

**ICEST 2021**

**II International Conference on Economic and Social Trends for Sustainability of Modern Society**

**CRISIS OF 2020: DRIVERS OF GROWTH IN THE RUSSIAN  
CONSTRUCTION MARKET**

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**Abstract**

The article forms a portrait of the construction market for the near future, identifies restrictions that prevent its recovery, growth drivers, and studies the necessary measures of state support for its development. Coronavirus infection, falling oil prices, devaluation of the ruble - all these events have had and continue to have an extremely negative impact on the vast majority of industries and companies in Russia, in particular on the construction industry. Decrease in demand, suspension of activity, an increase in the cost of building materials, the emergence of financial problems, both for companies themselves and for counterparties, problems with the movement of workers due to the closure of borders - this is a small list of the negative impact of the crisis on the construction industry. In this regard, the relevance of social and economic monitoring is increasing in order to identify the economic expectations of market participants. Determining the drivers of growth in the construction industry and the recovery of construction companies from the crisis is becoming a fundamental moment for the future development of the industry. Improving the financial situation is a key driver of demand for housing. At the same time, the current state of affairs is significantly complicated due to rising unemployment and falling wages against the backdrop of the 2020 crisis.

2357-1330 © 2021 Published by European Publisher.

*Keywords:* Construction, demand, crisis, construction companies, tenant



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## 1. Introduction

The share of Construction in the gross domestic product (GDP) has been stable over the past three years and is equal to 5.5%. However, against the backdrop of the crisis, by the end of 2020, the construction industry is expected to decline in revenue by 17% and in profit by 16%. As a result, developers plan to attract additional credit resources to implement projects. This, in its' turn, will lead to an increase in the debt-equity ratio by 9%. The deterioration in the material situation of the population, caused by an increase in unemployment and a decrease in wages, can lead to a decrease in demand for housing by 14% (which is two times higher than the decrease in demand in the economy as a whole). Mainly due to the increase in the cost of the import component of the developers, an increase in housing prices is expected by 3% (which is twice as high as the expected price dynamics in the economy as a whole). The number of people employed in construction may decrease by 400 thousand people (-8.2%), and the average monthly wage - by 3,225 rubles (-7.7%) (Lukyanchikova, 2019).

## 2. Problem Statement

The aim of the study is a comprehensive analysis of the drivers of recovery and development of the construction market after the 2020 crisis.

Research objectives:

- to assess the impact of the 2020 crisis on the main financial and economic indicators of the industry;
- to identify industry problems amid the 2020 crisis and key drivers for recovery;
- to assess the possible effects on the market from the implementation of potential government support measures.

Against the backdrop of the 2020 crisis, construction companies faced the following problems:

- the construction of individual objects has been suspended;
- difficulties of free movement of transport involved in the delivery of construction materials, both on the territory of a separate constituent entity of the Russian Federation, and between constituent entities of the Russian Federation;
- significant financial problems of contractors, suppliers of materials and other counter parties;
- due to the strengthening of safety measures, there was a decrease in labor productivity;
- frequent interruptions in the supply of materials and equipment;
- decrease in demand for concluding contracts for participation in shared construction - due to the closure of borders between countries and the suspension of transport links, problems arose with the movement of workers;
- growth in the cost of certain categories of building materials.

### 3. Research Questions

The problems that arose demanded urgent and effective measures to support the industry from the state. As a result, the following measures have been implemented:

1. Loans restructuring (in the form of postponement of payment, reducing its size or using other possible measures to ensure debt sustainability);
2. Restrictions on scheduled inspections have been introduced (during 2020);
3. Term licenses and other permits (which expire from March 15 to December 31, 2020) have been extended for 12 months;
4. Postponement of licensing procedures for 12 months, or recognition of such procedures as completed, and the permit valid (for a number of activities requiring accreditation, certification and other licensing procedures);
5. The possibility of changing due to the spread of the epidemic, the timing, price of government contracts and the amount of advance payment on them;
6. Deferral from payment of rent under real estate lease agreements;
7. Deferral or exemption for the payment of rent payments when federal property is leased;
8. Granting the tenant the right to demand a reduction in rent for the period of 2020 due to the impossibility of using the property;
9. Full or partial write-off of penalties for government contracts;
10. Introduction of special rules for calculating penalties for violation of the deadline for the execution of a separate stage of the state contract;
11. Free certificate of force majeure for foreign trade contracts;
12. A 6-month moratorium has been introduced on filing bankruptcy petitions by creditors (for backbone organizations, strategic enterprises/joint-stock companies/organizations).

As for tax measures, as of June 2020, only two anti-crisis tax measures were in force for the construction industry: 1) a declarative delay/ instalment plan for the payment of tax and insurance premiums, 2) a two-fold reduction in insurance premiums. At the same time, these measures are applied to different categories of taxpayers: the first - to strategic, system-forming and city-forming organizations, and the second - to small and medium-sized businesses.

Interestingly, the share of large developers who received a tax deferral/instalment plan is higher than the share of small and medium-sized businesses that have already applied reduced insurance premium rates. Thus, 34% of eligible companies used the declarative deferral/instalment plan for the payment of taxes and insurance premiums by June 2020, which makes it the absolute leader among tax and non-tax measures to support developers in terms of the share of successful applications. Reduced insurance premium rates were applied by only 7% of developers small and medium-sized businesses. By June 2020, over 70% of these companies were in the process of receiving this measure or planning to receive it in the future. Such a demand for this benefit may be due to the fact that construction projects have been suspended and the volume of payments to employees has been reduced. With the gradual removal of restrictions on

construction, the volume of payments to employees increases, and with it the demand for reduced rates of insurance premiums is increased too (Dudukalov et al., 2020; Lipatnikov & Udalova, 2020).

In general, construction companies appreciate the measures taken to support the construction sector. Developers note the greatest positive influence from the introduction of a preferential mortgage program at a rate of 6.5%, which is able to stimulate demand in the housing construction market. At the same time, against the background of a decline in the material well-being of the population during the 2020 crisis, the effect of such a measure is likely to have a rather limited effect in the current year. According to an all-Russian poll conducted by the Center for Strategic Research in May 2020, only 5% of respondents may change their decision to purchase housing in response to a rate cut (Ermilova & Finogenova, 2017; Mezitova, 2020; Polyakov, 2020).

#### **4. Purpose of the Study**

Despite the fact that measures of state support ensured the functioning of the industry during the pandemic, they are insufficient for the companies to fully recover from the crisis. In this regard, it is proposed to introduce additional measures of state support, which are primarily necessary for the development of the construction industry:

1. Reducing the tax burden on developers;
2. Purchase (withdrawal) of land plots for renovation, their reclamation and provision of investors on preferential terms;
3. Possibility of phased disclosure of escrow accounts until the completion of construction;
4. Simplified procedure for connecting to networks, subsidies for reimbursing part of the connection costs;
5. Subsidizing the creation of infrastructure at the expense of future tax revenues from the project;
6. Assistance in resettlement of emergency and pre-emergency housing stock, in dismantling, liquidation, dismantling and disposal;
7. Providing a line of structured financial products;
8. Improvement of the public procurement system, namely the criteria for evaluating proposals
9. Introduction of a system of support measures for participants (developers) of the Integrated Territorial Development Program (ITD);
10. Improving the market for individual housing construction (IHC).

Reducing the tax burden is not only the main factor in the recovery of the construction industry, but also a driver of its development. To assess the fiscal measures with the greatest potential impact on the industry, the structure of taxes and fees paid by developers are presented below (Ermilova et al., 2018; Semakina & Shamanov, 2020; Semenenko, 2020).

In second place in terms of importance (from the point of view of the development of the construction business) is the possibility of buying out a land plot for renovation, their reclamation and provision of investors on favourable terms.

In third place is the possibility of phased disclosure of escrow accounts until the completion of construction. Note that the escrow account mechanism came into force in the summer of 2019 and for many potential buyers of residential real estate is an important condition for purchasing a home. However, if the introduction of escrow accounts leads to an increase in the cost per square meter, then the majority of Russians will choose an alternative object for the transaction - without escrow (for example, in the secondary market), but with more favourable price terms. Among the important conditions for development, the demand for a system of state support for participants in integrated development projects of territories shall be noted.

Despite the decline in interest in such a mechanism during the crisis, it is necessary to take into account the potential of this instrument in terms of creating jobs, increasing housing affordability, improving the image and investment attractiveness of the city. Also, one of the ways of state support for developers can be subsidies for the construction of infrastructure facilities (Morozova et al., 2020; Viktorov & Yaskova, 2020).

From July 1, 2019, in accordance with the Federal Law of December 30, 2004 N 214-FZ (as amended on June 27, 2019) "On participation in the shared construction of apartment buildings and other real estate and on amendments to some legislative acts of the Russian Federation" all developers are switching to a new model of project financing using the escrow mechanism. Against the background of the 2020 crisis, the relevance of the question of the potential effects of the introduction of this mechanism is increasing.

The following are the results of the analysis of the consequences and risks of introducing escrow accounts for all stakeholders of the process: buyers, developers, banks, the state.

A quantitative risk analysis allows us to conclude that the integral social and economic effect of the escrow mechanism is rather negative. The integral assessment (taking into account the probability of each risk occurrence) is minus 0.35. First of all, this is due to the fact that the positive effects for the state and banks do not exceed the negative effects for large, medium and small developers, expressed, first of all, in a decrease in the indicators of economic efficiency and investment attractiveness of projects.

The consequences of the 2020 crisis, in particular, the deterioration of the financial situation, are shaping the downward trend in demand for housing for at least 14% by the end of 2020. Due to these fact end-user support mechanisms are key to the construction industry.

## **5. Research Methods**

Today, experts' opinions on the impact of the escrow mechanism on the demand in the primary housing market are divided: some believe that the escrow system will increase the attractiveness of the primary housing market by reducing the risks of buyers and by ensuring the safety and reliability of citizens' investments in housing construction, making it impossible for new defrauded shared construction participants to appear. Other experts are convinced of the negative impact of the escrow system on final demand. These experts argue their position by the high sensitivity of demand to price, especially in a crisis.

According to surveys, for the majority of Russians planning to buy a home in 2020, it is important to have an escrow account when buying real estate. However, no more than half of them are willing to pay for such a transaction format: 56% note that if the cost per square meter is more expensive during escrow,

they will choose another option for the transaction, for example, an apartment in the secondary housing market. The phased disclosure of escrow accounts has a positive effect on pricing. It allows to reduce the risk of growth in real estate prices due to the use of credit funds, including during the construction phase (Yumashev et al., 2020).

Despite the fact that the decline in property prices is the second most important driver of demand for housing, today the sensitivity of demand to property prices is low.

The availability of funds and a down payment is also noted by citizens as the main factors contributing to the decision to purchase housing. At the same time, both the availability of funds for repairs and the availability of an initial payment largely depend on the ability of citizens to save money.

According to the annual report of the Bank of Russia for 2019, the increase in household savings decreased by almost 14%, and their share in the structure of cash income also decreased by 0.8 pp (from 4.2% to 3.4%). Taking into account the expected changes in the labour market in 2020 (an increase in unemployment, a reduction in wages), in 2020 the savings of citizens will decrease even more.

## 6. Findings

Analysis of the sensitivity of the number of mortgage loans to the rate for the period 2010 - 2019 reflects a fairly high dependence of these indicators. A decrease in the rate by 1 pp leads, on average, to an increase in the number of mortgage loans by 18-20% in the residential real estate market as a whole. On the primary market, it is lower and is 7-10%. During the crisis of 2014-2015 the weighted average rate at the end of the 1st quarter of 2015 increased by 2.7 pp (compared to the same period of the previous year), which was due to the implementation of the restraining monetary policy of the Central Bank of the Russian Federation (the key rate was increased from 7.5% in April 2014 to 14% in April 2015).

The increase in the interest rate led to a 46% decrease in mortgage loans issued in the housing market as a whole. The current economic situation differs significantly from the 2014-2015 currency crisis. The 2020 crisis is primarily associated with a shock contraction of domestic and external demand in the real sector. To adapt to the changed conditions, business is forced to optimize costs, including payroll. By June 2020, every fifth company notes that it was forced to lay off employees, 40% were forced to cut wages. All this leads to a decrease in the purchasing power of the population and to a contraction in demand (Akhmetshin et al., 2018; Ignatova & Cherkasova, 2010).

Against the background of a worsening financial situation, a decrease in mortgage rates (despite the previously identified strong dependence of demand on the rate) has a limited effect on the development of the housing construction market. For the majority of Russians (59%) who have a need to buy a home, the key condition for this is an improvement in their financial situation, and only for 5% - a decrease in mortgage rates is the key condition. In April 2020, despite a 2.2 p.p. decrease in the mortgage rate compared to April 2019 (which was facilitated by the implementation of a consistent monetary policy by the Central Bank of the Russian Federation aimed on reduction of the key rate and the implementation of a preferential mortgage program at a rate of 6.5%), the number of mortgage loans decreased by 17% in the whole housing market. In the primary market, the number of mortgage loans in April decreased even more (-31%) with a decrease in the mortgage rate by 3.2 pp. Taking into account the high sensitivity of mortgage loans to changes in the bank rate, a further decrease in mortgage interest rates can be an effective tool to stimulate

the housing construction market, provided that the material well-being of the population improves and other conditions for mortgage lending are improved (decrease in the initial payment, increase in the loan term, etc.).

## 7. Conclusion

Thus, the effect directly from the preferential program could amount to 70 billion rubles, or 8% of the volume issued in 2019 (this is the amount by which the growth of mortgage lending will be due to citizens who made a positive decision to buy a home due to the availability of a preferential rate). It is important that the effect has greater potential in case of conditions prolongation. Proceeding from this, it seems expedient to extend the period of implementation of the preferential mortgage program for the period 2021-2022 (until the recovery of incomes of citizens after the "shock" events of 2020) along with an increase in the volume of the mortgage loan to 6 and 12 million rubles.

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