

LT in Focus

Revolution in residential construction: developers obligated to switch to escrow accounts

Federal Law No. [175-FZ](#) (the Law), which changes the rules of funding for the residential construction projects, entered into force on 1 July 2018.

It lays the groundwork for the transition from the joint investment schemes to project financing via escrow accounts.

The new provisions ban raising funds from off-plan buyers for projects where the first 'co-investment contract' (i.e. the first property sale) was filed for state registration after 1 July 2019, and require the use of escrow accounts instead.

At the same time, alongside such rigid funding limitations, developers will be granted certain regulatory easing.

Read on for an overview of the key changes introduced by the Law.

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New opportunities for developers attracting co-investments from home buyers:

- **Simultaneous construction under several construction permits**
- **Purpose loans from parent companies**
- **Expanded list of permitted expenditure types.**

Simultaneous construction under several construction permits

Developers will be allowed to run construction projects under several construction permits simultaneously:

- In accordance with the land development plan
- On the basis of an approved site plan
- If a construction project runs on one or several land plots within the territory that is already developed under a contract for complex development or utilisation.

Yet, the developer may not simultaneously conduct activities under several contracts for complex development or utilisation.

Purpose loans from a parent company

In accordance with the Russian legislation, parent company is a company that, by virtue of holding a controlling interest or on other legal grounds, may influence the decisions made by a subsidiary.

The developers will be entitled to raise loans from their parent companies not exceeding 20 percent of the project. value per each construction permit.

The interest rate on such loans may not exceed a then-applicable key rate of the Central Bank of Russia, increased by two percentage points.

Expanded list of permitted expenditure types

According to the Law, the funds available in the developer's bank accounts can be used for the following purposes:

- To purchase land plots for construction of multifamily housing or other types of real estate
- To change the permitted land use
- To lift a statutory ban for construction or modernisation of buildings (structures) on the lands bought out from the state before 1 July 2012 in the cities with a

population of over 3 million people

- To establish (make capital investments in) subsidiary developers.

One of the positive changes is an increase of the permitted level of establishment expenses from 10 to 20 percent of a construction project's value, subject to the disclosure of IFRS financial statements.

Please note that the law now contains an exhaustive list of forbidden expenditure types.

Restrictions on raising financing from homebuyers

The Law limits the instances when a developer may attract financing from homebuyers at the pre-commissioning stages of construction.

The developers will not be allowed to issue the so-called 'housing certificates' and the use of housing cooperatives will be limited to the construction projects carried out on land plots allocated by the state free-of-charge and for a fixed term.

Compliance with financial strength requirements

Federal Law No. 214-FZ entitled the supervisory authorities to seek suspension of non-complying developer's operations from commercial courts. According to the Law, such compliance is a necessary prerequisite for attracting financing from homebuyers.

Additional requirements for developers attracting homebuyer co-investments:

- Restrictions on raising financing from homebuyers
- Compliance with financial strength requirements
- Maintenance of a separate bank account for each construction permit
- Expanded disclosure requirements

Maintenance of a separate bank account for each construction permit

The Law obligates a developer attracting financing from homebuyers to maintain a separate bank account per each construction permit.

Moreover, the contracts with the bank must contain the developer's consent to mandatory disclosures to the relevant regulatory authority under Federal Law No. 214-FZ.

Expanded disclosure requirements

Now that the Law entered into force, developers must make their statutory public disclosures via the unified residential construction database and not their websites.

The scope of information to be disclosed was expanded to include:

- The information on capital and financial strengths

- The information on bankruptcy procedures
- The beneficiary owners.

For the purposes of the Law, 'beneficiary owners' will mean the individuals that ultimately hold, indirectly, independently or jointly with other persons, an interest of five percent or more of a developer's voting shares (stock).

Additional powers of construction regulatory authorities

Government control (supervision) earlier exercised by the regional controlling authorities by virtue of Federal Law No. 214-FZ will now be subject to the procedures established by the supreme executive authority of a region taking into account the government's requirements.

With the enactment of the Law, the controlling authorities

will also report to the real estate registration agency:

- The developer's failure to hand over property to a homebuyer (co-investor)
- The status of the developer's compliance with the federal legislation requirements.

Liability of beneficiary owners

In accordance with the Law, the beneficiary owners that may give instructions to a developer's sole executive body or a member of its management bodies are jointly and

severally liable for the damages caused to homebuyers (co-investors).

Use of escrow accounts

The Law introduces a number of amendments to the rules of using the escrow accounts for settlements with off-plan homebuyers.

The developers that use escrow accounts will be exempt from most of the Federal Law No. 214-FZ requirements that regulate raising funds from homebuyers.

Such developers will be permitted to operate under several contracts for complex territory development and utilisation simultaneously.

The funds deposited on the escrow accounts with one bank will be insured for up to RUB 10 million (irrespective of the number of accounts).

Recommendations for developers

Developers should get ready for the transition to the escrow-based model:

- Analyse the financial and administrative impact
- Select an escrow agent — it should be a bank that

meets both the regulatory requirements and the developer's interests

- Plan the transition costs
- Adjust the pricing model.

We hope that you will find this newsletter interesting and informative. Please feel welcome to contact us for more information on the topics covered.

Deloitte CIS Partners

Contacts

Real Estate services



Yulia Krylova
Director
ykrylova@deloitte.ru

Legal services

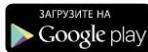


Andrey Goncharov
Director
agoncharov@deloitte.ru



Konstantin Fisunov
Senior Consultant
kfisunov@deloitte.ru

TaxSmart app



deloitte.ru

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