Transition to the project housing construction financing scheme

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Abstract. In current social and economic conditions, the construction industry has a lot of problems. It is necessary to reform the industry. One of the significant changes was implementation of the project financing scheme and abandoning of the equity construction financing scheme. Project financing is a more mature market development model. By 2020, the bank project financing scheme into the construction market will have been implemented by the Russian Government.

1 Introduction

The issues of affordability of housing, quality of the housing stock, comfortable urban environment, commissioning and deceived real estate investors have attracted attention of government authorities for quite a long time. One of the main government tasks is to provide citizens with affordable housing and increase the level of comfort of the housing stock. Chairman of the Government of the Russian Federation D.A. Medvedev said that "the state of the housing stock and the housing market is one of the most important factors affecting living standards of any family." [6]

The end of 2017 was the starting point for solving problems existing in the construction industry. No results have been achieved despite the fact that the shared construction financing legislation was regularly amended, the
requirements for developers hardened, the mechanism for protecting rights of participants in the equity construction market became more thoughtful, and legal norms protecting co-investors from investment risks were adopted.

In October 2017, at the meeting on the problem of deceived real estate investors, the President of the Russian Federation suggested a project financing scheme. The transition to this scheme was reflected in the Decree of the Government of the Russian Federation of February 15, 2017 “On the Program ‘Project Financing Factory’” [2] which has to create an updated mechanism for investing in the construction industry.

In February 2019, at the extended meeting of the State Council Presidium devoted to the national project “Housing and urban environment”, V.V. Putin said that “the industry is undergoing major changes, it is undergoing a stage of deep reforming.” In July 1, 2019, a new housing financing scheme will be launched. It should be safe and not burdensome for citizens, it should protect people from excessive risks when buying houses, and allow them to enter market relationships on a more sustainable, professional, civilized basis.”

2 Materials and methods

The initiative of the President is not the first attempt to reform the system of shared construction. Figure 1 shows the main stages of implementation of the shared construction scheme in Russia.

In his article “Russia-2024: A Strategy for Socio-Economic Development”, Dmitry Medvedev paid attention to the development of housing construction and the problem of defrauded co-investors. For almost twenty years, shared financing has been the main housing construction financing scheme. In the near future, the construction industry will follow the “principles of project financing.” This scheme has been successfully implemented by many developed countries. [6]

For example, the shared construction scheme does not exist in the European market due to the fact that it is more profitable for developers to interact with credit institutions rather than with end users, since European loan interest rates are significantly lower than Russian ones which allows developers to use credit resources.

Moreover, even for construction companies, it is not profitable to sell apartments at the construction phase. At the construction stage, the price of apartments is 20-30% lower than at the commissioning stage.
Figure 1. The main stages of the shared construction scheme in Russia.

In European countries, developers make exceptions for large investors who purchase a large number of premises – for example, a third of all apartments. However, at the construction stage, they do not deal with retail buyers [11, 12].
Therefore, in foreign countries, project financing is a full-fledged investment product. To attract investments, Initial Public Offering (IPO) is used.

This measure significantly reduces the burden on the borrowers, and the project receives investment funds that can bring dividends. A subject acquiring shares becomes the owner of a part of the project or the company.

According to the Project Finance & Infrastructure Journal, in 2007–2017, the world volume of project financing transactions amounted to more than $3.3 trillion (8.5 thousand units). Russia accounts for less than 1% of the volume of these transactions, and only about 2.7% of their value (Fig. 1)

![Figure 2. Dynamics of project financing in the world and the share of Russia, billion dollars [9].](image)

![Figure 3. Project financing in Russia in 2007-2017 [9].](image)
3 Results

Thus, at present, the large-scale transformations are taking place in the housing construction industry. In 2019, the housing construction project financing scheme will be implemented, i.e. bank resources will be attracted to the housing construction s. Figure 4 shows the main milestones of this transition.

**Figure 4. Stages of transition to the project financing scheme in the Russian Federation.**

One of the main innovations is creation of escrow accounts as a new guarantee for the buyers. Escrow accounts will increase the availability of funds borrowed by construction companies [15].

The scheme of escrow account operations is quite simple. A buyer or an equity holder transfers money to the special escrow account as a payment for the real estate object being acquired, funds are kept on this account (“frozen”) until the object is put into operation. According to paragraph 1 of Article 860.7 of the Civil Code of the Russian Federation, the right to the funds on the escrow account belong to the account holder until the transfer of the funds to another person (beneficiary) which is a construction company [1].

The construction company gets access to these funds only after the real estate object is accepted as commissioned. If the object has not been put into operation within the period specified in the contract, the funds will be returned to the shareholder. Figure 5 shows the project financing scheme with the use of escrow accounts.
4 Discussion

In general, the project financing scheme is able to protect both developers and builders and buyers. The latter will be insured against the risks arising when buying apartments at the construction stage [10].

At the same time, most of the construction companies believe that credit institutions will become “principal beneficiaries of this scheme” due to the fact that they will make a profit in the form of interest payments. The bank grants loans for housing construction and apartment purchasing. By and large, the bank participates twice in making a profit [10].

![Figure 5. The mechanism of the project financing scheme with the use of escrow accounts.](image)

Implementation of the construction project scheme does not depend on the dynamics of sales and seasonal demand. Bank monitoring of targeted funds will improve business transparency. This model determines a more specific term for putting a house into operation. Therefore, for the customer, the project financing scheme is an indicator of developer’s reliability and project’s success. [7]

The government focuses on the banking control, i.e. the bank will check equity agreements and other construction-related contracts, acts of
acceptance and transfer of the object, waybills, etc. The costs of all these activities will be accounted for by the developer. To improve the reliability of the targeted use of credit resources, the developer will have to report on progress at the construction site. [8]

One more innovation is the Unified Information System for Housing Construction implemented on January 1, 2018. It involves photographing of progress at the construction site and monitoring of the following indicators: potential of housing construction, building density, provision of land plots, housing construction operations, financial conditions of the developer, housing statistics, housing facilities.

Phased spending of co-investors' funds on the escrow accounts according to the scheme presented in Table 1 could be efficient.

| Stage                                              | Phased spending (of the PA price) |
|----------------------------------------------------|----------------------------------|
| 1 Construction permit (advance)                    | 10 %                             |
| 2 Zero cycle                                       | 20 %                             |
| 3 50% completion of the building frame             | 20 %                             |
| 4 100% completion of the building frame            | 20 %                             |
| 5 Closing the thermal contour of the building      | 10 %                             |
| 6 Permission for commissioning                      | 10 %                             |
| 7 Commissioning of the shared construction building| 10 %                             |

5 Conclusion

In general, transition from the shared construction scheme to the project financing one is a measure required to protect the rights of real estate buyers.

Thus, the prospects of the project financing scheme in the Russian construction industry should be considered within the government policy focused on the development and implementation of government tasks. Otherwise, the project financing scheme will not function properly even if there is an adequate regulatory mechanism. Russia will not be able to take advantage of the global capital market.

The project financing scheme could have developed without government intervention if the banks had created conditions for attracting larger amounts of mortgage loans.
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