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# THE REAL ESTATE MARKET IN KIEV: HISTORY AND ISSUES

by Gary Roseman

## ABOUT THE AUTHOR

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## THE MARKET IN KIEV

The real estate markets in the former Soviet republics are evolving. This article reviews some of the background and history of the Ukrainian housing market situation and concludes with some measurements of sizes and prices in the rental and sales markets so that the reader will have some quantifiable characteristics for possible comparisons to other markets. The focus of this article is primarily on the local market properties that affect Ukrainian citizens. The topic is of interest because housing constitutes a significant portion of a typical household's wealth in the Ukraine and other former communist and emerging market countries.

Many studies on East European real estate have focused on various problems that slow the development of these markets, such as the legal uncertainties in land ownership (Kaganova, 1998), the lack of mortgage markets comparable to those in the West and the complete absence of a secondary market<sup>1</sup> (Kaganova, 1998), and the undeveloped state of the appraisal industry (Levine, 1995). The Ukrainian market faces all of these difficulties.

## BACKGROUND ON KIEV

The city of Kiev was home to the first organized eastern Slavic state, which reached prominence under Prince Vladimir in the 10th century. Mongols, Tatars, Poles, and Russians invaded the city in later centuries and while it remained a religious and cultural center, it began its renaissance only in the 17th century with the expansion of Russian power in Ukraine. By the 19th century, Kiev was a prosperous administrative, educational, and industrial center.

The Germans and Austro-Hungarians occupied the city in World War I and stayed there until 1919 when anarchists, Ukrainian nationalists, Bolsheviks, and anti-Bolsheviks all vied for power. The Bolsheviks won and Kiev lost its position as Ukrainian capital to Kharkov until 1934. During World War II, the Germans again occupied the city. Retreating Soviet forces left time-delayed bombs that destroyed buildings on the main thoroughfare, Khreshchatik Street. The Germans retaliated but Kiev gained a respite until November 1943, when Soviet advances and German retreats again destroyed parts of the city.

After the war, the Soviet government poured resources into rebuilding Kiev. These efforts included construction of an extensive subway system. Rising communist Nikita Khrushchev, who was head of the Ukrainian Communist Party, supervised the overall effort. Kiev was the third most populous city in the Soviet Union.

After the Ukrainian declaration of independence in August 1991, Kiev became the capital of Europe's second largest country in land area after Russia. Foreign embassies and representative offices of corporations eager to do business in a country of 52 million arrived. A shortage of suitable office space led these companies and embassies to move into renovated hotel suites, apartments, and offices in institutes. Recognizing that the demand for reasonable office space was growing while the supply was still small, builders embarked on a minor construction boom in the years that followed. Some of the funds for this construction were from local sources, some from Russian and Western sources. There were also Swiss and Cypriot investors who, according to widespread belief, funneled Ukrainian and Russian untaxed profits into real estate projects. The mild spurt, which was not much in comparison to the construction booms in Warsaw, Prague, Budapest, or Moscow, lasted until the Russian default of August 1998.

While the increased construction moderately increased the availability of office space for Western and Ukrainian companies, the residential offerings increased only slightly. There had been a housing shortage in Kiev with its artificially low Soviet rental payments system with the result that several generations of a family often shared the same apartment. Privatization of the housing stock was the first step toward the efficient rationing of housing, but the additional requisite conditions of a functioning banking system and legal support for contracts and property rights were absent. New owners who had no need for a three-room apartment in the center of the city were nevertheless reluctant to part with this asset without money up front. When housing sales did occur, the medium of exchange was often something other than Ukraine's first currency, which was a raffle ticket-dimensioned and rapidly depreciating coupon for the proposed currency unit, the *karbovonets*. On September 1, 1996, after some months of stability with the *karbovonets* at a rate of approximately 176,000 to the dollar, the *hryvna* became the official currency at 1.76 *hryvnas* to the dollar. Gradually, with growth in the banking system and some limited recognition of property rights, some construction of apartments began. Still, the sale of existing apartment units remains hampered by the lack of both a foolproof title check system and a market for title insurance.

The municipality owns the common areas of a residential building, unless the whole building is privatized as a cooperative, which is not the usual case. The municipality assesses a fee to apartment owners for maintenance and cleaning of the common areas. The common lines for utilities and water/sewage are also municipal property. Given the state of municipal governments in Ukraine, this means that cleaning, repairs, and maintenance are often lacking.

Problems with land ownership rights affect the location and quantity of housing. As in many Soviet cities, residential growth in Kiev in the 1960s and later occurred on the edges of the city. Because land could not be bought and sold, no bidding process could reallocate land parcels in the more central areas from their current uses. Even with an increased demand for housing in central areas, the absence of a market for land prevented this demand from resulting in the construction of new housing in these areas.<sup>2</sup> Families located in the outer districts because this was the only avail-

able option and commuted to jobs in the center, usually on crowded public transportation. The presence of large residential districts in the outer areas and long commutes are features of life in Kiev today.

The ability to own land is nominally guaranteed under certain parts of the Ukrainian legal system, but there have been no practical steps to implement this right. In 1992, a land code for the country allowed local administrative councils to authorize the sale of land with exceptions for strategic reasons. In 1996, the Constitution guaranteed the right to own land, and a presidential decree in 1999 allows the sale of non-agricultural land. But unlike Russia, where sales of certain types of land are becoming practical realities, land is still held by the state. Strong opposition to allowing the sale of land remains. For example, a former speaker of parliament, Alexander Tkachenko, called the sale of land "misanthropic." Remedies of this impediment to the development of the real estate market in Ukraine do not appear imminent.

#### RENTAL MARKET

Kiev's status as the capital brings with it many of the benefits of a modern city. Because of its attractiveness, the rental market there is more active than in other Ukrainian cities. These benefits of living in Kiev range from the more mundane aspects of personal comfort, like regular running water and garbage disposal, to the presence of job opportunities that do not exist in other cities. For the relatively educated and ambitious, opportunity in Kiev means a chance to work in a Western company, embassy, or in a Ukrainian company that has regular dealings with Western entities and can therefore regularly pay salaries. The state sector is also large and offers some security as well as possibilities for extra, off-the-job income.

Broadly, there are two residential rental markets in Kiev, both of which usually offer furnished apartments: "Western standard" and regular Soviet-style. Renovated "Western standard" housing can be found in either old Soviet apartment buildings mixed in with the Soviet-style apartments, or in completely refurbished buildings. Kiev has no "Western Quarter"; Western apartments are typically mixed in with local-standard apartments in the same building. In the rare case of a building built to above-local-standard

specifications, these buildings are on the same street with local-standard buildings.

The characteristics that separate "Western standard" from Soviet or local standard housing are the quality of the furniture, appliances, water heater, and the finishing on the floor and wall, as well as the use of materials in construction that will prevent the cold drafts of wind in the winter. Western apartments will have relatively new furniture and appliances from Western Europe or Slovenia, German water heaters, some type of independent heating, plastered walls and ceilings, and floors that are carpeted or, if hardwood, with individual planks that fit neatly together. Western apartments will also have new windows, usually with plastic frames that will close evenly so that cold air does not come in. Often there will be window air conditioning units and a telephone line serviced by one of the private telecommunications companies that operate in Kiev. Local apartments have Soviet-made furniture and Soviet or Ukrainian appliances. They depend on the city for hot water, which is sometimes not available, and heating. In Russian and Ukrainian cities, residential heating comes from district distribution centers, which date from Soviet times and distribute heat wastefully. Apartments have no individual control over the temperature. Adjusting the heat involves either opening a window to reduce the temperature if that occasion arises, or buying a space heater, which is necessary if one wants heating before the date which the local authorities have determined for the start of the heat distribution period. The number of rooms in an apartment includes bedrooms and a living room or den area; that is, a two-room apartment has two rooms, one of which is typically furnished as a bedroom, in addition to a toilet and bathroom, either in separate rooms or combined, and a kitchen.

On the demand side of the Western standard rental housing market are primarily corporations, embassies, and Western taxpayer-funded programs that have sprouted in the capital cities of the former Soviet Union. The supply of this housing is from locally based entrepreneurs, both native and Western, who started activities in the early 1990s when apartment sales prices were very low. They bought these properties, renovated them, and earned high rental yields, often in excess of 20 percent annually. Apartments in this Western standard market are concentrated in the center of the city.

The demand for local-standard housing is from Ukrainians who arrive in Kiev from the rest of the country looking for job opportunities. The supply is from Kiev residents who have vacated their housing while retaining ownership. The common reasons for vacating can be related to health, as extended care is a family-provided service in Ukraine and often requires the sharing of accommodations, or simply the desire to generate income from a property. For some elderly and low-income households, rental income from the apartment in which they lived for decades may be their main source of income. Because the allocation of housing was for years based on non-market considerations, lower-income households still own properties in the central areas of many formerly socialist cities.

There are similarities in the working of the markets for Western and local rental housing. Both markets rely on leases, which are hard to enforce given the state of the judiciary. A measure that prevents this institutional failure from destroying the leasing market is an institutional feature called the *propiska* (meaning registration or residence permit) system, which requires a registered address, stamped in the civil passport issued to citizens at age 16, for all residents in Ukraine. In order to have a valid registration for a time period, a person must present proof of residence to the authorities, and this proof, for a tenant, can be a lease. If this lease is terminated and the tenant moves to another location, the tenant must provide proof of residence at the other location. This change would mean nullification of the registration of the previous lease and the opening of possible questions to both lessor and lessee from authorities, who can be capricious.

Both the Western-standard and the local markets often use dollars, called "conventional units" in leases, as the unit of account. Specification of dollar payments in the lease is prohibited even though most lessors insist on payment in this currency. Thus, one of two options arises: either using the dollar as the unit of account while specifying *hryvnas* as the medium of exchange with a verbal agreement that the actual medium of exchange is dollars, or signing a second legally invalid lease with a written provision for dollar payments. A lease with *hryvnas* is required for registration purposes.<sup>3</sup>

### REAL ESTATE VERSUS OTHER INVESTMENT ALTERNATIVES

Like many who have experienced hyperinflation, Ukrainians see real estate as a relatively low-risk

income-generating asset. A specification of the payments in dollar terms (conventional units) preserves the purchasing power of the rental income stream. There is a low probability of confiscation by the government of the housing asset, in contrast to bank deposits. Dollar deposits have been subject to forced conversions at unfavorable exchange rates in many post-Soviet republics, while local currency deposits were effectively seized by inflation in the 1990s. Banks have sometimes been unable to meet withdrawal demands in a timely manner, thus further decreasing the desirability of bank deposits as a store of wealth. With alternatives such as securities, the ownership rights are often not well defined. For example, charters and by-laws of some corporations are often arcane and they may, in some cases, conceivably allow spin-offs of subsidiaries without due compensation to the corporation, or dilution of shareholders' ownership. Not only has this state of Ukrainian corporate governance made securities undesirable in international finance, but it has not inspired confidence among Ukrainians, who look to other assets, like real estate, for holding wealth.

### OBSERVATIONS ABOUT SIZE AND PRICES

For some insights into some of the quantifiable variables in the local market, data come from three city districts where the local-standard rental market is most active. The Obolon district is north of central Kiev and is known as a bedroom community. The Darnitsa district is across the river from the city center and is the location of several affordable new housing developments. Both districts are filled with high-rise Soviet-style apartment buildings and both have extensive connections to the center by subway, streetcars, and bus routes. The Moskovskiy district is south of the city center with easier access to the center. Building there began in the 1950s. These buildings are more often from brick, instead of the concrete pre-fabricated construction that was common in later periods. Other districts of the city had limited numbers of observations, with the exception of the central districts, where both local- and Western-standard properties were advertised.

The observations were drawn from the only city-wide real estate publication in Kiev at the time of collection, *Vestnik Nedvizhimosti*,<sup>4</sup> which first appeared in June 1997 and in March 2000 had a fortnightly print of 15,000 copies. The intervals between the chosen months allow time for advertised properties to clear out in the market.

The observations in Table 1<sup>5</sup> are from the districts and apartment types for which sample sizes were above 20 in November 1999, and March 2000 and November 2001. There were, for example, three-room apartments for rent and sale in the districts at these times, but the numbers available were small, and not all districts had sufficient sample sizes of one- and two-room apartments for rent or sale at each time. The data are separated into one- and two-room categories to control for size.

compared to the rental market. In Table 2 there is a clear positive correlation between size and sales price,<sup>7</sup> while in Table 3 no pattern appears for correlation between size and rental rates.<sup>8</sup> A reason for this is the nature of the demand side in the rental market. As discussed, many renters are relatively young arrivals in Kiev who are in search of opportunity. Without dependents, they would not put much value on marginal space, and the results attest to this market feature.

*Table 1*  
*Average Sizes of Properties (with standard deviation of each sample in parentheses)*

Region, Type	Month	Average Size of Units for Rent (square meters)	Average Rental Price per Month (dollars)	Sample Size	Average Size of Units for Sale (square meters)	Average Sales Price (dollars)	Sample Size
Obolon, 1 Room	November 1999	23.429 (8.971)	101.76 (31.39)	37	34.241 (5.674)	11,180.95 (3,333.55)	63
Obolon, 2 Rooms	November 1999	36.706 (9.511)	168.38 (59.20)	34	50.038 (8.259)	17,476.47 (7,115.77)	85
Obolon, 1 Room	March 2000	24.806 (9.115)	94.81 (18.74)	36	34.050 (4.739)	10,761.78 (2,349.95)	57
Obolon, 2 Rooms	March 2000	38.595 (9.998)	166.62 (53.28)	37	51.170 (8.878)	17,091.49 (6,647.14)	94
Darnitsa, 2 Rooms	March 2000	36.739 (10.150)	128.70 (30.16)	23	47.866 (6.076)	13,319.72 (4,113.28)	71
Moskovskiy, 1 Room	March 2000	24.183 (8.978)	178.26 (57.23)	35	34.438 (5.793)	15223.08 (4257.47)	39
Moskovskiy, 1 Room	November 2001	23.454 (7.347)	196.82 (53.04)	22	36.543 (5.229)	16443.48 (4362.43)	23
Moskovskiy, 2 Rooms	November 2001	43.280 (10.761)	373.80 (145.50)	50	54.804 (9.444)	26642.47 (9637.82)	74

Table 1 shows that the average size of properties for sale are larger than those for rent. If Kiev property purchasers allocate their resources to the highest valued use, then the reason for this difference must be a greater value for increased size in the sales market than in the local-standard rental market. An examination of the correlation coefficients<sup>6</sup> between apartment size and both sales prices and rental rates offers evidence of a difference in valuation of space among buyers and renters. The higher correlation coefficients in the sales market are evidence of a greater premium for additional space in that market when

Space in the Moskovskiy district is more valuable than that in the other districts for both the sales and rental markets. This is a reflection of the greater ease of transportation to the center, where many jobs and shopping opportunities are located.

Factors other than size, such as quality and location, affect price. These factors are not likely to vary greatly among units in the current sample. Limiting the calculations to intra-regional data provides some control for variation in location. The access to public transportation, on which most Kiev residents rely, does vary within regions but,

*Table 2*  
*Coefficients of Correlation Between*  
*Size of Apartments and Sales Prices*

	November 1999	March 2000	November 2001
Obolon			
1 Room	0.7915	0.6801	
2 Rooms	0.7429	0.7429	
Darnitsa			
2 Rooms		0.6412	
Moskovskiy			
1 Room		0.5993	0.7377
2 Rooms			0.7320

*Table 3*  
*Coefficients of Correlation between*  
*Size of Apartments and Rental Prices*

	November 1999	March 2000	November 2001
Obolon			
1 Room	0.1709	0.1384	
2 Rooms	-0.2974	-0.0412	
Darnitsa			
2 Rooms		0.3842	
Moskovskiy			
1 Room		0.4128	0.3465
2 Rooms		0.0770	0.3067

given the small physical area of each region, the differences are small. Quality and style are also fairly uniform within a region. The inner regions, which are not discussed in this paper, are older and have some variation between pre- and post-war buildings and between refurbishment levels. The buildings in Obolon and Darnitsa regions are mostly from the 1970s and 1980-90s, respectively, with refurbishment almost exclusively of a post-Soviet quality.

## CONCLUSION

The Kiev real estate market is still in transition from its tough beginnings a little over a decade ago. Property rights are still an issue to be settled satisfactorily. The state of development of financial markets is not conducive to an active housing sector. For example, the mortgage market is still small and hampered by a lack of access to funds from savings. The rate of inflation has been low for the past six years, but vivid memories of the early

1990s, when inflation rates were at times 50 percent per month, have prevented the emergence of a pool of domestic savings that is necessary for a mortgage market. In addition to these fears of another period of inflation, skepticism toward banks exists because of misgivings caused by the lack of transparency in firms in all sectors of the economy, including the banking sector. The result is that prospects for savings to supply adequate funds to mortgage markets in the near future are dim.

Even with the considerations in the preceding paragraph, real estate should be an attractive investment vehicle for Ukrainians, if and when a large class of savers emerges. Its relative attractiveness in this market, compared to other countries, is likely to be greater because of risk and uncertainty associated with other assets in Ukraine, whether they are securities, bank accounts, or holdings of money balances. While foreign financial institutions have offices in Ukraine, their activities are limited and Ukrainians' access to their services is restricted because authorities fear increased capital flight and tax evasion.

In attaching some quantitative measures to this market, this paper found different mean sizes for apartments for sale and those for rent. That apartments for rent were smaller is to be expected, given the sources of demand in the rental market, which consist largely of younger tenants with few dependents who arrive in Kiev for the unique opportunities afforded by the capital city. Space does not command a premium in the rental market in Kiev.

## NOTES

1. For a review on how mortgage markets have fared in the former Soviet Union, see Olga Kaganova's 1998 article (see references). David Clapham (1995) reviews the situation in Bulgaria, where almost no banks were engaged in mortgage lending in 1992, even though it had been permitted since 1989.
2. The article by Alain Bertaud and Bertrand Renaud examines land use in the absence of markets for land.
3. In the Western-standard lease, it is common for a landlord to have an offshore company that signs the lease with the Western firm or embassy for offshore payment. The lease may specify settlement of disputes in a non-Ukrainian court but this is of questionable legality in leases for Ukrainian properties. In other words, a Western lessee may disregard a lease with these terms and suffer little monetary damage, but Western lessees generally have fixed periods of employment in Kiev and lack the market knowledge and available time to arrange for other living conditions without some costs. The probability that a Western tenant will seek to prematurely terminate a lease is therefore sufficiently low for Ukrainian landlords to enter into agreements.
4. The title is translated as *Real Estate Bulletin*. The publication is primarily in the Russian language, which remains the language of business in most of the former Soviet Union.
5. Sources: *Vestnik Nedvizhimosti*, Numbers 52, 66, 97 for all tables. A

- test of  $H_0: m_1=m_2$ , where  $m_1$  and  $m_2$  are the means for the sizes of apartments for sale and for rent, respectively, is rejected at the  $\alpha=.01$  level for all regions and types of apartments.
6. A correlation coefficient is the covariance between two variables divided by the product of their standard deviations. A value of 1 for the coefficient means a perfectly linear relationship exists between the two variables, and close to 1 means that there is a strong positive but not perfectly linear relationship, such that large values of one variable are associated with large values of the other. Conversely, negative correlation coefficients mean that large values of one variable are associated with smaller values of the other. In Tables 2 and 3, coefficients closer to 1 mean that large sizes of apartments are associated with large prices, smaller positive coefficients imply a weaker relationship between these variables, and negative coefficients mean that large sizes are associated with lower prices.
  7. All coefficients are statistically significant at the  $\alpha=.01$  level.
  8. Only the coefficients for Obolon, 2 Rooms in November 1999 and the Moskovskiy coefficients for each month and category are statistically significant at the  $\alpha=.05$  level.

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