

Developer's Participation in Infrastructure of Inhabited Area



by Anna V. SISETSKA

Applicable Ukrainian law requires that developers participate in development of engineering-transport and social infrastructure of an inhabited area. Actually, there are two possible ways of such participation: to pay a contribution (share participation) in the amount stipulated by the municipality as a general obligation prescribed by laws, and to construct utility networks as a complementary obligation that may be imposed by the technical conditions of utility providers.

As business practice shows, share participation has always been a sensitive issue, having an sufficient impact on the budget of a construction project. Yet, the law did not stipulate clear provisions for its payment. That was one of the reasons for changes to the law made a year or so ago. Thus, Article 27¹ of the *On Building Up Act*¹ as amended by the *On Construction Facilitation Act*² and the *Anti-Crisis Act*³ introduced a share participation mechanism to put an end to disputable regional practices. All amendments described below in brief, have made a difference for a developer. However, as usually happens within the Ukrainian community, developers still have no possibilities to exercise certain basic rights granted by the amended law.

¹ *On Planning and Building Up the Territories Act of Ukraine No.1699-III of 20 April 2000* as amended (hereinafter shall be referred as the *On Building Up Act*)

² *On Amending Certain Legislative Acts to Facilitate the Construction Act of Ukraine No.509-IV of 16 September 2008.*

³ *On Prevention of Negative Impact of World Financial Crisis on Construction Sphere and Residential Construction Act of Ukraine No.800-IV of 25 December 2008* (hereinafter shall be referred as the *Anti-Crisis Act*)

Special consideration

Summing up the analysis of existing law, certain principal features of the share participation mechanism established should be highlighted as follows:

— *legal basis*: shall be a share participation agreement executed between the developer and the local authorities prior to obtaining the construction permit by the developer;

— *amount*: in any single case shall be stipulated in the share participation agreement to the extent of 4% of the total estimated costs for residential construction, including construction of certain types of social infrastructure, and 10% — for non-residential construction;

— *basis for amount calculation*: shall be the estimated construction costs without regard to expenditure for obtaining the land rights, demolition of property on the site, installation of engineering and transport networks on and out of the site;

— *payment date*: shall be provided in the share participation agreement, but, in any event, no later than within one month after commissioning;

— *temporary suspension*: is provided as the right of a residential construction developer to request for a delay in payment till 1 January 2012;

— *release*: is applicable to the construction of certain socially significant property such as affordable housing, facilities constructed within the State Special Profile for Hosting the Final Tournament of the UEFA EURO 2012, and otherwise as provided by part 4 of Article 27¹ of the *On Building Up Act*.

Local authorities may adopt their own by-laws as to the issue falling within their competence determined by the *On Building Up Act* and the *On Local Government Act*⁴. However, such by-laws shall not clash with the requirements stipulated in the applicable laws.

Substantial facilities

Among other benefits granted to developers, there are also two progressive mechanisms provided by the law as amended by the *On Building Up Act* and *Anti-Crisis Act*. They refer to the developer's right to decrease share participation and to receive compensation for the utility networks and facilities constructed by such developer according to the technical conditions issued by utility providers in order to ensure the rendering of utility services upon commissioning of the constructed property.

Thus, pursuant to part 7 of Article 27 of the *On Building Up Act*, an amount of the share participation payable should be reduced by the developer's expenses incurred to construct utility networks beyond the boundaries of the land plot designated for development, if such construction is required by the technical conditions obtained by the developer.

Furthermore, as provided by Article 179 of the *Commercial Code*⁵, Article 7 of the *On Pipeline Transport Act*⁶ and Articles 18, 24, 25 of the *On Electrical*

⁴ *On Local Government Act of Ukraine No. 280-/97-BP of 21 May 1997* as amended.

⁵ *The Commercial Code of Ukraine No.436-IV of 16 January 2003* as amended (hereinafter referred as to the *Commercial Code*)

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*Energy Industry Act*⁷ as amended by the *Anti-Crisis Act*, developers are entitled to a refund of their expenses for construction of utility networks, provided that such construction is required by the technical conditions. In this case the law obliges the utility providers to compensate such developer's expenses.

Utility networks and facilities so constructed by developers are to be transferred to the balance sheet of respective providers in accordance with the *On Building Up Act*.

According to given laws all matters related to utility networks construction, transferring the constructed networks to the balance sheet of the utility providers, compensation, method of payment and settlement procedure shall be subject to a separate agreement to be concluded between the developer and utility provider.

Implementation difficulties

Notwithstanding such rights being established, developers face problems upon their exercise in practice. Following current practice, local authorities, as a general rule, refuse to reduce the share participation to be paid by the developer by its expenses incurred for construction of utility networks. Utility providers in turn reject the compensation of such developers' expenses in violation of the law.

This is due to the fact that neither implementation procedure nor model agreement nor payment methods for compensation are approved by the Cabinet Ministers of Ukraine as required by the *Commercial Code*, the *On Pipeline Transport Act* and the

⁶ *On Pipeline Transport Act of Ukraine No.192-196—BP of 15 May 1996* as amended (hereinafter referred as to the *On Pipeline Transport Act*)

⁷ *On Electrical Energy Industry Act of Ukraine No.575-97 of 16 October 1997* as amended (hereinafter referred as to the *On Electrical Energy Industry Act*)

On Electrical Energy Industry Act. Similarly, no legal mechanism for defining the value of networks constructed by developers that should be compensated by providers or deducted from the share participation by municipality has been developed by the Cabinet Ministers of Ukraine.

Besides, at present it is not clear how those two mechanisms for reducing share participation and receiving compensation shall be simultaneously applied since they both refer to the developer's expenses for constructing utility networks as a basis for compensation and deduction. Obviously, the same costs may not be counted twice and, therefore, it appears that the described mechanisms cannot be exercised jointly.

Prospects

With due consideration of the rights granted to the developer by the law, it is supposed that a developer may file a lawsuit against the municipality or utility providers claiming for deduction of the share participation amount or compensation of expenses for utility networks constructed by such developer pursuant to technical conditions. For this purpose it appears to be reasonable to enforce a respective agreement under a court decision, in particular, to recognize it as concluded with the required provisions on deducted share participation (as to the agreement with local authority) or with conditions on refunding of actual developer's expenses for constructed utility networks as provided in design documentation developed and approved pursuant to the technical conditions obtained from utility provides (as to the agreement with such providers).

The Ukrainian Ministry for Regional Development and Construction also points out that a lack of by-laws should not result in cancellation of the developer's right or releasing providers for their liability to compensate

construction expenses related to utility networks⁸.

Conclusions

The high estimation of recent law amendments related to a developer's participation in infrastructure of the locality cannot be understated. No doubt, such law provisions as to amount and payment period will reduce the administrative and financial pressure on developers.

However, there is an urgent need to elaborate and adopt resolutions of the Cabinet Ministers of Ukraine providing for model agreements, procedure for transferring the constructed networks to providers, legal mechanism of defining the value of networks constructed, method of payment and other procedural issues as required by applicable laws in order to enable the out-of-court implementation of mechanisms for deducting share participation and refunding expenses related to the utility networks constructed by developers.

It appears that further by-laws shall be developed under the priority of the mechanism on share participation deduction, since it is more expedient from the practical point of view. Moreover, the compensation mechanism shall be complementary. In particular, such a complementary mechanism may be applied, for example, should the value of the constructed networks exceed the amount of the established share participation or should the developer be released from the obligation of share participation.

Such improvements are expected to have a positive effect on the developers standing and the real estate market, which was actually the purpose of the latest law changes on overcoming the adverse impact of the financial crisis on the construction industry.

⁸ The Letter of the Ministry of Regional Development and Construction of Ukraine No.12/19-1-8/5-1173 of 15 December 2009.

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of the RIGHT
to recover
COSTS for
LOCAL UTILITY
NETWORKS
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