

Artículo de investigación

## Housing legislation modernization and development of effective financial model of apartment building management in modern Russia

О Модернизации Жилищного Законодательства И Построении Эффективных Финансовых Моделей Управления Многоквартирными Домами В Современной России

Legislación de viviendas modernización y desarrollo de un modelo financiero efectivo de gestión de edificios de apartamentos en la Rusia moderna

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### Abstract

The article substantiates a set of proposals for amending housing legislation aimed at building effective financial models of various ways to manage apartment buildings in modern Russia. The implementation of the proposals will allow the creation of financially sustainable management organizations in the housing and utilities sector, who receive their remuneration in legal form and are interested in the results of their financial and economic activities. The study was carried out with the financial support of the Russian Foundation for Basic Research in the framework of the research project No. 18-010-00090 "Study of the financial and economic aspects of the activities of management companies in the housing and utilities sector and the development of proposals to improve their financial sustainability."

**Key Words:** Management of an apartment building, management company, direct management, housing services, housing payments, financial model, settlement relations.

### Аннотация

В статье обосновывается комплекс предложений по изменению жилищного законодательства, направленного на построение эффективных финансовых моделей различных способов управления многоквартирными домами в современной России. Реализация предложений позволит создать финансово устойчивые управляющие организации сферы ЖКХ, получающие свое вознаграждение в легальной форме и заинтересованные в результатах своей финансово-хозяйственной деятельности. Исследование выполнено при финансовой поддержке Российского фонда фундаментальных исследований в рамках научного проекта № 18-010-00090 «Исследование финансово-экономических аспектов деятельности управляющих компаний в сфере ЖКХ и разработка предложений по повышению их финансовой устойчивости».

**Ключевые слова:** управление многоквартирным домом, управляющая компания, непосредственное управление, жилищные услуги, жилищные платежи, финансовая модель, расчетные отношения.

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## Resumen

El artículo respalda un conjunto de propuestas para enmendar la legislación de vivienda con el objetivo de construir modelos financieros efectivos de varias maneras de administrar edificios de apartamentos en la Rusia moderna. La implementación de las propuestas permitirá la creación de organizaciones de gestión financieramente sostenibles en el sector de vivienda y servicios públicos, que reciben su remuneración en forma legal y están interesados en los resultados de sus actividades financieras y económicas. El estudio se realizó con el apoyo financiero de la Fundación Rusa para la Investigación Básica en el marco del proyecto de investigación N° 18-010-00090 "Estudio de los aspectos financieros y económicos de las actividades de las empresas de gestión en el sector de la vivienda y los servicios públicos. y el desarrollo de propuestas para mejorar su sostenibilidad financiera".

**Palabras clave:** Gestión de un edificio de apartamentos, empresa de gestión, gestión directa, servicios de vivienda, pagos de vivienda, modelo financiero, relaciones de liquidación.

## Introduction

According to the Housing Code of the Russian Federation, there are three possible ways to manage an apartment building in Russia, - management companies, associations of homeowners or housing cooperatives and direct management by house owners (The Housing Code of the Russian Federation, 2004). This determines its specificity in external and internal financial relations and approach organization for a financial model development of different management methods.

In the framework of the scientific project of the Russian Foundation for Basic Research, the authors identified and analyzed the problems of economic activity of the managing organizations in the housing sector, revealed their massive financial instability, which leads to inefficiencies in the activities of these organizations and their short life on the market (Sukharev et al., 2018a). This indicates the problems of the economic mechanism and the system of financial relations in managing organizations (Sukharev et al., 2018b; Tkhorkov et al, 2018).

Housing and utility management organizations in Russia are usually unprofitable, and every third of them has a negative amount of equity. All this does not ensure strong incentives for such organizations for quality housing service provision, and profit generation is carried out in an illegal form (Burova & Panichkina, 2018; Kachalov & Kvitova, 2017; Panichkina & Burova, 2018).

In this regard, the task is to modernize financial legislation in the field of apartment building management in the Russian Federation on the basis of a regulatory framework ("legal foundation") development, which allows to

create cost-effective financial models for the activities of such organizations.

### Features of management company financial model development in the field of housing and communal services

The financial model of housing and utility management companies should include:

- The development and maintenance of a sufficient amount of equity. Moreover, it is advisable that equity should be in the form of share capital. The organization must maintain the value of net assets not less than the amount of the authorized capital. If the management company decreases its capital adequacy to a level less than permissible, the State Housing Inspectorate should have an appropriate norm for revoking license from such an organization providing the right to manage apartment buildings. If the capital amount is adjusted, the organization could obtain such a license again. The mechanism for revoking a license should serve as a kind of restriction for the accumulation of debts by the management company, leading it in the future to bankruptcy and loss of solvency, as is usually the case in modern Russia. The mechanism should include:
  - A clear division of the tariff rate on the mandatory elements (for cleaning entrances, cleaning the local area, passport office maintenance, etc.);
  - A clear mechanism for the redistribution of funds between approved cost items;

- A fixed part of the management company remuneration, which serves to cover the total costs of the management company maintenance (salaries of the management staff, rental of premises, etc.), writing off bad debts and making a profit;
- Recount of funds in case of provided housing service incompleteness;
- Introduction of the cumulative part in the tariff in order to finance current repair and landscaping;
- Effective financial control of the management company by the owners of the apartment building, banks and the state (represented by the State Housing Inspectorate).

In order to increase financial control, provision should be made for the submission of the following two financial statements to management companies:

- Monthly financial report;
- Annual financial report.

The monthly financial report must include the costs incurred by elements (in value and in kind) and presented in the utility bills issued by the management company (for example, on the back of the receipt). This will allow the owners of an apartment building to carry out operational control of spent money.

A legislatively established procedure should be developed for the consideration and approval of the annual financial report of the management company. At the end of the calendar year, the management company must submit a detailed annual financial report to each owner of the premises in the apartment building. The house council must consider this report at its meeting and draw up a reasoned opinion on the advisability of its approval or denial at the general meeting of the house. At the general meeting of the house, the annual financial report should be reviewed and approved or denied by the owners of the premises.

If the annual financial report is not approved, the chairman of the general meeting of owners of the apartment building premises must send a reasoned opinion on the reasons for the report denial to the management company.

It would be advisable to fix the procedure for the issue resolution legislatively related to the refusal of the property owners to approve the annual report. For example, it could be prescribed in the

Housing Code of the Russian Federation that in case of non-approval of the annual financial report it should be sent to the State Housing Inspectorate for verification. If it does not reveal financial irregularities, the annual financial report will be considered as approved by the State Housing Inspectorate. Otherwise, the management company will have to amend the annual financial report in order to bring it into line with the actual expenses incurred.

In order to increase the responsibility of management companies for a reasoned annual financial report provision, a sanction should be introduced for non-approval of the annual financial report (for example, in the amount of 5% of housing payments calculated for the year in favor of the owners of the apartment building premises). The introduction of such a sanction is advisable from the point of view of the financial risks arising for the management company concerning unreasonable inclusion of expenses in the annual financial report.

A provision should be introduced into the Housing Code of the Russian Federation that the funds received by the housing management company constitute the property of the owners of the apartment building and should not be included in the bankruptcy estate upon the management company bankruptcy. For these purposes, within the framework of one management company, it is necessary to distinguish the movement of funds of each of the apartment buildings that are serviced by the management company. It seems correct for each apartment building to open a settlement account in a credit institution. Housing payments must be received on this account and funds must be spent from it. Such a separation of funds (in the asset of the managing organization balance sheet) will increase the degree of financial control over the movement of funds of each apartment building and make it more difficult for managers and owners of the management company to withdraw assets from it (in fact, to make theft of funds).

### **Features of HOA and housing cooperative financial model development**

Homeowners associations and housing cooperatives are the collective forms of an apartment building management which are based on the fact that the owners of the house premises organize their management through the formation of the relevant governing bodies - the board. This form of management requires the creation of a legal entity by the premise owners. The Civil Code of the Russian Federation and the

Housing Code of the Russian Federation allow them to make a choice between HOA and housing cooperative. According to the Civil Code of the Russian Federation, HOA is the legal form of a partnership of real estate owners, and a housing cooperative is a type of consumer cooperatives (Civil Code of the Russian Federation, 1994). Homeowners associations and consumer cooperatives are non-profit corporate organizations.

Cooperatives, unlike HOAs, provide for the development of a mutual fund, and each member of the cooperative is given one vote, regardless of the premise area in the house. On the contrary, in the HOA the number of votes of the owner is proportional to the area of his premises. Another important difference is that the members of a cooperative must jointly and severally bear subsidiary liability for the obligations of the cooperative (in terms of the share of each member of the cooperative), while there is no such obligation in the HOA (its members are responsible for the obligations of the partnership). It is also interesting to note that cooperatives can distribute the profits among its members, but this is not established in the HOA, although in practice housing cooperatives and HOAs do not have a profit, and if they do, they direct it to the house maintenance and servicing.

The presence of a mutual fund allows the members of the cooperative to form such a volume that will be sufficient to finance working capital generated for the implementation of uninterrupted activities for home maintenance. The HOA does not have such funds, but such funds can be formed when such a norm is established in the charter (for example, due to entrance fees).

In HOAs and housing cooperatives, funds received for the maintenance of the house are not accounted for as income (as is the case with management companies), but as earmarked income (or membership fees). The revenues for servicing the house from the house owners who did not become the members of the HOA or housing cooperative are the income of the partnership. Thus, the financial nature of housing payments by the members of the HOA or housing cooperative does not appear as the organization income, but as targeted income. This means that they, while not forming the organization income, do not generate profit at the same time, and accordingly, income tax is not required. However, the HOA or housing cooperative may receive a profit (loss) from other operations or

from premise owner funds that are not the owners of the premises in the house.

The amount of housing payments in the HOA and housing cooperatives largely depends on the area of the premises in the house: the larger this area, the lower the cost of maintaining the governing body and accountant will be per square meter of such premises. Since the HOA and the housing cooperative are not aimed at making a profit during housing payment determination, the amount of profit should not be determined. Management companies, being commercial organizations, pursue their goal of making a profit (either explicitly or implicitly).

The financial model of HOA and housing cooperatives should include the following structural elements:

- A sufficient amount of the organization own funds (a mutual fund for housing cooperatives; the amount of partnership member contribution for HOAs);
- The amount of contributions for the apartment building maintenance and servicing;
- The establishment of remuneration (basic and incentive) for the organization governing body;
- The method of calculating and paying expenses for general household needs (CU);
- Organization of a system of cash settlements, including the mechanism for calculation, accounting and housing payments;
- Financial control over the expenditure of funds;
- Financial sanctions for non-payment of housing payments;
- The system of financial relations between these organizations and the owners of premises who are not the members of the HOA or housing cooperative.

We will dwell in some detail on the last element - the financial relationship between the owners of premises in an apartment building who do not wish to become the members of the HOA or the housing cooperative.

To create a HOA it is necessary that its members become the owners who own at least 50% of the square meters of premises in the house, and during a housing cooperative creation it is necessary that it has at least 5 members. One HOA, or one housing cooperative can be created

in one apartment building. During a HOA or a housing cooperative creation, the management and maintenance functions in the house are transferred to the organization, and the previously created council of the house resigns.

The creation of an HOA or a housing cooperative in an apartment building leads to the separation of the premise owners into members and non-members of the managing organization. Accordingly, the members of organizations gain more authority in the field of home management, including the right to be elected to the board and become its chairman. Accordingly, the members of organizations gain more authority in the field of home management, including the right to be elected to the board and become its chairman. "Additional" rights of members are determined by the need to manage not only the apartment building, but also the management of the managing organization itself. The non-members of the managing organization still have the right to participate in the general meetings of the apartment building.

The division of the premise owners in the apartment building gives rise to the problem of financial relations between non-members and the managing organization. Will members of the organization incur increased costs due to the need to maintain a legal entity or will they be able to receive some additional costs?

The members of the HOA or housing cooperative must pay an entry fee. In addition, the members of a housing cooperative pay a share fee, which forms a mutual fund. Payments for servicing an apartment building for the HOA members or a housing cooperative take the form of membership fees, and housing payment for non-members. Membership fees do not constitute the organization income and therefore do not form its financial result (profit or loss). On the contrary, housing payments are considered as the organization income.

Potentially HOA (housing cooperative) can make a profit, but it is not the goal of the organization and is not subject to distribution among its participants (members). Profit can be obtained by renting property (premises, space for an antenna or telecommunication network installation, etc.). The profit of the HOA (housing cooperative) will be considered to be received from the property of the apartment building, and therefore should be spent on the maintenance of this apartment building.

The non-members of the HOA (housing cooperative) should not receive benefits and be discriminated in respect of the organization members. This means that the amount of housing payments paid by them per square meter of premises should be equal to the contributions of the HOA (housing cooperative) members paid by them for the maintenance and management of an apartment building. The costs of maintaining the management apparatus of the HOA (housing cooperative) are the costs of an apartment building management and are to be included in housing payments.

However, the financial relationship between the owners of premises that have not become the members of the HOA (housing cooperative) gives rise to the following problems with the HOA (housing cooperative):

- The feasibility of attributing certain expenses of the managing organization to the reimbursement of non-members of the organization in the form of housing payments;
- A decision-making mechanism on the expenditure of funds received from the common property of an apartment building (only by the members of the organization or all owners of the apartment building);
- Distribution of property of the liquidated management organization between its members or in general between all owners of the apartment building premises, etc.

So, for example, ¿should the penalty imposed on the organization be taken into account in the structure of housing payments for non-members of the HOA (housing cooperative)? If not, then it should be reimbursed by increased current or additional contributions of the HOA (housing cooperative) members. In this case, the members of the organization will be in less favorable conditions as compared to the owners who have not become the organization members. On the one hand, getting a fine is the fault of the managing organization, and, on the other hand, it is the result of normal (ordinary) economic activity, which obtains financial sanctions in the housing sector.

The Housing Code of the Russian Federation should introduce the rules governing legal, financial and economic relations between property owners who have not become the members of HOA (housing cooperative) with HOA (housing cooperative).

### **Features of financial model development for the direct management of an apartment building**

During direct management of an apartment building, the owners of the premises in it do not choose a management company, nor do they create a housing cooperative or partnership in it. The house is managed by the owners of the premises without creating a legal entity. The houses with 30 apartments at most can switch to such a control system.

The Housing Code of the Russian Federation does not contain prescriptions that allow the formation of a financial model of direct management. In accordance with the Housing Code, the owners of premises in an apartment building must switch to direct settlements with resource-supplying organizations and arrange a way to conclude contracts for servicing the common property of the house.

In this case, two options are possible:

- 1) The owners of the premises authorize a person who will conclude contracts on their behalf or carry out other business activities (delegation of authority) at the general meeting. In this case, a written power of attorney from the owners of the premises (or their majority) shall be issued for such a person;
- 2) Conclusion of contracts at the same time by all owners of premises (or their majority). This method is practically not used, since it is difficult to implement in practice.

In the conditions of direct control, tenants, as a rule, clean the entrances and the local area themselves, and if necessary, carry out repairs or other works, collect targeted contributions for this. When hiring a cleaner or janitor, they usually pay wages directly, without personal income tax and social security contributions. Employees are hired primarily without formalization.

Direct management can significantly reduce the cost of maintaining and servicing an apartment building due to the following factors:

- There is no need to bear the costs of maintaining administrative staff, renting premises and the costs of a legal entity operation;

- There is no need to pay taxes and payments (PIT, etc.) for social purposes;
- It is not required to include profit making in the tariff (as for management companies whose purpose is to make profit).

The difficulty of switching to direct management today is the ambiguity of the financial model of this form of apartment building management. As you know, the financial model is built on the basis of legal norms that create the corresponding requirements and restrictions. The Housing Code of the Russian Federation does not contain such provisions, which causes questions and misunderstanding among residents when the house is transferred to direct control. Usually these issues are devoted to the procedure of housing payment collection, the procedure for cash balance storage, the need to pay taxes and other payments, the procedure and the very possibility of concluding labor and other civil law contracts necessary for an apartment building servicing.

According to the authors, the Housing Code of the Russian Federation should provide for the possibility of the choice concerning the premises of various legal structures by the owners for direct management (free and regulated).

Free direct management is the legal construction of direct management that currently exists under the Housing Code, while regulated construction prescribes certain implementation procedures. The regulated direct management may turn out to be more understandable to the owners of the premises due to the formation and refinement of financial and economic mechanisms.

It would be advisable to give the State Housing Inspectorate the status of a regional operator to maintain the settlement account of an apartment building and provide settlement receipts to the owners of the house premises, similar to what is happening today in the field of major repairs of apartment buildings. The owners of premises in an apartment building should be given the right to choose the transition to the services of a regional operator or to perform the functions of housing payment operation, issuing receipts and collected funds keeping. When switching to the settlement from a regional operator you will need to incur additional costs, the amount of which, based on the work of the regional operator in the field of capital repairs, will be 1 ruble per square meter per month.

The advantage of switching to settlement services with a regional operator is the following:

- Saving of internal (labor, financial) resources for settlement services and receipt issuance;
- Organization of settlement relations in an apartment building in the absence of active citizens;
- Prevention of fund theft of from the owners of premises who are authorized to collect housing payments.

In addition to the settlement service function, the regional operator must take measures to fully pay housing payments by the owners of the premises of the apartment building, which means submitting court orders and speaking on behalf of all the owners of the premises in court. The legal expenses of the regional operator should be covered at the expense of the tariff approved by the subject of the Federation to the regional operator, as well as reimbursement of these costs on the basis of a court decision in favor of the regional operator.

The offer of various options for the direct management of an apartment building organization to the residents is important. Based on the characteristics of each apartment building, the mentality of its inhabitants, the presence of active citizens in the house and the degree of trust and mutual understanding between citizens, it is possible to choose one or another model of direct management and monetary settlements. In some cases, the choice will be made in favor of a regulated model, and in others - in favor of a free system.

Given the prospect of direct management of an apartment building, the restriction on the maximum number of apartments in the house in which it can be implemented should be removed at all. Previously, there was the restriction of 16 apartments at most in the Housing Code, and then it was increased to 30.

### Conclusion

Improving the quality of housing and communal services should be implemented on the basis of financial interest and financial responsibility, they are the core of an effective financial and economic model of management organizations in the housing sector.

The following conceptual trends can be identified for the development of legislation in

the field of managing apartment buildings in Russia.

The first trend is the strengthening of financial control over the movement of housing payments to management companies, including their reasonable spending and the formation of carry-over balances for the next calendar (financial) year.

Secondly, the degree of housing legislation concretization increase governing the legal framework for apartment building management and the activities of management companies. The "legal vacuum" does not allow to find the answers to the questions in the field of managing apartment building within the legislation, which can lead to abuse by management organizations.

Thirdly, it is necessary to determine legislatively the system of financial relations between members and non-members of Housing Companies (housing cooperatives) in order to resolve property problems in servicing an apartment building when a collective form of management is selected.

Fourth, it is necessary to provide for the introduction of a regional operator institution for the direct form of management of an apartment building, with the assignment of this function to the State Housing Inspectorate.

The implementation of the proposals will create financially stable managing organizations in the housing sector, receiving their legal remuneration and interested in the results of their financial and economic activities.

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