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## **The financialization of large-scale urban redevelopment** **[Long abstract for RC21]**

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### Abstract

*The paper focuses on the role of financial institutions in large-scale real estate projects. The relationship between urban projects, land development and finance is increasingly consolidated but surprisingly under-investigated; there is little evidence of how global trends of financialization affect land development policies. There is a large variety of planning responses across national and urban contexts, depending on local political, institutional and economic conditions. We present a conceptual and empirical paper aiming at identifying the variables that play a major role in determining how the financialized economy and urban planning interact. Based on a specific case of large-scale redevelopment in the Milan metropolitan area, the paper inductively argues that the effects of financialization on urban development depend on the variegation in two main factors: the increase/decrease of the distance between capital and project ownership; and the degree of dependence of public governments on the yields of the project.*

**Keywords:** brownfields, financialization, urban redevelopment, real estate, land use planning

### **Introduction**

This paper proposes an analysis of the effects of financialization on large-scale urban projects. We aim to sketch the basic lines for a research agenda on the relationship between the financialization of real estate markets and urban planning processes. Although some general effects of the financialized economy on urban production are already known, financial capital is continuously inventing new tactics of ‘capital switching’ (Aalbers, 2012; Harvey, 1985) in order to reconnect global and non-territorial financial strategies with the production of built spaces, and to cope with altered perceptions of ‘risk’ in times of crisis (Ashton, 2011; Clark, Dixon and Monk, 2009). The current economic crisis has put urban development into question, problematizing the negotiation processes between large development corporations and cities, the public risk of planned projects, the financial risk for public governments of land development and weaker public budgets (Hackworth, 2002; Janssen-Jansen and Mulders, 2012; Kirkpatrick and Smith, 2011; Lovering, 2010).

Financialization is a pattern of accumulation in which profit making occurs increasingly through financial channels rather than through trade and commodity production (Arrighi, 1994; Krippner, 2005). Financialization demands that commodities become more liquid, enabling them to be compared to other investments and traded as such. The understanding of the effects of liquid capital, securitization and global trading on the built environments requires a combination of different fields of research, ranging from political economy and economic geography to urban and planning studies. In the last decades, three major research approaches have addressed the connection between global financialization, real estate and planning policies. Firstly, political economists and others have addressed the effects of the rescaling of statehood on the governance of city regions and looked at the emergence of new spaces for planning policies to address the challenges of global urban competition, giving way to the de-territorialization of financial capital and liquid assets (Aalbers, 2012; Brenner, 2001; Gotham, 2006; Langley, 2006). Secondly, an urban strand of this field of research has more precisely focused on the responses of city politics to these global trends and on the typologies of urban development policy. After the crisis of Fordism and of modern welfare state conceptual models have been developed to frame the new bounds and coalitions between local political forces and powerful business interests (Fainstein, 2008; Logan and Molotch, 1987; McGuirk, 2011; Savitch and Kantor, 2002). Thirdly, urban planners have studied the planning responses to and accommodation of globalization trends. Global processes of capital accumulation have been interlinked with local processes of social and political exclusion by means of ambitious large-scale projects. The rising trend of planning through large-scale development projects in the 1990s and early 2000s expresses a larger availability of credit, concentrated in the

hands of powerful development business groups, that parachute investments into selected 'prime' urban areas as well as in heavily subsidized 'sub-prime' urban areas, with the agreement of local entrepreneurial governments (Aalbers, 2011; Fainstein, 2001; 2008; Moulaert et al., 2007; Olds, 1995; Swyngedouw, Moulaert and Rodriguez, 2002). In this way, the real estate and financial markets extract value where they can, often enabled by direct and indirect state support that is said to be necessary to increase livability and spur local economic growth, but that often ends up costing more than the benefits that are delivered.

In this paper we follow Harvey Molotch' suggestion that "By tracing how land gets developed and how buildings get produced, you will have a key to understanding the social structure of the society and the basis of power, at the local level" (Molotch in Aalbers, 2004, p. 2). Although the growth coalition/machine literature (e.g. Logan and Molotch, 1987; Mollenkopf, 1983) has overcome its early criticism of being too much a one-size-fits-all model, the literature could still be criticized for paying too little attention to financial agents (but see Fainstein, 2001) and for ignoring the extra-urban powers at play here. The local elites are connected to national and global elites (Terhorst and Van de Ven, 1995) and these are increasingly financial elites. To understand *local* real estate and urban planning dynamics in the 21<sup>st</sup> century, one needs to understand the dynamics of *global* financial capital.

After the economic downturn of 2008 it is even more important to question how two decades of consolidation of the financialized economy and the ongoing process of welfare restructuring radically affect land use planning. There is evidence that urban development is, and will be, more and more dependent on large-scale projects (Lovering, 2010), but it is not yet clear whether these trends have changed neoliberal planning processes or generated a new balance between public governments and large business concerning land use planning (Adams and Tiesdell, 2010). We should look at how global financial players adopt new tactics of investment on land or whether local pro-growth coalitions maintain conservative investment strategies despite the current crisis (Dolphin and Nash, 2011; Feindt, 2010). In this paper we do not provide a clear-cut answer to this question but propose an exploration of possible key variables to address them. We discuss the hypothesis that the effects of financialization on urban development depend on the variance of two main factors: a) the increase/decrease of the distance between capital and project ownership in urban development; b) the degree of engagement of public governments to the yields of the particular project. We illustrate the hypothesis by looking at the tools, processes of negotiation and arrangements in one large project. First, however, we sketch the current trends of financialization in urban development projects.

## Conclusion

The in-depth investigation of the Falck case shows how financialization affects urban development. First, projects tend to gigantism. Developers cluster different projects to reduce the risk of the intervention and transfer gains to other expensive interventions. Second, projects tend to be particularly critical in strategic peripheral locations; these are areas where higher land rent can be extracted, such as brownfields with opportunities of dense development and larger margins of negotiation over possible developments. Furthermore, usually no large public investments on infrastructure are needed as these areas are already urbanized. Third, planning becomes instrumental to financial calculations. Land use planning is used to manage the balance between supply and demand of spaces, and turn the project into a positive business case for the private developer involved.

In the case of the Falck site, the project looked doomed, never-to-be-realized, as a result of high costs and high uncertainty a spiral of increased financial dependency developed. Yet, it is too early to come to any definitive statements. Looking at the Falck case it is possible to highlight the variables that, among others, have affected the masterplanning process. We inductively argue that a great deal of variation among cases can be explained by looking at the interactions between two sets of trends: the degree of detachment of project from capital and the degree of public dependency to the yields of the project.

*Degree of detachment of project from capital:* the institutional ‘distance’ between the developer of the project and the investor or creditor. The financialized economy has radically changed and enlarged the constellation of actors involved in land development. While traditional forms of finance include a wide use of debt finance (bank loans, mortgage), today there is a larger use of capital-based finance (equity finance versus mortgages) leveraged from existing land assets, which means the raising of capital either through issuing of securities by SPVs to investors or by selling different stocks or other financial products to finance the projects, whose earnings are returned as dividends. The search for larger sums of capital to invest in risky developments has somehow generated a gap between processes of capital increase and ownership, and project development (Theurillat and Crevoisier, 2012). The financial games played by banks affect interest rates to debtors; the need to draw ever-larger sums of credit to finance projects (often through risky products with high interest rates) directly increases the need to augment the produced marketable square meters of project. This more indirect link between capital and

project ownership is maintained by intermediate agents, including special purpose vehicles (SPVs) (Torrance, 2008). SPVs are commonly used in planning to separate project risk from corporate assets and to allow local management of the project, whose financial decisions are taken at distance. The use of these tools has weakened any hierarchy in the calculation of investment risk and contributed to a supply driven real estate crisis (Beitel, 2000; Goldin and Vogel, 2010).

As we saw from the redevelopment of the Falck project, the increasing distance between capital and project seems to have two sorts of effects. First, it tends to detach the calculations of return investments from local fluctuations of demand. In the long run, with higher perceptions of risk, developers might become more dependent on the profit expectations of the shareholders of these companies, often consortia comprising different companies, some of them transnational. The expected yields of investment tend to increase, including the dividends of the shareholders, together with the managerial complexity of these consortia. The projects tend to become inflated to match the expected returns and cover increased financial costs. In the Falck case, it tended to include more residential and large retail space, while overlooking local demand of small-scale industries and diversified spaces. Secondly, the detachment seem to strengthen the risk of speculative tactics; trading land becomes a business on its own, to ensure money streams to creditors and to cover debts generated from other bad investments. The Falck land was indeed traded to cover the debts accumulated through other projects and its planning eventually became an item (among others) on the company's (i.e. Risanamento Spa) financial saving plan. The developer's SPVs become the tools to protect the originator corporations from liabilities (Glenn, 2005). SPVs are used to manage land assets and securitize mortgages for development, whose potential value is transferrable to other corporations. SPVs can turn concrete land assets into bonds to generate further credit for the project. While the gains go back to the originator company, the risk entailed in these bonds remains with the project developer. The use of these kinds of financial instruments of risk management implies a disconnection between the project and the capital that's backing it.

*Degree of public dependency to the yields of the project:* this depends on the pro-activeness of public authorities and investors in the development process. This dependency can be inferred from two sorts of variables, the financial set up of public-private development corporations and the type of instrumental use that municipalities make of zoning regulations, development regulations and planning frameworks. First, the development process can be bounded by local regulations in planning. There is evidence that zoning regulations and environmental restrictions on development plans have actually increased rather than decreased (McLaughlin, 2012). In this case, public authorities make use of regulatory tools (first of all zoning

plans) to control the project output or capture unearned ‘betterment values’ (Alterman and Balla, 2010) from the private initiative (Micelli, 2002). In other instances however, cities might become proactive initiators and investors in the project. Local governments can proactively participate in the project and become active players in the development industry. They can use active, public-led types of land readjustment techniques and institute hybrid forms of mixed capital development corporations (Larsson, 1997; Van der Krabben and Jacobs, 2013). In doing so, they operate as a mediator between private shareholders expectations and their own needs and demands. Since local governments also guarantee returns, the development risk starts to weigh heavy on the public budget. Rather than becoming co-developers of projects, local governments can also issue project-bounded bonds or directly guarantee yields of a project through of fiscal policies (e.g. ‘Tax Increment Financing’) (O’Neill, 2009; Weber, 2010).

The choice between a regulative or proactive approach to planning gigantic projects ultimately depends on the risk tolerance capacity of public treasuries (Sagalyn, 1997) or on the autonomy of public authorities from returns produced through ‘betterment fees’ and subdivision costs. In the Falck project, a small municipality to the north of Milan has played a reactive role, working on zoning restriction and on specific claims of public amenities to be produced by the developer. Opting for an active partnership in the project development is not a viable option, as it would dramatically increase the public risk in such a gigantic project. However, the Falck project has eventually showed that a purely regulative role and zoning has not limited private initiative or financial games. The city eventually decided to get involved through new plans of public health facilities to boost the project. It is too early to assess the effect of this public support to boost a private project in times of crisis.

In this paper we have investigated how ongoing trends of investment relocation tactics, urban projects gigantism and instrumental land use planning work in practice and how they are related to the involvement of financial agents in land and real estate development. It suggests that future research on financialized urban development should focus on the outcomes of the co-variation of both *the source of capital* and *the degree of public dependency to the yields of the project*. The role of government is a crucial one against arguments in favor of more deregulation to free up competition in land markets. However, the extent to which this means more proactive involvement of public authorities in land development needs to be assessed. Public land development agents might turn into institutionalized instruments of land rent, equally dependent on self-raised revenues through securities or financial products. On the other hand, a strictly regulative role of public bodies might fail to exercise the adequate influence on territorialized financial investments. Equally important is the management

of the boundaries of financial processes, which turns land assets into simple items to be bought and purchased, oblivious to the local demands of urban space.

In the end, the financialized development model has demonstrated to be far from sustainable. Many development firms are in crisis or even out of business. At the same time, local governments are faced with tight budgets. There is, however, not only a 'fiscal gap' that would make Keynesian policies difficult; there is also a lack of political will to enable local government to intervene and kick-start the economy (i.e. austerity). The mistakes that so many a city have made are not only making local governments careful not to get too deep into development projects, they have also crippled them from taking any action, leaving the development of key city projects in the hands of the few private actors that have not been wiped out, or at least forced to deleverage and scale-down. This leaves brownfields, such as the Falck site, undeveloped – at least for the time being – but it also calls into question the absurdity of over-financialized urban redevelopment that takes into account the demands of global capital at the expense of local communities. Perhaps the only way out is one of small-scale, bottom-up, urban redevelopment, although brownfield sites often still demand massive funding to ensure a healthy environment. In the face of the aforementioned budget cuts, this suggests commercial developments that can cross-subsidize some of the costs of environmental clean-up are necessary. Yet this also demands a redefinition of the role of local government, which although it could range from more regulative to proactive in land management, needs to be strong and convinced, independent from those dynamics that have proven unstable and unsustainable.

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