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High return, but with high risk, in Moscow

By Otto Pohl International Herald Tribune

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MOSCOW Statistically speaking, Moscow's residential real estate market has shifted from several years of explosive price gains into a period of steady, robust growth. In Russia, however, nothing is ever that simple.

Underlying the sales statistics, real estate professionals here say, are both the opportunity and the opacity that have characterized the market since the collapse of the Soviet Union.

"It's shocking what's going on in the local real estate market," said Nuri Katz, managing director of Beatrix Real Estate. "Shockingly good and shockingly sloppy."

A 2006 report, "Emerging Trends in Real Estate," released on Jan. 25 by the Urban Land Institute and PricewaterhouseCoopers, ranked Moscow 10th among European cities for overall returns, and worst - 27th out of 27 - for risk.

With high oil prices, political stability and a renewed confidence about the country's long-term prospects, Moscow real estate is growing into its large upside potential. Huge numbers of apartments are being renovated, while decrepit buildings are being torn down to make room for new ones that sell briskly at Manhattan-level prices. According to data compiled by Kirsanova Realty, apartment prices rose 27 percent in 2002, 32 percent in 2003, 24 percent in 2004 and 32 percent in 2005.

But buyers face many of the same problems and risks that have challenged the Russian real estate market for what seems like forever.

Real estate agents tell stories like the one about a great apartment and a title search that uncovered a lien from a bank that had collapsed years earlier.

Only the bank could authorize removal of the lien, but because it was defunct the apartment was in limbo for months until a bribe reached the appropriate person.

"It's not an easy market for foreigners to swallow," Katz said.

The relatively few foreigners who buy here tend to have lived in Moscow long enough to have developed thick skin about the uncertainties of doing business in Russia. These days, however, they are doing very well.

Russia's wealth, based largely on the growing value of its vast natural resources, is concentrated in Moscow. With more than 15 million inhabitants, it is Europe's largest city. It also is the capital of the world's largest country: Russia sprawls across one-ninth of all the land on earth.

Despite decades of misguided, megalomaniacal construction during the Soviet years, much of central Moscow retains a stately feel. And, as values rise, more and more brick facades gleam with fresh yellow and green paint, contrasting with the white moldings of czarist-era buildings. The stone facades from Stalin-era buildings and the red brick apartment blocks from the Khrushchev era also are being cleaned up.

An old apartment in a less desirable area will sell for about \$3,000 per square meter, while renovated units in the best areas, like the area around Patriarch's Ponds, will be \$9,000 a square meter.

(Moscow's housing stock is almost exclusively apartments, with prices listed in U.S. dollars and sizes in square meters.)

Prices are significantly higher for new construction, which does not have a sense of history but offers security features, like underground parking with private elevators, that appeal to wealthy buyers.

The area around Ostozhenka Street has the highest concentration of these buildings, and prices there are as high as \$15,000 per square meter for what is known as "shell and core" - an unfinished unit with basic plumbing. Completing the apartment is the buyer's responsibility and can cost from \$1,000 to \$3,000 per square meter.

Olga Bogoroditskaya, a real estate agent from Kirsanova Realty, recently showed such an apartment on Korubeinikov Lane, off Ostozhenka Street. The "shell and core" penthouse, of 297 square meters was on the market for \$18,000 a square meter.

"That's a little high," she said, but she added that it would sell quickly for \$15,000 to \$17,000. The view outside the floor-to-ceiling windows sweeps from the Moscow river to the area's visual centerpiece, the enormous golden dome of Christ the Savior Cathedral.

Because Moscow still lacks a trustworthy legal environment, sales are almost exclusively handled in cash, with buyers reserving enough bundles of bills at the bank to cover the transactions. Each "brick," made up of a thousand \$100 bills, is about 11 centimeters, or 4.5 inches, thick and weighs about 1 kilogram, or 2.25 pounds. So, for example, a \$600,000 apartment sells for a stack of bills that is about 70 centimeters high and weighs about 6 kilograms.

Even mortgages, in the rare instances that they are used, are paid out in cash for the buyer to give to the seller.

Stand-alone businesses have sprung up around Moscow providing little more than a warren of small rooms, cash-counting machines and a lot of security. This is where the cash changes hands and the final documents are signed.

There have been times, although they have been rare, when signing ceremonies have turned into ordeals. Philippe Bogdanoff, who represents Christie's Great Estates in Russia, recalled the closing of a \$2 million apartment a year ago in which a spot check turned up a few counterfeit notes. As a result, each of the 20,000 \$100 bills had to be checked individually.

The experience of an American investment executive, a long-term resident of Moscow, captures both the opportunity and the challenges of the city's real estate market. In 2001 the executive, who asked that his name not be used for legal reasons, purchased two 200-square-meter apartments in a stately 19th-century building less than a kilometer from the Kremlin.

Because these were communal apartments, in which each room was occupied by a different family and all shared the kitchen and bathroom, he had to spend \$320,000 to buy new apartments elsewhere for the families.

In all, he estimated that he spent \$900,000, about 10 percent of which was paid as bribes. Bribes solved every problem he encountered, except when a city inspector was asked to provide a permit for a second elevator that was installed during the renovations.

"I require such a huge bribe it's not even worth you asking me how much it's going to cost," the inspector told the executive, who still is unsure whether that was a negotiating strategy or simply a statement of fact. The elevator remains in use, but it has no official registration.

More recently, the city's electricity authority demanded that the investor pay for a new neighborhood substation to make up for the large amount of electricity his tenants had used. Negotiations are continuing.

But the two apartments now are worth more than \$3 million, and they are rented to executives from international companies for more than \$20,000 a month.

Such payoffs have pulled more people into real estate investment. "There's still loads of opportunity here," said Mark Jochumsen, a Dane who has lived in Moscow for 11 years.

His first apartment, a total of 240 square meters, rents for \$20,000 a month. He is renovating a second one, a 180-square-meter unit that he bought for \$660,000 in July and intends to rent furnished for \$15,000 a month. "It's a good pension plan," he says of the cash flow.

Overall, the market is buoyant and optimistic. And political instability, the greatest cloud over the long-term viability of the market, can be considered to diminish with each renovated apartment.

"Someone who invests three million won't just abandon this country," said Tatiana Tchaldimova, who began designing houses for the most favored singers from the Bolshoi Theater in the 1970s. Tchaldimova recently renovated a 265-square-meter apartment just off of Ostozhenka Street that sold recently for more than \$2 million.

On a recent visit to oversee the finishing touches on her design, she spoke to the larger effect of the construction and renovation boom.

"My work helps this country save its wealth and keeps the people who can support this country here," she said. Then she paused under the ornate scrollwork and summarized the situation for a visitor: "As long as the pipes carry oil, everything will be just fine."

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