not completion of construction increases 100 times. Blocking the registration of the DDU actually means the termination of the proceeds from the sale to complete the construction, and the refusal of the developer to open a special account indicates a problem in the company, which can serve as a signal to the buyer.

According to experts, by the end of 2019, the real estate market may lose up to 30% of developers. The reason for this is the tightening of rules for working with shareholders – from July 1, 2019, the developer must transfer the attracted funds to escrow accounts to authorized banks, they are defrosted after commissioning, while the companies can build on the money of shareholders and Bank loans, which accordingly increases their financial burden. [3]

The requirements introduced by the new law will bring not only unscrupulous developers from the market, but also just medium-sized companies. One of the conditions for developers to participate in project financing is the commissioning of at least 10 thousand square meters. For the regions, this is too large and sometimes impossible.

4. Discussion

The government proposes to solve this problem in several ways:

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attract funds of compensation funds (CF) of self-regulatory organizations (SRO) in the construction sector to solve the problem of deceived shareholders;

developers should finally go on sale in the kindergarten through escrow account;

the State Duma introduced a draft providing for the transfer to the Fund for the protection of the rights of citizens participating in the shared construction of funds collected by insurance companies in the period from 2014;

according to the amendments to the legislation on shared construction approved in December 2018, the developer will be able to independently set the amount of payments to be paid, but in proportion to the planned cost of each object;

finally, to proceed to the project financing.

If we go to the first way of solving the problem, then we are talking about the direction of compensation funds, which is about 97 billion rubles to complete the construction of long-term construction on a return basis. Given the lack of the ability to carry out low-income long-term borrowing in financial markets, this measure could significantly solve the problem, since it involves the return of funds, but on the other hand it can lead to additional financial burden for those companies that are not related to the problem objects.

Against such a measure is the Ministry of construction and the industry community – they offer to solve the problem of deceived investors by providing various benefits and indulgences to those companies that will undertake the completion of unfinished construction projects. But to implement
such a measure is possible only in certain regions, where problems with deceived investors are isolated cases, and not a mass phenomenon.

As for the second measure, the transition to the financing of construction and sale of housing through escrow accounts, this measure is related to the need for the developer to transfer the funds of buyers to special Bank accounts and keep them there until the completion of construction. It is at the expense of these funds that banks will lend to the developer. In respect of such accounts, the state provides for an insurance system for 10 million rubles on average. The new system will replace the usual scheme of shared construction and provide certain guarantees for shareholders.

In the construction of housing under the old rules, without the use of escrow accounts, developers may face the problem of falling profitability by an average of 25-30%. The same situation may arise if the contributions to the Fund of shareholders from each contract of the DDU increase to 6%. [6]

At the end of 2018 for consideration in the state Duma was introduced a bill that would oblige insurers (which enters into a contract, the construction company) to transfer to the Fund for the protection of shareholders of the funds collected from developers under agreements of compulsory insurance. At the expense of these funds in the future will cover the risks of buyers of apartments in case of problems with the developer.

The mechanism of compulsory insurance has been in force since 2014, according to it, developers are obliged to deduct 1.2% from the cost of each prisoner of the DDU. Under the bill, it is assumed that the insurance and contributions system will operate in parallel.

However, at the stage of adoption of the bill, many insurance companies overrate their strength, were forced to declare bankruptcy. In addition, insurance companies become bankrupt themselves in order not to pay deceived investors.

This situation arises because of the unwillingness of large insurers to work with the risks of shared construction, as such risks are very difficult to assess, and small insurance companies often do not have enough money to return the invested amount to shareholders in case of a problem situation.

Self-selection of the amount of payments to be paid, but in proportion to the planned cost of each object will allow a better distribution of costs in the development of the territory, which will reduce the risks of possible unfinished. In addition, it is proposed to change the type of liability of the developer from solidarity to subsidiary, as well as not to stop the sale of equity contracts (DDU) due to the revocation of the license from the largest company—the insurer of the developer's liability.

As we can see from the above, each measure proposed as a solution of the problems in the housing market has advantages and disadvantages, one by one, none of them will not bring a proper solution to the problem with deceived investors, which has worsened in recent years, while a comprehensive solution can significantly change the situation.

In tandem with the opening of escrow accounts for construction projects started before July 1, 2019, it is planned to launch a mechanism for project financing of buildings and a five-fold increase in contributions to the Fund for the protection of shareholders.

In developed countries, in the implementation of the transaction under the project financing scheme, the Bank invests in the housing project, which act as collateral for debt obligations. The return of the invested funds of the credit institution is not at the expense of the developer's assets, but at the expense of cash flows that are formed by the new project. Thus, it turns out that the construction of the facility is carried out at the expense of the Bank. At the same time, project financing is not considered as an alternative to lending, since rates can be significantly lower than for current loans for industries.

In Western Europe, the project financing scheme is used as the main scheme for attracting funds for construction. For example, in Germany there are savings banks, where the buyer makes a contribution, and after a few years can issue a housing loan, respectively, the money is sent exclusively to the construction of real estate.

In the UK, the sale of real estate is carried out according to the following scheme – the construction of the project is financed by the developer himself, but can take an advance payment of 5%, the rest at
the expense of own or borrowed funds. Full payment of the project is made after commissioning, and most often the object is handed over with a fine finish. [8]

The transition to project financing will allow the Russian real estate market to reduce, and possibly completely solve the problem of the risk of loss of investments of individuals in housing under construction. For the developers themselves, the mechanism of attracting funds for construction will be simplified, that is, instead of a large number of individuals, there will be one or two banks and a limited number of professional investors. [2]

In addition, the risks for the state will be reduced – the need for state funding and support for the construction industry will be reduced. In case of default by the developer, the object will be completed not at the expense of the budget, but at the expense of the Bank or insurance company.

This scheme is approved by the government and will really reduce all the risks for both buyers and the state in terms of the emergence of new defrauded investors. However, at the same time, many developers are concerned that the transition to a new scheme can increase the cost of housing and alienate potential buyers, especially those who resort to buying real estate through mortgage lending.

And the price increase is likely not in the Central regions of Russia, where the level of competition is higher than in the regions, and therefore in some entities, where the cost in addition to everything else is higher due to additional costs (climate, seismicity, etc.) and a small number of regional developers.

The project financing scheme is implemented in three stages. At the first stage, a Fund for the protection of the rights of shareholders appeared, at the second stage, amendments to 214-Federal Law of July 1, 2018 came into force and at the same time, a unified system of control over shared construction in the regions was created.

At the third stage, the mechanism of housing construction financing by banks will be evaluated with positive dynamics and competent risk assessment. This scheme will fully enable the gradual replacement of equity construction with project financing, taking into account the preservation of housing affordability.

In General, many experts give a positive assessment of project financing. Today, this kind of scheme is implemented in the framework of a pilot project in the Moscow region with the involvement of project financing of Sberbank of Russia. At the same time, the resources of shareholders are attracted, but they do not affect the financing of the construction and, accordingly, the company - cutter does not depend on them.

Taking into account the assessment of the situation, small companies will find themselves in a difficult situation, which do not have a proper reserve of stability and, accordingly, the opportunity to attract the Bank's money – for such companies the only way out is to leave the market [2]

Nevertheless, even with the use of project financing by large companies, do not forget that efficiency is possible only under mutually beneficial conditions. For project financing, the rate should be commensurate with the level of inflation, plus the corresponding remuneration. For example, if the inflation rate is 4%, taking into account the remuneration, the final rate should not exceed 8%. This ratio will keep the price level in the market and will not lead to large margin losses on the part of developers.

Perhaps, in order to prevent mass bankruptcies of construction companies and rising housing prices, it is necessary to pay attention to foreign experience and provide for the right of developers to receive money in parts from escrow accounts as construction works are carried out, and interest on loans to be paid after the commissioning of the facility.

Summing up, we can say that the mechanism of project financing will be implemented within three years, however, to date, until the end of a clear algorithm of interaction between banks, developers and buyers.

5. Conclusion
The final transition to the new scheme of sale of DDU is planned on July 1, 2019, however, the consequences of the changes in the legislation have affected the housing market today.

Thus, according to a number of real estate agencies, analytical and rating companies, prices for new buildings began to rise in early 2019 and are expected to further increase. In many cases, the growth is driven by the expectation of a reduction in supply in the primary market in some regions and an increase in mortgage rates.

In addition, not all developers are ready to switch completely to new financing schemes, in particular project financing. Most likely, other schemes to reduce the cost of borrowing will be considered, for example, housing cooperatives will be created, providing for an equity financing scheme or closed-end mutual real estate investment funds.

The financing schemes considered, in particular the opening of an escrow account, could result in additional financial burden and, consequently, a rise in the cost per square meter.

The rise in the cost of the basic resource - almost all materials - is also a serious problem. In addition, the increased value of value added tax is inevitable.

According to the forecasts of the housing market’s experts the growth of prices on average can range from 2 to 5%, such an increase in the existing competition will not be significantly noticeable, though for some regions (mainly Central) of the country.

Possible reasons for the increase in housing prices may also be the lack of the possibility of its acquisition at the initial stage, which involves the cost of 20-25% lower than in the finished form. If we are talking only about ready-made houses, the rise in price can reach 10%, taking into account interest rates on loans.

It is planned to regulate the growth of prices by achieving a balance between supply and demand, as many projects were launched before the entry into force of changes in legislation, which today allows you to keep the prices of primary housing at a low level in relation to the secondary market.

In addition, in a number of regions, prices are constrained by the implementation of state programs – preferential mortgage with state support, the renovation program also contributes to the growth of construction of new housing and, accordingly, an increase in supply, and in such a situation, an increase in prices is not advisable.

The most noticeable increase in prices will be after July 1, 2019 because of the abolition of equity construction, plus the situation with the globalization of the real estate market, which will lead to the withdrawal or merger of small construction, associations in the so-called construction trusts.

In addition, the growth of requirements for construction companies in the field of security and infrastructure around the housing under construction will also contribute to the growth of prices per square meter.

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