

Working Paper 600

**Designing Private Sector Land and
Housing Markets: A
Demonstration Project for
Ekaterinburg, Russia**

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INTRODUCTION

One of the major activities of transition economies in Central and Eastern Europe (CEE) is to privatize state-owned assets. Such assets cover a bewildering array of properties and businesses. To date, Moscow has privatized over one million housing units. Hungary and Poland are both engaged in the mass-privatization of thousands of state enterprises. Up until now, foreign assistance has principally centered on helping transition economies privatize enterprises and housing units.¹ However, little attention has focused on privatizing land, a vast asset held by virtually all local governments. Nevertheless, due to fiscal constraints, decentralization of government powers, infrastructure shortages, and the massive restructuring of urban economies, land privatization has now begun to be considered by municipalities across the region.

By creating urban land markets, municipalities can make significant strides towards greater economic prosperity. Substituting markets for administrative mechanisms can help to increase land use efficiency and raise urban productivity (Bahl and Zhang, 1989; Reiner, 1990). It can also facilitate the birth and development of private sector real estate development companies and create user-driven property markets. If municipalities promote the transfer and redevelopment of under-utilized and derelict areas, industrial restructuring will move more quickly. Properly structured, land privatization generates substantial financial resources which can be used to build modern infrastructure systems for cities.²

Discussions with decision-makers and real estate professionals in cities of the CEE reveal widespread interest in how to design an effective system of land privatization. How should parcels be selected for privatization? What role should urban planning and development controls play in dictating use? How should parcels be disposed of — through auctions, sealed bids, negotiated prices, or lotteries? How can cities be sure that they get the best price for sites?

In response to these and similar questions, U.S.A.I.D. recently launched a land and housing market privatization demonstration project in Ekaterinburg, Russia. The purpose of the project was to design and test the feasibility of promoting private-sector housing construction on privatized land. The Ekaterinburg demonstration project followed land privatization methods used in other cities, primarily in North America. The purpose of this paper is to describe how these techniques can be used in cities with a transitional economy and illustrate their application in Ekaterinburg, Russia.

STRATEGY FOR LAND PRIVATIZATION

Experience in North America with public real estate development provides a useful model for consideration in CEE cities. Across the United States and Canada, cities have reviewed their land holdings and identified surplus but highly attractive sites that they have sold or developed.³ Local governments in North America generally follow three routes to privatize land: auctions; negotiated sales of land to winners of RFP (request for proposals) competitions; and joint ventures with developers. Auctions are used when cities know exactly how surplus sites should be developed. In other cases, such as when the best use of a site is not known, cities hold competitions among developers to identify the best possible projects and sales prices. Sometimes

sites are awarded not to the highest cash bidder, but to the developer who proposes a project that best meets the overall objectives of site privatization. In most competitive procedures, sites are sold or leased to developers; however, in some cases cities form joint ventures with developers to develop sites and share in the costs and benefits.

Experience shows that local governments privatize and develop public lands for a variety of reasons. For example, transit agencies promote the collateral development of surplus land (and airspace) near transit facilities to help finance their investments and to boost transit ridership. School districts, faced with declining enrollments, have sold surplus schools to generate revenues for capital investments in other growing areas. Redevelopment agencies sell or lease land to revitalize derelict areas, increase employment, and raise tax revenues.

While many of the above North American motivations equally apply to the CEE, there are obvious fundamental differences that will condition the applicability of North American models of land privatization to Central and Eastern Europe. First and foremost, CEE cities neither have well-functioning land and property markets nor well-established private sector developers. Second, there is very limited technical and professional expertise in most CEE cities, and it will be difficult for cities to ensure that property disposition yields market-level prices. Third, data on property market transactions, rents, sales, and valuations are limited and often inaccurate. Fourth, most CEE cities are undergoing fundamental economic restructuring. Budapest, Warsaw, Kiev, Ekaterinburg, and scores of others have seen their industrial bases crumble, creating hectares of derelict industrial land. Fifth, most properties to be privatized require substantial infrastructure upgrading and modernization before they can be profitably developed. Finally, cities are being pressured by residents to quickly redress decades of social and economic distress, such as poor housing conditions, pollution, and the conspicuous waste of the state.

The climate for privatization is much more uncertain in CEE cities. While in the U.S. it is relatively easy to determine a property's probable selling price, in the CEE it is extremely difficult. For example, if a city decides to rapidly auction sites, how can it be sure that it receives prices approximating market value? Is there a market? Can comparable sales be found on which to set auction minimums? How can cities insure that enough qualified bidders will bid for parcels if new developers have limited experience in the private sector? In light of these conditions, cities clearly will have objectives different from their North American counterparts when it comes to land privatization. For reforming cities, an obvious goal of municipal privatization will be to facilitate the access of small private real estate developers to land. Another objective may be to structure privatization activities in ways that promote economic redevelopment, not necessarily maximize short-term financial return.

Despite these radically different contextual factors, the North American land privatization model transfers reasonably well. Recognizing the contextual differences between North American and Central and Eastern European land privatization, the rest of this section outlines a model framework for structuring

municipal land privatization. The model draws on North American practice, but it is modified to respond to the unique needs of Central and Eastern European cities (Dowall, 1990). It follows a six-step process:

1. Set goals and objectives for property disposition
2. Establish privatization process
3. Conduct an inventory and assess public properties
4. Identify high-priority sites for privatization
5. Package sites for privatization
6. Site disposition

Step 1: Set Goals and Objectives for Property Disposition

Before embarking on land privatization, cities should think through exactly what they want to gain from the process. Is it to rapidly sell off parcels so that ownership is transferred from the public to the private sector? Is privatization being undertaken to explicitly spark the creation of a private real estate development industry? Is the city primarily interested in generating cashflow? Is the city interested in attracting foreign capital and modernizing its commercial and industrial sectors?

Clear, well-defined goals and objectives can help cities to determine what type of process is needed, what types and sizes of sites should be privatized, what types of uses should be promoted, and how revenues from privatization should be used. Program goals and objectives can be used as criteria for designing implementing institutions and they can serve as benchmarks for ongoing program evaluation.

It is common for North American cities to seek the input of citizens and other concerned governments when setting program and project objectives. One method is to set up taskforces and working groups to evaluate the potential of urban land privatization (Peattie, Cornell, Rein, 1985). In the course of setting goals and objectives, conflicts are likely to emerge within and among the various stakeholders. To prevent controversy at later stages in the privatization process, consensus on project goals should be achieved before projects are initiated. Techniques for mediating and resolving conflicts should be used early and often.

Step 2: Establish Privatization Process

Once the goals and objectives of the land privatization program have been defined, an institutional structure for land privatization can be designed and implemented. While there is no universal model, most local governments either set up an internal or external agency to administer privatization.

Program targets will help to define appropriate institutional structures. If the city is interested in rapidly transferring public lands to the private sector, a broker-oriented external structure is appropriate. If the goal is to facilitate industrial restructuring, the city should consider designing an institutional framework dedicated to promote economic and industrial development. If infrastructure modernization is a principal goal, then linkages should be developed with utility operating units.

Human and financial resource constraints also influence the process of structuring the appropriate organization. One major factor to consider is how much property is targeted for privatization. While a small, internal team may be appropriate for quickly selling off a limited stock of public land, it may be more appropriate to invest in the development of a separate external real estate development entity if the agency controls a substantial stock of property. Another factor which may influence institutional options is whether legislative and statutory articles circumscribe a local government's ability to acquire and develop property, to negotiate with the private sector, to use various financing mechanisms, and operate with limited public scrutiny. In cases where such constraints are likely to exert a detrimental effect on privatization activities, cities should structure external programs for implementation.

Most cities' staff lack the expertise to implement land privatization. Can cities then recruit new staff or bring in consultants? Or will civil service hiring requirements, fixed salary ranges, or budget constraints make staffing difficult? It may be easier to recruit staff if the agency is organized outside of the government.

These institutional issues are complex and must be carefully considered when setting up an agency to carry out land privatization. Regardless of its ultimate structure, there are a number of important characteristics that should be included in the implementing institution:

- continuity so that agreements and policies are not disrupted by changing political administrations and staff
- experienced personnel who know the components of real estate marketing and development
- legal authority to dispose of real estate assets through sales and leases
- financial capability to receive grants and loans
- ability to deliver commitments on time with a minimum of bureaucracy
- ability to facilitate inter-governmental and interagency coordination
- flexibility to adapt to changing circumstances and conditions

Step 3: Conduct an Inventory and Assess the Public Properties

A thorough inventory is essential for identifying opportunities, marketing sites, and providing a reference file for outside parties interested in publicly held land (Dale and McLaughlin, 1988). Once privatization goals have been defined and an executing agency put in place, an inventory of public land and property assets should be made. In most cases, considerable effort will be required to prepare an accurate and up-to-date inventory. The inventory should include all public real estate holdings and contain basic site information, including parcel identification, current land use, parcel size, parcel configuration, and access (Carlson and Duffy, 1985). The City of Warsaw, to cite one CEE example, has developed a systematic process for inventorying properties, and it circulates a listing of public properties for sale (Dowall and Mikelsons, 1993; Sendrove, 1992).

Land inventory data can be managed either manually or by computer. A manual system is viable for an entity charged with the management of a small number of parcels. Use of an automated data management system has several advantages; it can handle a larger amount of information in a form that is easy to access and update, and a computer database may be analyzed more quickly, simultaneously determining all sites of a particular size with access to particular forms of transportation (Godschalk et al., 1985). The inventory should be updated periodically to reflect the acquisition or disposal of properties and major changes in the current planned uses of parcels, particularly ones that are declared as surplus.

Using the overall goals and objectives of the land privatization program, an evaluation system should be set up as a series of "screens" that sites must filter through before they are considered for privatization. The series and type of screens will vary depending upon the needs, goals, and objectives of the government. A typical screening system might be constructed as follows:

Stage one: Eliminate perpetual public-use sites. Identify parcels that support a use or uses that for public purposes must remain fixed (for example, City Hall). These sites would be put aside unless they become redundant.

Stage two: Eliminate sites with poor configuration. Develop and apply criteria on the desired length and width of parcels to be considered for development. Using data from the inventory, identify parcels that do not meet the established criteria and drop from consideration.

Stage three: Eliminate sites with poor street access. Criteria should be developed and applied for excluding sites with inadequate access.

Stage four: Eliminate sites with significant environmental constraints. Parcels with poor soils, steep slopes, toxic contamination, and geologic hazards should be dropped from consideration.

The results of the screening process will generate three types of parcels:

1. Vacant, potentially developable sites not required for public use.
2. Under-utilized sites with potential for intensified development.
3. Fully developed sites with no potential for further development.

Sites placed into categories one and two should be evaluated further to assess development potential.

Step 4: Identify High Priority Sites for Privatization

Before sites are chosen for sale or lease, the local government should assess their development potential to determine which sites can be successfully marketed, what the likely sales prices will be, and whether each site's sale will lead to development that will advance overall privatization goals. Market studies need to be conducted to gauge whether sites have development potential. These studies can be generalized to cover an area encompassing a number of potential development sites, or can be more specialized to reflect market conditions at specific sites (Miles, et al., 1990). The studies should include an assessment of the

supply and demand of any and all uses appropriate for the privatized sites, including residential, commercial, and industrial. In some cases, hotels and recreational activities should be considered as well.

Once market studies have been completed, an assessment of the physical development potential of candidate sites should be conducted. The constraints affecting development that should be evaluated include: construction constraints (slope, soils, possible environmental contamination), service availability (access to water, sewerage treatment, electricity, gas, heating) and public policy (zoning, subdivision controls, and building regulations).

After assessing market conditions and considering a site's development constraints, the best use of the site should be determined; that is, the use that, within the constraints of legal limits, will provide the maximum return on investment. The determination should be based on consideration of market conditions, physical constraints, and public regulations that affect probable and legal uses, and it should result in the highest land value (Miles et al., 1991). Analyses of general market conditions and site constraints and determining the best uses for particular sites provide a complete picture of economic potential. Ranking sites for privatization, however, requires more than merely identifying the sites with the highest income potential. Will a site's privatization help achieve the overall program goals of the privatization program? To answer this question requires an evaluation of site potential in terms of meeting previously set goals and objectives. Careful weighing of priorities is crucial when conflicts exist between the economics of development and other objectives.

The efforts of step four should culminate in a ranked or group listing of properties to be privatized. At this stage in the process, the local government will have a fairly good idea of the market for these sites and what range of prices can be expected. The local government must now decide how to proceed with the disposal of properties.

Step 5: Package Sites for Privatization

The decision of how to dispose of the sites directly influences its successful privatization. Should the sites be put on the auction block? Or should they be sold using competitive negotiated sales and requests for proposals?⁴

Because of the high volume of public properties to be privatized in most CEE cities, auctions are likely to be the most effective means of land privatization. Auctions have the advantage of speeding up the process of privatization and have been found to be efficient in terms of generating high sales prices (Quan, 1992). On the other hand, auctions do not provide the local government with any influence over the form of subsequent site development. As long as the buyer conforms to existing zoning and master planning controls, he can build what he wants.

A competitive negotiation process can yield different and in some cases better results. A widely used North American approach is the request for proposal (RFP) process. RFPs ask developers to submit a detailed proposal of how they would develop the to-be-privatized site. The responses are usually very

extensive, including materials on market feasibility, urban design and architecture, and financial performance, as well as a detailed statement of the developer's past experience and qualifications.

There are several advantages of using RFPs over auctions. First, RFPs provide local governments with detailed information about each bidder's approach to site development. By receiving multiple responses, the city has a variety of different proposals to consider, and depending on the overall goals of land privatization, a less-than-highest bid may be the best. The main disadvantage of the RFP process over auctions is that it is time-consuming and expensive. In some cases, developers will not participate in RFP processes unless they believe that they have a decent shot at winning. To attract the best bidders, cities have used a two-stage RFQ (request for qualifications)-RFP process. First, cities invite a wide range of firms to express interest in receiving the RFP and to submit their qualifications. Next, cities review submissions and then invite five or so firms to prepare responses to RFPs. The two-stage process encourages qualified developers to apply, since they are prequalified through the RFQ process prior to expending the resources necessary to prepare a response to the RFP. It also saves staff time and resources, since fewer full proposals are evaluated.

Step 6: Site Disposition

Depending on the choice of method, sites will be either auctioned off or sold through a process of competitive bidding using the RFP process.

Preparing for Auctions

In preparing sites for auction, the city should provide prospective bidders with an information package describing each site: its location; permitted development (zoning); access to infrastructure and streets; physical characteristics, including information about the presence of toxic wastes; bidding procedures; and the minimum qualifying bid (in order to avoid selling sites at far below their economic value and thus having sites under-utilized). Armed with this information, bidders would then assess market conditions, development potential, and prepare bidding strategies. Awarding of sites is straightforward: they go to the highest bidder.

Preparing RFPs

At a minimum, Requests for Proposals should contain the following information:

- background on the project, description of site, market studies, development potential, and the agency's objectives for development
- description of the developer selection process and the criteria that will be used to select the developer
- guidelines for what information the statement of qualifications should contain
- guidelines for financial performance characteristics
- guidelines for describing the proposed project

Evaluating Responses

Normally, a selection team put together by the agency evaluates the proposals in light of established criteria. Depending on the skills and capacity of the agency, the selection team can be composed entirely of staff members or it can include private consultants. The most critical elements of the evaluation criteria include:

- the developer's track record with similar projects
- the developer's responsiveness to the RFP
- the compatibility of the project with surrounding land use
- the phases of development and the construction schedule
- the financial returns to the government
- evidence of the development's feasibility over the short and long run

Once the selection is made, the winner is given an exclusive right to negotiate for a fixed period. Should the local government and the winner fail to agree on terms, the runner-up is invited to negotiate.

The auction or the negotiated sale will culminate the city's process to dispose of surplus public properties. Once the winning bidder takes control of the site, the city should monitor development activity to insure that the new owner is proceeding with development that is in harmony with the city's overall development plans and policies.

The next section of this paper describes a land privatization and housing development program recently designed for Ekaterinburg, Russia.

APPLYING THE LAND PRIVATIZATION STRATEGY TO EKATERINBURG, RUSSIA

In January 1993, U.S.A.I.D. set up an international resident advisors program in Ekaterinburg, Russia. Preparatory missions to Ekaterinburg identified serious housing and infrastructure problems, including a large shortage of housing, widespread housing deterioration, and severe infrastructure constraints. The city's ability to respond to these problems is extremely limited as its main source of financial support, subventions from the central government, is plummeting. To make matters worse, the city's traditional housing delivery system, based on the highly subsidized production of a handful of very large kombinats, is unraveling and housing production is falling.

The major challenge facing policymakers is what to do to overhaul and restart the stalled housing production system. Is it possible to spark the formation of a competitive and efficient private sector housing industry? Initial discussions with city officials in the summer of 1992 indicated interest in a project to create a market-based housing delivery system based on the sale of state-owned land (McCulloch and Levitsky, 1992). U.S.A.I.D. decided to pursue the concept further with the city and authorized the preparation of a study to test the feasibility of initiating a land privatization and housing development project

(Brown, Dowall, and Slingsby, 1993). The remainder of this section describes the process in terms of the six-step strategy outlined above.

Privatization Goals and Objectives

The U.S.A.I.D.-Ekaterinburg project identified five land privatization goals: (1) increase revenues to the city, (2) jump-start the stalled housing production system; (3) promote private-sector housing development; (4) demonstrate the feasibility of small infill housing projects requiring no additional infrastructure; and (5) illustrate benefits of alternative forms of low-rise, high-density housing development. The most effective way of achieving these objectives is to modify the current process of land allocation so that land for residential development is allocated through a competitive bidding process. The pace of reform could be gradual, starting with a dual system of market and administrative land allocation, but eventually shifting to a complete market-driven system for land allocation where all users of land purchase parcels (either fee interest or transferable use rights) in the marketplace. To launch such a market system, small (under one hectare), well-located, and fully equipped sites suitable for housing would be auctioned by competitive bid to prequalified housing developers. Developers would be free to design, build, and sell housing units at market prices, and the developer offering the highest price would be awarded the site and granted rights to develop and sell housing to buyers. (Depending on legal and legislative developments, the site would be either sold as a freehold, or a perpetual-use right would be granted. If the developer receives fee interest in the site, he would subdivide the property and sell housing and land to buyers, utilizing some form of condominium ownership structure. If a perpetual leasehold interest is conveyed, the developer would sell houses with long-term leasehold interests provided to buyers.)

Designated sites would then be packaged for competitive bidding. Each bid package would provide information about the site, market demand, access to infrastructure, land use planning, and zoning requirements (permitted use, floor area ratio, setbacks, and height limits). The bid package would also specify the timing and form of payment of bid, the required timing of project execution, the criteria used to evaluate bids, and a disclosure of the city's right to purchase a percentage of project units at market prices. Bid packages would be advertised nationally and the bidding would be open to all construction and housing development firms registered to operate in Russia.

Launched on a wide scale, private sector land and housing development could revolutionize housing production in Ekaterinburg. Not only would it generate considerable revenues for the city to reinvest in infrastructure or use to assist low- and moderate-income families obtain housing, but it would transform the structure of housing delivery away from mass production high-rise elevator buildings to a wide range of townhouses, single-family units, and low-rise high-density projects. Smaller scale projects would enable developers to better utilize smaller infill sites which already have access to infrastructure. Such infill development would reduce the need for costly greenfield development to support the massive high-rise

mircorayons favored by the kombinats. Even more importantly, the concept would help spawn the growth of small and medium-sized private sector housing developers.

While there is broad consensus for land privatization within the city, there are differences of opinion between the reformers and the old guard. The reformers want to use the land privatization process as a means for fostering a competitive private sector housing industry. The old guard see the need for land allocation reforms, but want to insure that the traditional system of housing production (the kombinats) continue as the main channel of production. While land privatization is acceptable to both factions, there are disagreements about its structure.

Establishing the Privatization Process

Initial discussions with city officials in 1992 and early 1993 indicated that the city council (the city Soviet) wanted to use its newly created Municipal Fund for City Development (MFCD) as the executing agency for land privatization activities. The MFCD had already obtained access to an 80-hectare site in the Isoplit District of Ekaterinburg. Additional meetings with other city departments indicated that there were at least three other possibilities for structuring an executing agency: the City Property Fund; the Office of the Vice Mayor for Development; and the Housing Privatization Office.

Further assessment of these institutions led us to propose that the land privatization initiative be lodged with the Office of the Vice Mayor for Development. Meetings with the staff of the MFCD revealed that they lacked technical expertise in land and housing development. They also have very poor relations with the Vice Mayor for Development and would have extreme difficulty obtaining access to surplus city land. The Office of the Vice Mayor for Development has access to land information records; controls the development approval process; and also manages YKS, the city's largest housing construction kombinat. Politically, only the Vice Mayor for Development can effectively implement the land privatization program. The other units do not have access to land nor can they count on development approval.

While lodging the land privatization program with the office of the Vice Mayor for Development is likely to insure access to state-owned lands for privatization and generate revenues from land sales, it is not likely to result in a process that opens up access to land for the kombinat's competitors, small private-sector real estate developers. In this instance, the institutional and political environment works to constrain the achievement of some but not all land privatization program goals.

Inventory and Assessment of Ekaterinburg's Properties

Our inventory and assessment of potential sites was geared toward the demonstration project. Accordingly, we developed criteria for selecting sites consistent with our project's objectives. The demonstration project should use an attractive and marketable site appropriate for small private sector developers. It should also provide an alternative to the main form of housing delivery in the city and illustrate the potential attractiveness of constructing low-rise, high-density housing on small, fully serviced in-fill sites. A review of real estate sales trends and interviews with real estate brokers indicates that

households are interested in apartments located near the city center in high-quality residential areas close to shopping and community services. Given these location, size, infrastructure, density, and design objectives, the following criteria were used to select a demonstration project site:

Location: within 5 kilometers of the city center

Size of site: less than one hectare

Infrastructure: all services provided to site

Number of units: 50 to 60 dwelling units

Design: low-rise, three story townhouse units

During late February, approximately 15 sites were examined, and three met all of the above criteria. Since then, additional sites which meet the criteria have been identified as well.

Next, a market survey of housing demand and supply was conducted. There is an emerging market for both recently privatized flats and newly constructed cottages. Given a certain price parameter (between Rub 98,000 and Rub 107,000 per square meter) and current patterns of household income, the annual demand for private sector housing in Ekaterinburg is estimated to range from 500 to 1,000 dwelling units. Based on our assessment of market demand, the Ekaterinburg land market could support the sale of between 10 and 20 sites, totaling 7.5 to 15 hectares, per year. Based on the market study and our assessment of potential sites, we next developed a demonstration project.

The Demonstration Project as a Prototype High-Priority Site

To further test the feasibility of small-scale infill housing projects, the market and financial feasibility of a hypothetical townhouse project was tested. After deciding on the overall development concept, the Sverdlovsk Architectural Institute was retained to prepare a development scheme for a hypothetical site of 0.75 hectares (100 by 75 meters). Based on urban planning and design standards, the site permits the development of 45 units, ranging from two- to five-room townhouses, grouped into five buildings (see Figure 1). Table 1 provides a description of the proposed development program. Table 2 provides a detailed breakdown of space allocation.

Based on the conceptual plans for the project, project construction costs were estimated. Itemized construction costs are shown in Table 3, and reflect February 1993 prices. The total project cost is Rub 273,964,000, an average of approximately Rub 54,000 per square meter of total constructed area, including site preparation, on-site infrastructure, overhead, and profit. We assume that the developer would bid the construction on a fixed-price basis.

The proposed project offers an attractive alternative to the current pattern of housing offered for sale in Ekaterinburg. At the present time, buyers can purchase privatized flats in existing buildings, which range in price from Rub 2,000,000 to over Rub 10,000,000. Wealthier households can purchase cottages in suburban locations for prices ranging from Rub 15,000,000 to Rub 30,000,000. The proposed townhouse project offers new, good quality, low-rise units, which are in centrally located neighborhoods close to shopping, community services, and transportation. The project design, illustrated in Figures 2 and 3, provides spacious and well-planned units. Thirty-nine of 45 units have private courtyards, and two- and four-unit

SITE PLAN M 1:500
 GROSS AREA - 0.75 HA



- EXPLICATION
- 1. 5 ROOM UNIT
 - 2. 4 ROOM UNIT
 - 3. 3 ROOM UNIT
 - 4. 2 ROOM UNIT
 - 5. CHILDREN PLAYGROUND

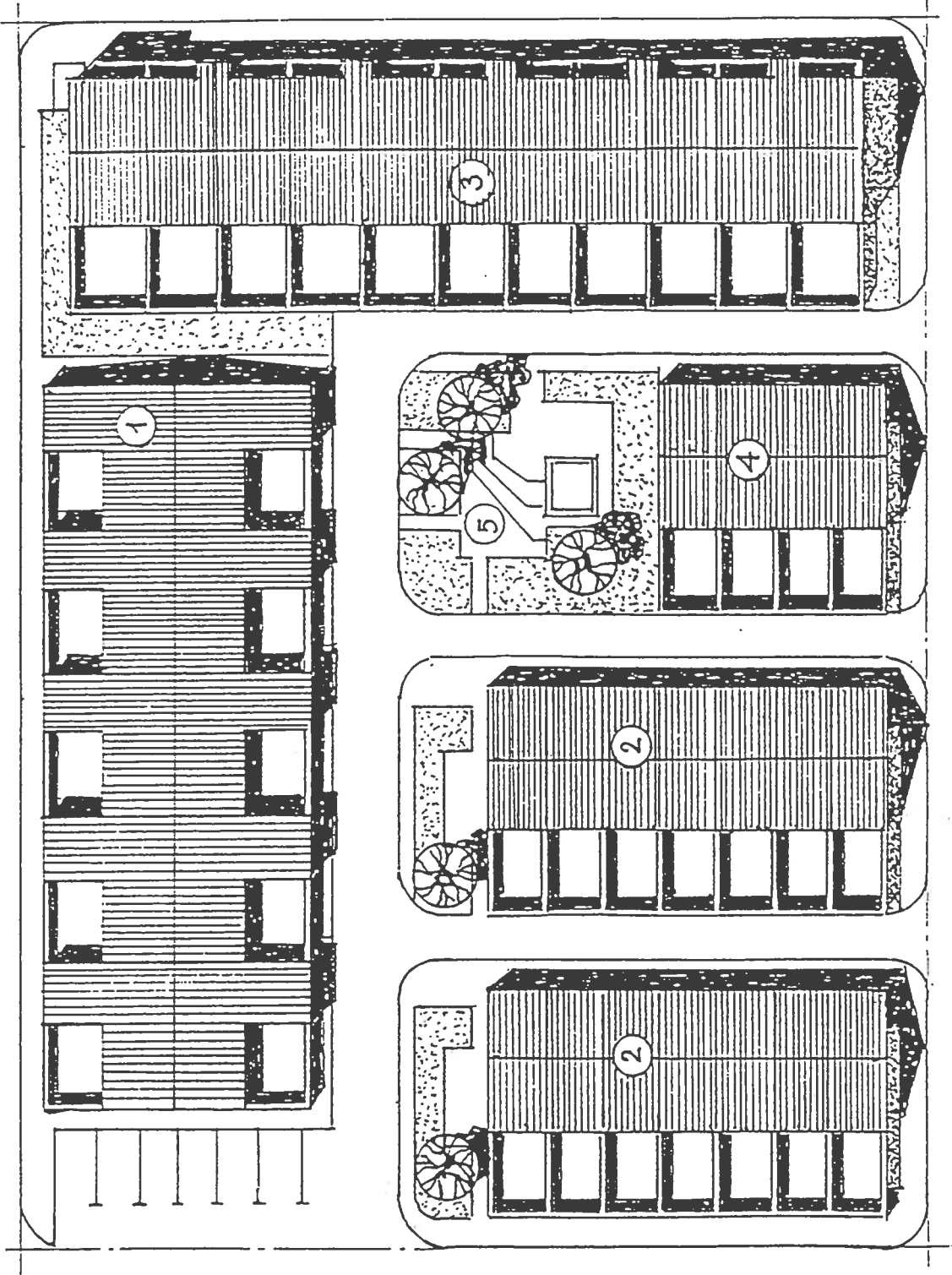


Figure 1

Table 1
Ekaterinburg Demonstration Project Development Program

<u>Characteristic</u>	
Site Area (m2)	7,500
Site Coverage including courtyards (%)	44.5
Site Coverage Including courtyards (m2)	3,338
Site Coverage excluding courtyards (%)	29.5
Site Coverage excluding courtyards (m2)	2,215
Courtyard space (m2)	1,123
Paved on-site roads (m2)	2,100
Stories	2-3
Total Constructed area (m2)	5,035
Floor Area Ratio (%)	1:67
Gross Living Area (m2)	4,967
Internal circulation (m2)	68
Two-room units total (units)	5
Two-room unit average gross area (m2)	73
Three-room units total (units)	16
Three-room unit average gross area (m2)	96
Four-room units total (units)	14
Four-room unit average gross area (m2)	119
Five-room units total (units)	10
Five-room unit average gross area (m2)	140
Garages (unit)	19
Garages average gross area (m2)	17.5

Source: Brown, Dowall, and Slingsby, 1993.

townhouses have enclosed garages. On the basis of current prices of privatized flats and new suburban cottages, we estimate that demonstration project townhouses could be priced between Rub 7,300,000 and Rub 11,900,000. At these prices, the project offers high-quality design and ample space for 30 to 80 percent of the cost of a suburban cottage. Therefore, we believe that the proposed project will be extremely competitive with both privatized flats and expensive suburban cottages. If townhouse prices are achieved, the project would generate total sales revenues of Rub 451,360,000; this is an average of Rub 10,030,222 per unit, or Rub 90,853 per square meter.

In market economies, developers bid for land on which to build housing projects. The developer who makes the highest bid is the one who will receive access to the site. The amount that a housing developer can bid for a site depends on four factors: what type and how many housing units can be constructed on the site; building costs; potential selling price; and how much profit the developer wants to earn. These four factors can be estimated and used to calculate a residual land value, the difference between:

Total sales revenues
- construction cost
- profit
Land value

Table 2
Ekaterinburg Demonstration Project
Detailed Space Allocation by Type of Unit

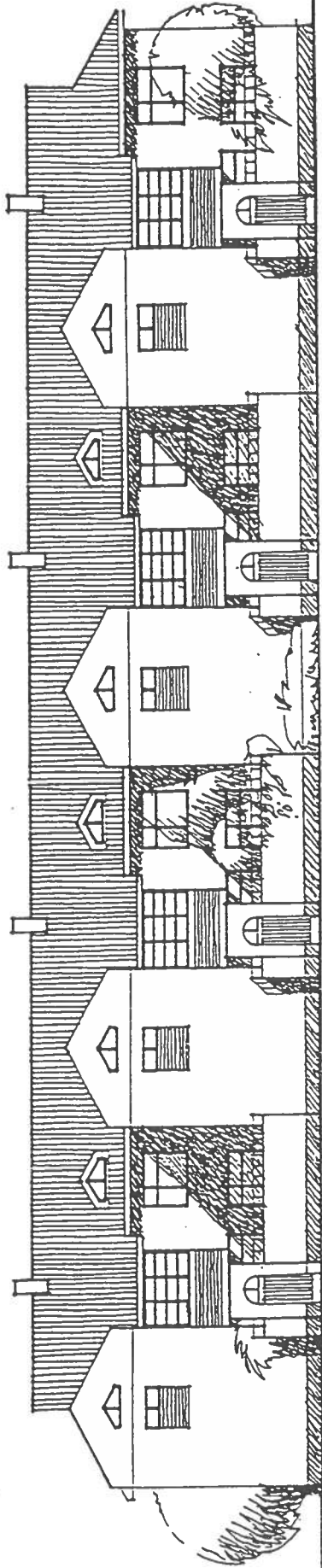
<u>Room</u>	<u>Room Size (m2) by Unit Type</u>			
	<u>2-Room</u>	<u>3-Room</u>	<u>4-Room</u>	<u>5-Room</u>
Room 1	20	20	25	25
Room 2	18	20	20	20
Room 3		15.8	17.6	16
Room 4		16	15.2	
Room 5			14	
Kitchen	12.9	12	14.7	13
Bath	5.7	4.8	5	5
Toilet	1.6	2	1.4	2
Internal Circulation	14.8	21.4	19	29.8
Gross Area	73	96	119	140
Garage	17.5		17.5	

Source: Brown, Dowall, and Slingsby, 1993.

Table 3
Ekaterinburg Demonstration Project
Development Cost, February 1993

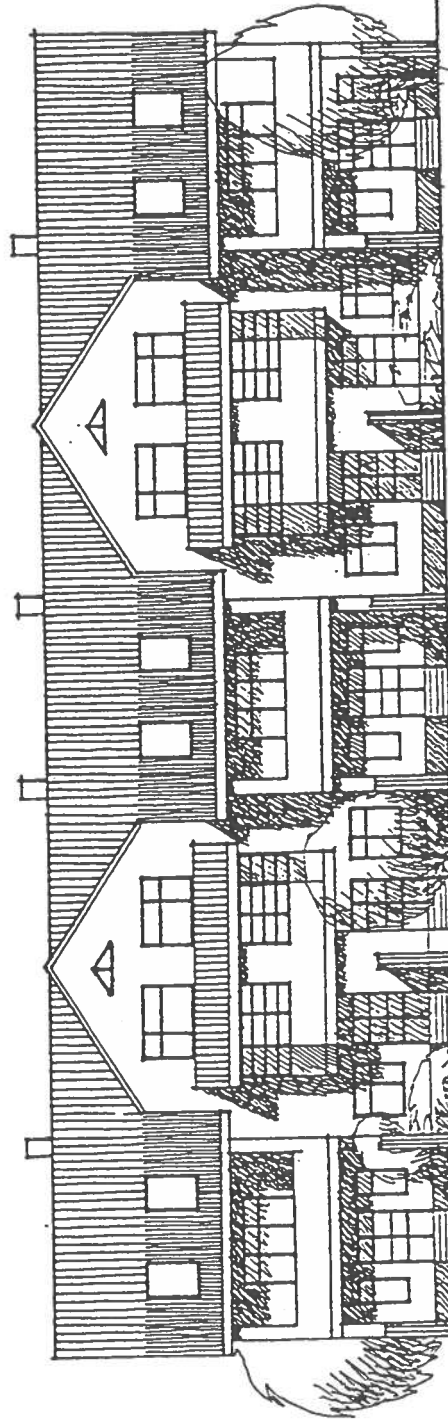
<u>Cost Component</u>	<u>Rubles</u>	
<i>On-Site Infrastructure and Site Work</i>		
Heating	10,600,000	
Sewers	1,100,000	
Water	1,400,000	
Electricity	350,000	
Communications	550,000	
Grading, Roads, and Landscaping	<u>1,600,000</u>	
Total Infrastructure and Site Work		15,600,000
<i>Building Cost</i>		
Foundation	5,078,000	
Walls	24,090,000	
Windows and Doors	20,724,000	
Ceilings	8,318,000	
Roof	11,720,000	
Finishes	33,021,000	
Labor and Contractor Overhead (40%)	<u>41,181,000</u>	
Total Building Costs		144,132,000
Total Infrastructure, Site Work, and Building Costs		159,732,000
Contingencies (15% of costs)	23,960,000	
Profit (20% of Total Sales Revenue) (see Table 2)	90,272,000	
TOTAL CONSTRUCTION COST		273,964,000
TOTAL COST PER SQ. M. (5,035 sq.m.)		54,412

Source: Brown, Dowall, and Slingsby, 1993.



5 ROOM UNIT BLOCK

STREET FACADE



4 ROOM UNIT BLOCK

SOUTHERN FACADE

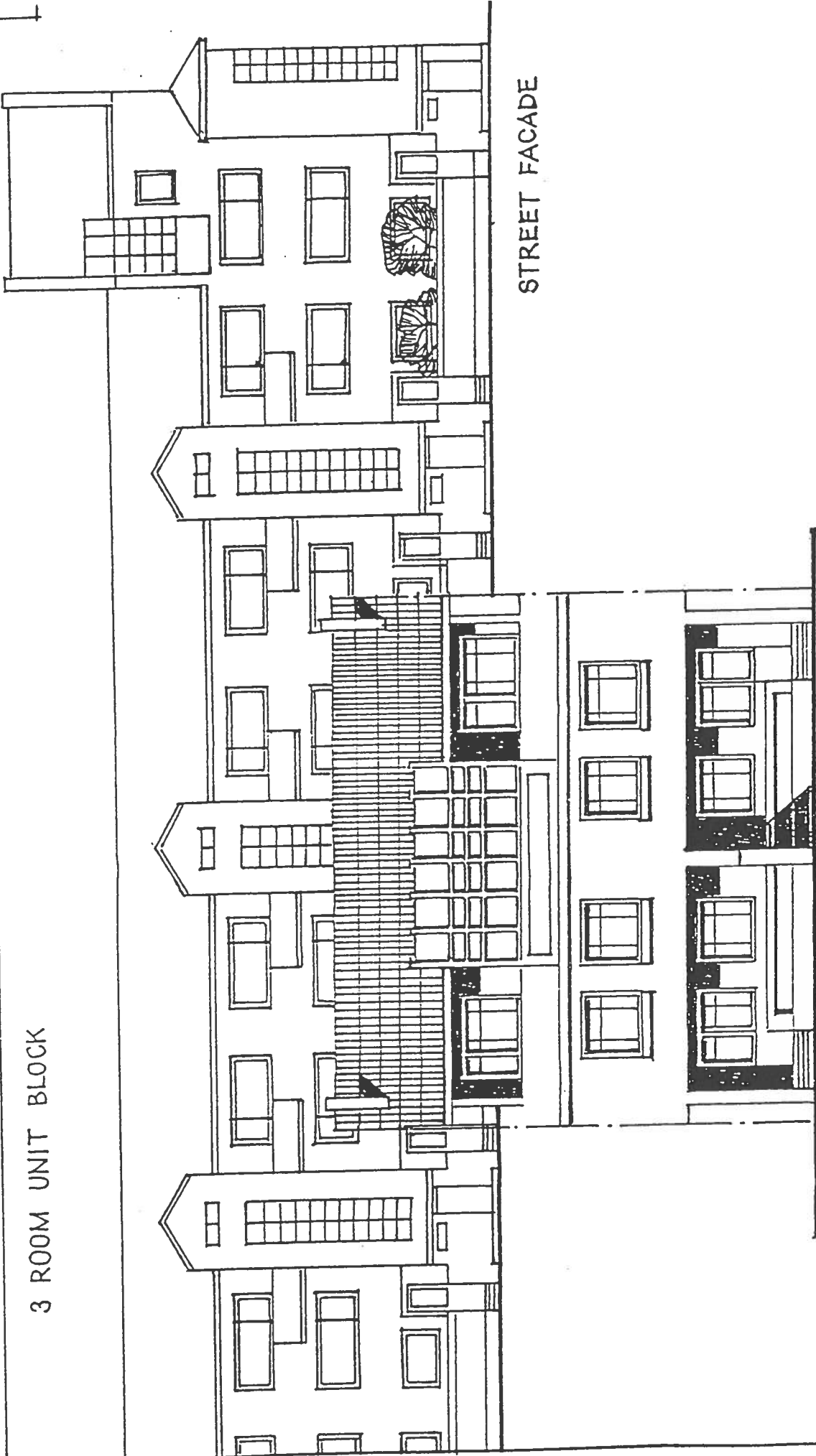
Figure 2

3 ROOM UNIT BLOCK

STREET FACADE

FRAGMENT OF THE BACK FACADE

Figure 3



Using the residual land value method, Table 4 presents an estimate of a potential land value of the demonstration project site of 7,500 square meters. The resulting land value is Rub 177,396,000, approximately Rub 23,700 per square meter.

Table 4
Ekaterinburg Demonstration Project
Estimated Developer Land Bid,
Based on Residual Land Value Method, February 1993

	<u>Rubles</u>
Total Gross Sales Revenues from Project	451,360,000
Total Construction Cost	183,692,000
Total Gross Developer Profit	90,272,000
Residual Land Value	177,396,000
Residual Land Value per square meter	23,700

Source: Brown, Dowall and Slingsby, 1993.

If the demonstration project is developed and sold as described above, both the city and the developer will receive significant financial benefits. First and foremost, the city stands to receive nearly Rub 180,000,000 from the competitive bidding for the land. If the winning developer made the bid estimated in Table 4, he would receive a 20 percent gross profit on total housing sales. In addition, he would receive payment for his time, labor, and management (this is reflected in the construction cost estimates). The project is extremely profitable in terms of the developer's return on equity invested. If we assume that the developer pre-sells all units before starting construction and that the buyers make payments to cover the cost of actual construction, the developer's equity contribution would be limited to the purchase of the land. If the developer pays Rub 177,396,000 for the site and earns a gross profit on the project of Rub 90,272,000, his return will be 50 percent. If the developer structures the pre-sales so that he only has to put Rub 100,000,000 into the project (the other portion of the land purchase comes from pre-sales), his return on investment will increase to 90 percent. While these profit rates are high, they reflect the novelty of the market. Over time as the market matures and developers gain experience, profit rates will fall.

The demonstration project described in this section appears to be economically and financially feasible. The success of the project will depend on picking a site, making it available for purchase through a competitive bidding process, ensuring that a sufficient number of firms bid on the project (at least 5), and that the winning bidder can pre-sell units to buyers. Throughout the analysis, we assume that the developer will index prices for inflation and that purchasers will agree to absorb inflationary costs; if the developer successfully negotiates fixed-price construction contracts, escalations may be minimal.

Packaging a Site for Privatization

To date, a specific site has not been successfully packaged for privatization. Recently, however, U.S.A.I.D. proposed including Ekaterinburg in its Military Housing Assistance Program. If Ekaterinburg would agree to privatize a site and have it auctioned to private developers who would build housing for returning Russian military, U.S.A.I.D. would agree to finance the project. Despite the fact that the city picked a site and initially agreed to participate in the project, it has recently declined to participate in the project, and negotiations between the city and U.S.A.I.D. broke down. The city insisted that it wanted YKS, the city-controlled kombinat, to construct the housing. U.S.A.I.D. rejected this proposal, stating that since it is interested in promoting private sector housing development, it wanted the housing project built by private firms. Currently, the U.S.A.I.D. resident advisor in Ekaterinburg is working with the city to continue developing the land privatization program, and for the time being is agreeing to work with the city and both public and private housing developers.

The Fate of Land Privatization in Ekaterinburg

In the best of all possible worlds, land privatization should foster private sector housing development. When impediments such as the one in Ekaterinburg develop, the process of land privatization should be slowed down. Initially, perhaps only 10 or 20 percent of the annual demand for land for residential development should be auctioned to the private sector. Then, over time, the portion can be increased until the "playing field" between the private sector and the kombinats is level. This gradual process will slowly impose market discipline on the kombinats as consumers start to demand a variety of well-built and competitively priced housing products.

IV. CONCLUSIONS

CEE cities are gradually starting to implement land privatization. For most, especially those in Central Europe, the process will proceed quickly and a few mistakes will be made, such as selling assets too low, or allowing inappropriate development on key sites. Cities across the region are beginning to develop and follow models of land privatization similar to the one outlined here (see for example Buczek, 1992). In other cities, where there is a less developed real estate industry and a greater reliance on public housing delivery, the process of land privatization will be much more gradual. It is unlikely that these cities will structure their land privatization programs in ways which undermine their public housing companies. In such cases, reform efforts should encourage cities to privatize land and help them set market prices for sites. Less attention should center on trying to use privatization as a way of promoting private sector development. Instead, a collateral program of technical assistance to encourage the privatization of kombinats should be encouraged. Here the Chinese model of promoting limited competition between land and housing development corporations might be considered as a possible model (Dowall, 1993).

NOTES

¹For an overview of the literature on housing privatization see: G. Thomas Kingsley and Jeffrey P. Telgarsky (1992); James R. Alm and Robert Buckley (1992); Harold M. Katsura and Raymond J. Struyk (1991); and G. Thomas Kingsley and Raymond J. Struyk (1992).

²There are numerous examples, especially in Asia, where cities have financed major infrastructure projects by providing developers with land. Hopewell's rail system in Bangkok is one example, another is Ho Chi Minh City's current proposal to trade land rights for infrastructure.

³The privatization of municipal real estate became widespread in the 1980s. For a review of useful studies see: Association of Bay Area Governments (1981); Atlanta Regional Commission, (1974); Brett, (1983); Carlson and Duffy (1985); Cole, (1983); Deane and Hankla, (1985); Dowall (1987); Gordon, (1985); Lerable and White, (1986); and Starr and Schloss, (1979). More recently, with the U.S. savings and loan crisis, the Resolution Trust Corporation is in the position of having to sell thousands of properties and is struggling with many of the same land privatization issues faced in transition countries. On this point see Quan, 1992.

⁴At this point it is important to stress that in almost all cases local governments should not attempt to pre-design projects and sites into packages. The track record of government efforts to pick "winners" is poor. It is better to let those at risk — the buyers — determine project design. Furthermore, preparing project designs is time-consuming and costly; local governments would be better off concentrating on targeting sites for privatization and letting the private sector work out design and marketing plans. CEE local governments have no experience in designing market-oriented demand-driven projects. In some cases, the private sector should be provided with technical assistance to assess market conditions and prepare bids.

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