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96-107 **ANDREA MARIA JANDRIČEK** COOPERATIVE LAND READJUSTMENT  
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FOR RECONSTRUCTING AREAS  
OF UNPLANNED URBAN DEVELOPMENT  
PRELIMINARY COMMUNICATION  
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ZA REKONSTRUKCIJE PODRUČJA  
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PRETHODNO PRIOPĆENJE  
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FIG. 1. UNPLANNED CONSTRUCTION IN PROTECTED AREAS IS ONE OF THE CHALLENGES OF PHYSICAL PLANNING  
SL. 1. NEPLANSKA GRADNJA U ZAŠTIČENIM PODRUČJIMA JEDAN JE OD IZAZOVA PROSTORNOG PLANIRANJA

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## COOPERATIVE LAND READJUSTMENT A BOTTOM-UP STRATEGY FOR RECONSTRUCTING AREAS OF UNPLANNED URBAN DEVELOPMENT

### ZADRUŽNA KOMASACIJA

#### *BOTTOM-UP* STRATEGIJA ZA REKONSTRUKCIJE PODRUČJA NEPLANSKE GRADNJE

ECONOMIC DEVELOPMENT  
LAND READJUSTMENT  
RAPID URBANIZATION  
TOURISM CROATIA  
URBAN SPRAWL

EKONOMSKI RAZVOJ  
URBANA KOMASACIJA  
RAPIDNA URBANIZACIJA  
HRVATSKI TURIZAM  
NEPLANSKA GRADNJA

This paper examines how small property owners in low density residential areas could establish a cooperative to finance a demolition and reconstruction of their community in order to improve urban and economic conditions. A fee developer is contracted to oversee the project while residents become full or majority owners of high income generating commercial properties as well as new housing. This paper considers a hypothetical application to areas of unplanned construction on the Adriatic coast in Croatia.

Ovaj rad proučava kako vlasnici manjih posjeda u području nize stambene gustoće mogu uspostaviti zadrugu za financiranje, uklanjanje i rekonstrukcije svojih područja da bi poboljšali urbane i ekonomske okolnosti. Konzultant koji je stručan u razvoju nekretnina bio bi angažiran da nadgleda proces, a vlasnici ostaju punopravni ili većinski vlasnici visokovrijedne poslovne imovine te vlasnici novih stambenih jedinica. U ovome radu razmatra se hipotetska primjena područja neplanske gradnje na Jadranskoj obali u Hrvatskoj.

## INTRODUCTION

### UVOD

*"A cooperative is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise."*

International Co-operative Alliance [ICA]

*"cooperative: [Origin- early 17<sup>th</sup> century: from late Latin cooperativus, from Latin cooperat- 'worked together', from the verb cooperari]"<sup>1</sup>*

**R**apid urbanization, often accompanied by unplanned urban development or urban sprawl, has intensified in recent times creating a unique set of challenges for cities in both the developed and developing world. Unplanned development manifests itself in a variety of physical forms in different cultures and economies, but eventually becomes part of the fixed urban landscape, representing some of the more durable<sup>2</sup> features in the physical environment. It sets the structure for future growth<sup>3</sup> and affects the functioning of the larger region as a whole. Unplanned urban development occurs within a complex set of conditions over time and is a reminder that actual land use management never happens in a vacuum, but is shaped by a multitude of private and political interests (or disinterest), real market pressures and sometimes unforeseeable social and economic forces. Challenges arise when the immovable urban form or structure begins to adversely affect a community or its environment, or can no longer effectively accommodate the more fluid changes in society such as the fast moving demands of capital markets or the shifting needs of changing demographics.

While unplanned development affects all land types, unplanned residential development may be especially problematic to reassemble because of the multitude of small property owners involved. This paper consid-

ers how a cooperative property structure could be applied on a larger geographic scale to reconstruct an area of unplanned residential development. It examines how a bottom-up financing approach, driven by local landowners and broken down into smaller phases might be a more manageable and motivating method for residents to reconfigure their environment for the betterment of their communities. The ideas expressed in this paper are exploratory in nature and consider more a general framework for rearranging existing urban space and creating new value for property owners and their communities, and not so much on the specifics of cooperative property structures or construction loan financing. The model could be effective in areas that have naturally high land value and could support a more vigorous level of economic activity, but are currently affected by unplanned growth or low density urban sprawl in different parts of the world.

The Republic of Croatia was caught in between two major political shifts when rapid urbanization and an unprecedented construction boom of private accommodation and secondary vacation homes took place most notably along the Adriatic Coast. What resulted after many years of this pattern of building was a disorderly patchwork of low density unplanned construction, along with an urban infrastructure that now limits guest capacity and future significant development in locations of high touristic value. The purpose of the cooperative land readjustment model applied to Croatia would be to rehabilitate the physical urban environment in areas affected by the unplanned construction; establish a more competitive business infrastructure that would encourage larger

\* Author's note: This paper is a continuation of ideas initially researched at the University of Zagreb, Faculty of Architecture. It suggests one of many possible approaches to property reassembly with the goal of rehabilitating urban environments and strengthening communities. The author is thankful for the ongoing academic feedback and support from professors N. Lipovac, Lj. Mišević, K. Šerman and J. Tica.

1 <http://dictionary.cambridge.org>

2 FUJITA, 2001: 1

3 SOULE, 2006: 80

4 PETRIC, MIMICA, 2011: 11

5 PETRIC, MIMICA, 2011: 12

6 PETRIC, MIMICA, 2011: 12

7 PETRIC, MIMICA, 2011: 11

8 The Council for Mutual Economic Assistance [COMECON] 1949-1991, was an economic organization under the direction of the Soviet Union, which united countries of the Eastern Bloc along and a number of socialist states to facilitate trade. COMECON was formed as a reaction to the establishment of the Organization for European Economic Co-Operation in Western Europe. Yugoslavia entered in 1964 under an associate status.

9 The Republic of Croatia as a new EU member state is facing many economic challenges and is in need of deep structural reform on both the national and local levels. In

scale job creation and future investment; and provide a platform for the eventual development of other industries outside of the tourism sector.

## CROATIAN TOURISM AND UNPLANNED URBAN GROWTH

### HRVATSKI TURIZAM I NEPLANSKA GRADNJA

The Yugoslav Economic Reforms of 1965 identified tourism as a strategic interest in order to create an ongoing supply of foreign currency as the existing domestic currency was non-convertible for international trade.<sup>4</sup> While there were significant developments in planned hotel construction during this time, private accommodation provided a quick way to increase overnight capacity without a large investment.<sup>5</sup> Government policy encouraged the construction of private accommodation with lower interest rate loans to individuals<sup>6</sup> and by 1965, private accommodation flourished contributing to more than 42% of overnight stays according to the Chamber of Economy in Split.<sup>7</sup> Growth in the private accommodation category grew strongly in the following decades until the Croatian War of Independence (1991-1995) brought a disruption to the tourism market. The end of the Homeland War and coinciding Fall of Eastern bloc countries created tectonic shifts in COMECON<sup>8</sup> markets and traditional Eastern bloc trading partners virtually dissolved overnight.

The coming years in Croatia were characterized by adjustments to new market conditions both internationally and domestically including a large scale privatization process. While privatizations are intended to create

2014, Croatia has the third highest unemployment rate after Greece and Spain among EU member states at 17% (with youth unemployment at 52.4%) and is the only new member that is projected to have a negative GDP of -0.5% in 2014 according to the World Bank. The country has sold or exhausted many of its economic resources and currently depends on high interest rate foreign loans, at a credit rating of BB (two levels below investment grade).

<sup>10</sup> PORTOLAN, 2012: P 42

<sup>11</sup> Croatia has only two laws regulating touristic private accommodation operations: *Zakon o ugostiteljskoj djelatnosti* or *The Hospitality and Catering Industry Act* [NN 138/2006, act 28] and *Zakon o pružanju usluga u turizmu* or *The Act on the Provision of Tourism Services* [NN 68/07, 88/10]. Little requirements are outlined for operators of such facilities. For example, there is no foreign language requirement or no specialized education or ongoing training.

<sup>12</sup> The private accommodation industry in Croatia does not have a well-organized national marketing platform and owners rely on their own strategies and resources to reach guests. Services and facilities are not standardized and guests are not completely sure what type of accommodation they will be receiving.

<sup>13</sup> In an attempt to stay outside of the VAT system, some owners do not record all of their overnight stays resulting in loose accountability and a grey tourism economy.

TABLE I QUANTITY OF ACCOMMODATION TYPES IN CROATIA 2012-2013  
TABL. I. KOLIČINA I VRSTA SMJESTAJA U HRVATSKOJ 2012.-2013.

Type of Accommodation	Number of Beds		INDEX 2013/2012	Structure (%)	
	2012	2013		2012	2013
Hotels and Apartment Hotels	129,151	132,755	102.8	14.67%	14.34%
Tourist Resorts	29,144	29,842	102.4	3.31%	3.22%
Camping Sites and Small Camps	226,785	239,424	105.6	25.77%	25.86%
Private Rooms	401,137	416,991	104.0	45.57%	45.04%
Spas	2,510	2,493	99.3	0.29%	0.27%
Vacation facilities	5,400	4,113	76.2	0.61%	0.44%
Hostels	7,209	8,907	123.6	0.82%	0.96%
Other	73,999	87,523	118.3	8.41%	9.45%
Uncategorized Accommodation	4,835	3,725	77.0	0.55%	0.40%
TOTAL	880,170	925,773	105.2	100.00%	100.00%

Source: Ministry of Tourism Report, *Tourism in Figures 2013* (Edition 2014), Republic of Croatia, Ministry of Tourism

more jobs and a competitive economic framework, the one in Croatia weakened the economy considerably<sup>9</sup> and valuable national assets including highly prized hotels and resorts were sold to foreign investors. Future earnings were put in foreign hands, while very little hotel facilities remained in local ownership.<sup>10</sup> In the absence of a more structured tourism industry, private individuals continued to seize opportunities in the private accommodation sector, leading to an uncontrolled expansion in this segment far beyond any other accommodation category (Table I, Fig. 2). However despite its disproportionate prevalence, the private accommodation category never became a well regulated sector neither from a legislative<sup>11</sup> nor business development<sup>12</sup> perspective. It also became a contributing factor to the current grey tourism economy<sup>13</sup>. In addition to the overly built private accommodation inventory, what confounded the physical environment even more was an equally large surge of secondary home construction built both legally and illegally (Table II, Fig. 4). Spontaneous construction led to unplanned urban

FIG. 2. PRIVATE ROOM ACCOMMODATIONS MAKE UP NEARLY HALF OF THE ACCOMMODATION CAPACITY IN CROATIA  
SL. 2. PRIVATNI SMJESTAJ ČINE GOTOVO POLA SMJESTAJNOG KAPACITETA U HRVATSKOJ

FIG. 3. THE PRIVATE ROOM ACCOMMODATION INDUSTRY ENCOURAGES A LESS STRUCTURED ECONOMY  
SL. 3. SEKTOR PRIVATNOG SMJESTAJA POTIČE SLABIJU REGULIRANU EKONOMIJU





FIG. 4. THE CROATIAN ISLAND OF VIR IS AN EXAMPLE OF AN AREA AFFECTED BY UNPLANNED SECONDARY HOME CONSTRUCTION

SL. 4. HRVATSKI OTOK VIR PRIMJER JE PODRUČJA UGROŽENOG NEPLANSKOM GRADNOM SEKUNDARNOG STANOVANJA

areas which created a physically and visually disorganized environment, lacking a sense of identity along with the basic amenities necessary for a tourism destination such as recreational, cultural, entertainment and other open spaces (Figure 5). Inadequacy in the areas of road structure, parking, utilities, poor water supply and sewage<sup>14</sup> now not only limits the current capacity for more or different types of visitors, but also real development in the tourism sector as well.

While the tourism industry in Croatia continues to grow, latest reports from the Croatian Ministry of Tourism suggest that the emphasis of activity still tends to be oriented around the shorter summer season in the lower profit generating accommodation categories (Table 1 and 3). The global tourism sector on the other hand surges strongly forward in all travel segments, growing 4.7%<sup>15</sup> in 2014 despite overall slow economic growth. Today's global tourism has evolved into a highly competitive and diverse industry not only in the traditional areas of business, luxury, family travel and the like, but in newly emerging sectors such as genealogy and set-jet<sup>16</sup> travel to name a few. As world economies are shifting, so are visitor demographics and large unexpected population segments such as the middle class in China and India are beginning to travel.<sup>17</sup> Changing traveller behavior and higher expectations are shaping the industry with a greater emphasis on quality experiences that provide substance and meaning to travel activities. Traditional destinations are becoming less interesting, which may put destinations such as Croatia in a unique position for expansion and growth. However the important question for Croatian tourism at this moment may be, will the current physical urban environment affected by unplanned construction be able to capture new market trends effectively and attract return visits, or will it foster an under regulated commercial environment hindering real economic development.

## COOPERATIVE LAND READJUSTMENT

### ZADRUŽNA KOMASACIJA

Any significant change to the current physical urban structure would require a land adjustment strategy including improved infrastructure and the physical expansion of public space. An effective land readjustment initiative would require not only large financing capacities, but would have to reflect local values on property ownership and gain strong consensus from the residents as well. In contrast to traditional top-down investor driven real estate development, perhaps another option worthy of pursuing may be a reverse bottom-up approach where local owners rep-

resent themselves as a single landowning entity through a business cooperative to secure financing for a collective redevelopment of their area. Cooperative agreements, referring to the concept of sharing resources due to individual limitations to create a more effective return, are historically universal ideas and can be associated as far back as ancient communal farming and hunting.<sup>18</sup> It was not however, until the Industrial Revolution that the modern Cooperative Movement, largely shaped by the ideas of Robert Owen, Louis Blanc and Charles Fourier began to emerge as both a formal business structure and an influential social force.<sup>19</sup>

Implementing a cooperative property model to a larger urban area for the purposes of demolition and reconstruction would have some similarities to a cooperative housing model. Assembling the owners would require that residents have legal claim to their properties, as the value of the property becomes the basis for shareholder participation in the cooperative. Although ownership structures vary from country to country, members usually form a Limited Liability Company [LLC] where individual shareholder value is equivalent to a capital contribution or in this case, the market value of the original residential property. Similar to any LLC structure, owners would form a Board of Directors who would work closely with a fee developer to oversee the project. Since smaller property parcels would be consolidated, the revised Master Plan could incorporate more robust changes in the physical environment, not dependent on current property lines or street networks (Fig. 7). Once construction would be complete<sup>20</sup>, owners would be entitled to new private residential units that would replace their original homes, in addition to becoming owners of a portfolio of new commercial, income generating properties.

**A. Private ownership: separating private residential units from the commercial portfolio** – Because the new development would be a mix development of commercial and residential properties, it would be beneficial to separate the residential and commercial properties into different legal entities such as a homeowner's association for the residential buildings and a holding company for the commercial properties (Fig. 8). This separation would create stability for homeowners,

TABLE II NUMBER OF BUILDING LEGALIZATION APPLICATIONS IN COUNTIES AND CITIES SURROUNDING COASTAL CROATIA

TABL. II. BROJ MOLBI ZA LEGALIZACIJU ZGRADA U ŽUPANIJAMA I GRADOVIMA U OKOLICI OBALNIH PODRUČJA HRVATSKE

Location	Number of applications for building legalization
Primorsko-goranska County	44,185
City of Rijeka	8,653
Ličko-senjska County	15,588
Zadarska County	53,669
City of Zadar	13,258
Šibensko-kninska County	22,181
City of Šibenik	8,591
Splitsko-dalmatinska County	54,603
City of Split	13,663
City of Kastela	8,380
City of Trogir	3,180
City of Makarska	2,318
Istarska County	24,404
City of Pula	5,686
City of Pazin	1,063
City of Poreč	4,176
City of Labin	2,008
City of Umag	3,093
City of Novigrad	1,072
City of Rovinj	2,883
City of Vodnjan	3,611
Dubrovačko-neretvanska County	17,989
City of Dubrovnik	5,440
TOTAL	319,694

Source: Accessed 21 March 2014/ Ministry of Construction and Physical Planning, Republic of Croatia [https://legalizacija.mgipu.hr/izvjesce]

<sup>14</sup> PETRIC, MIMICA, 2011: 18

<sup>15</sup> <http://unwto.org>

<sup>16</sup> Location or "set-jet" travel refers to visiting destinations that are represented in film or popular television series.

<sup>17</sup> <http://www.economist.com>; <http://www.oxfordbusinessgroup.com>

allowing them direct control over their personal property and not exposing their personal homes to risks associated with commercial properties.

The homeowner's association would be an administrative vehicle that would allow the residents to have direct title over their individual dwelling units while also allowing them to assemble formally as a single land owning entity to seek a construction loan for a multi-family dwelling. Individual units within the new structure would then be divided so that each homeowner would have title to an individual apartment condominium. Each homeowner would be entitled to a new apartment unit of equivalent market value of their original property (referred to in further texts as "private property entitlement" or PPE). The loan on the new multi-family building would most likely be paid by increasing dwelling unit densities and selling or leasing these additional units at market rate, thus increasing the overall population density of an area.

The holding company, on the other hand would be made up of individual commercial properties represented under separate LLCs, each financed by an individual construction loan to manage risk and provide owners more options for each property (Fig 9). In this way, separate commercial properties could be easily marketed, sold or leased and any legal claim, market failure or loan default against a specific property would not affect the other commercial properties in the holding company or individual residents in the homeowner's association. Each homeowner would be entitled to an ownership percentage in the holding company based on the market value of their original home or property in relation to the aggregated sum of all original properties.

**B. Public ownership: financing public land and related infrastructure** – Any new economic activity or an increased population density would bring about a substantial change in the urban character of an area which would require expanded public land and infrastructure. The financing for this could be seen as twofold and categorizes as (1) acquiring the necessary land or physical space and (2) paying for the infrastructure, materials and services. Since most municipalities do not have the capital to undergo



extensive changes, a combination of strategies, namely tax incentives and tax incremental financing [TIF] could be implemented to keep the public financing manageable.

In the case of acquiring additional land, a municipality could provide tax incentives in the amount equivalent to the value of land towards the holding company over time until the new public land acquisition is paid in full (Fig. 11). Depending on the tax jurisdictions of a municipality, this could mean a reduction of property or city taxes. In the case of Croatia, cities and municipalities have some, but smaller taxing authority which may be negligible when buying back large areas of land or expensive property. If this would be the case, an agreement could be made with federal taxing authorities to reduce, for example, corporate taxes on the holding company until the value of the land would be paid in full. While acquiring land may be achieved through a straightforward tax incentive, financing the actual infrastructure and related engineering and contracting services would be a different issue. Funding could come in the form of tax incremental financing [TIF] and would not need to burden the current city budget (Fig. 10). The idea behind TIF is to fund new public infrastructure by the project-

FIG. 5. UNPLANNED CONSTRUCTION HAS CREATED PHYSICALLY AND VISUALLY DISORGANIZED ENVIRONMENTS  
SL. 5. NEPLANSKA JE GRADNJA STVORILA PROSTORNO I VIZUALNO NEORGANIZIRANE URBANE SREDINE

FIG. 6. RAPID URBANIZATION HAS RESULTED IN MISMATCHED LAND USES

SL. 6. RAPIDNA JE URBANIZACIJA REZULTIRALA NEODGOVARAJUĆIM ZEMLJIŠNIM NAMJENAMA

TABLE III OVERNIGHT STAYS IN THE TOURISM SECTOR IN CROATIA ACCORDING TO MONTH IN 2013  
TABL. III. BROJ NOĆENJA U SEKTORU TURIZMA U HRVATSKOJ PO MJESECIMA U 2013.

	Total Overnights			Structure in %	
	Total	Organized	Individual	Organized	Individual
January	277,420	182,763	94,657	65.9	34.1
February	311,455	122,261	189,194	39.3	60.7
March	684,147	379,059	305,088	55.4	44.6
April	1,465,288	879,106	586,182	60.0	40.0
May	3,819,611	2,006,795	1,812,816	52.5	47.5
June	7,726,889	3,168,990	4,557,899	41.0	59.0
July	18,791,963	5,515,074	13,276,889	29.3	70.7
August	21,376,907	5,925,268	15,451,639	27.7	72.3
September	7,683,276	3,316,064	4,367,212	43.2	56.8
October	1,798,675	1,068,895	729,780	59.4	40.6
November	508,077	216,076	292,001	42.5	57.5
December	387,106	144,951	242,155	37.4	62.6

Source: Ministry of Tourism Report, *Tourism in Figures 2013* (Edition 2014), Republic of Croatia, Ministry of Tourism

18 ZEULI, CROPP, 1988: 1

19 The cooperative model became a response to the growing plight of the industrial worker in the 18<sup>th</sup> century and found its way into a number of industry sectors including consumer retail, finance and insurance and housing development.

20 Affected owners would be relocated to temporary housing during construction.

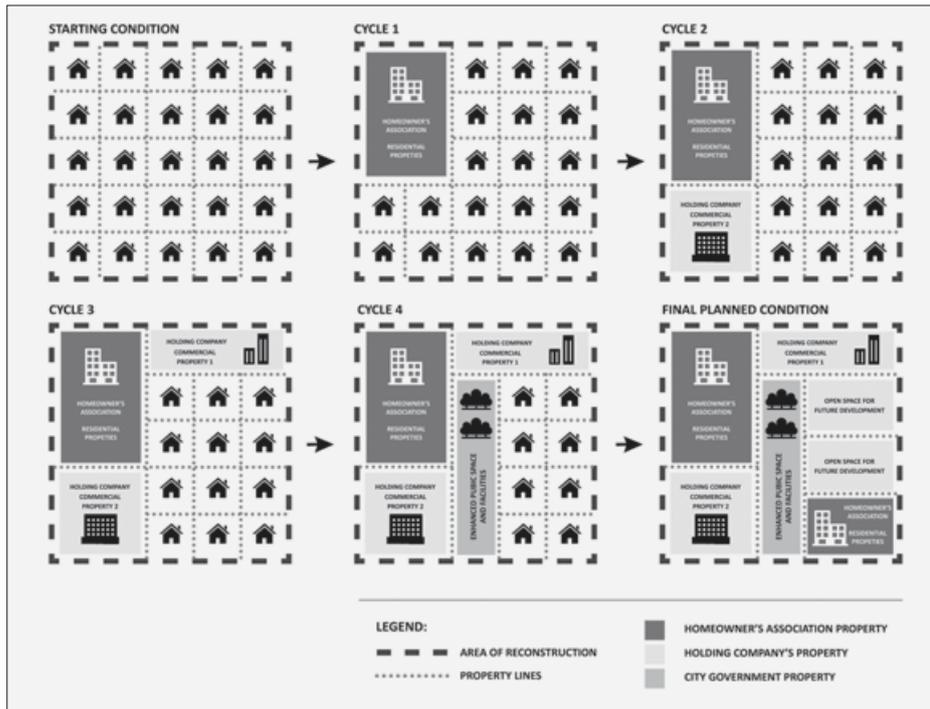


FIG. 7. SCHEMATIC DIAGRAM REPRESENTING INCREMENTAL URBAN CHANGES

SL. 7. SHEMATSKI PRIKAZ KOJI PREDSTAVLJA POSTEPENE URBANISTIČKE PROMJENE

ed tax revenue that will be generated due to the increased commercial activities and larger tax base derived from the new economic development. Although most TIF structures are typically based on a property tax system, other forms of taxes could also be considered as well. Croatia has not yet introduced a property tax, but could possibly use, for example, its current Value Added Tax [VAT] instead. In this case, projections on increased VAT in Croatia could come from, as an example, anticipated property sales of individual vacation units.<sup>21</sup>

## URBAN DEVELOPMENT PHASES

### URBANE RAZVOJNE FAZE

The new real estate development would follow many of the same phases of a typical building development project. However since a larger urban redevelopment would require a more interwoven economic and physical planning process, landowners could not work entirely on their own, but would need the skill from local planning authorities and other allied professionals. In order to keep local owners as owners of the new development, a fee developer would be employed instead of an investor developer<sup>22</sup>, which would change some of the financing dynamics of the various stages of development, typically broken down into (1) pre-development, (2) pre-construction, (3) construction and (4) permanent capital funding (Table IV).

**1. Pre-development** – Traditionally an investor finances all activities in a pre-development phase which usually consists of a market study, financial analysis, zoning and permit reviews while obtaining control of the site. An analysis for a larger urban development however, would need to be more comprehensive including density and demographic projections, transportation recommendations, utility enhancements, environmental impact studies and the like. The analysis would need to be exhaustive enough to provide the basis for a revised Master Plan which would redefine larger physical elements such as land uses and transportation corridors. Given probable changes in demographics and density, consideration would also need to be given to new or expanded public buildings such as schools, libraries and similar facilities. Pre-development would also need to include preliminary financial modeling studies to be able to scale and assess the general direction of the new economic activity. Given that such an urban development would be of great benefit to a municipality by greatly increasing the tax base and providing a more sustainable platform for future investments, it might be reasonable to expect that pre-development activities could be organized and financed by the public sector. If pre-development indicators suggest a promising outcome, the project could progress into pre-construction which would be led by a fee developer.

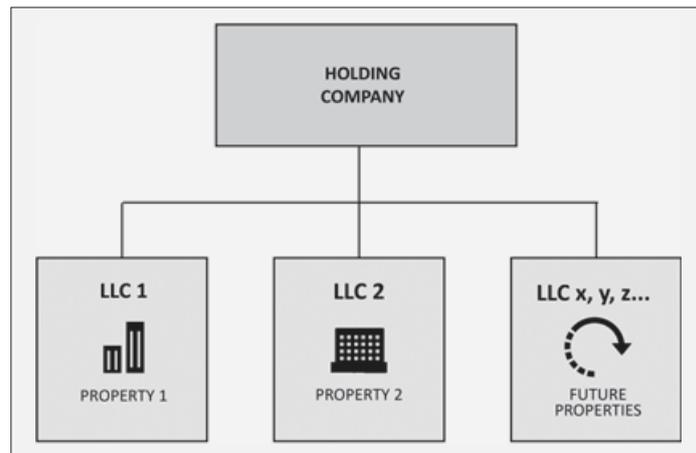
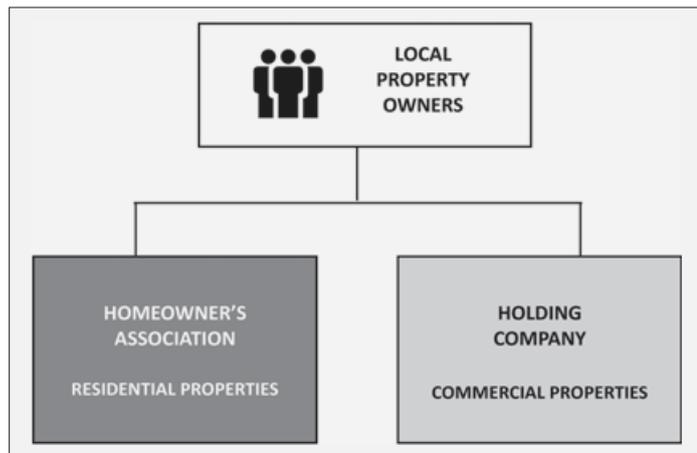
**2. Pre-construction** – The goal of pre-construction is to prepare all documentation necessary for a construction loan which would include assembling the residents into a cooperative structure; eliminating existing property liens<sup>23</sup>; legally and physically aggregating parcels; developing the architectural and engineering plans for both the housing and commercial structures in order to determine construction pricing; and the naming of a

<sup>21</sup> As a simple calculation, if 50 new vacation apartment units could be sold at an average value of EUR 100,000, the additional VAT of 25% generated by these sales would be a one-time EUR 1,250,000 amount directed towards a new public capital improvement. This would not include the increased VAT that would come from increased business activities generated over the years to come.

<sup>22</sup> A fee developer is hired by an investor to perform property development activities whereas an investor developer develops his properties using his own resources.

<sup>23</sup> Reconciling property liens, particularly mortgage liens is key to obtaining construction loan financing. There could be a few options for this. The first option may be engaging an investor to buy existing debt on a property allowing the investor to become a stakeholder in the new development. Another option may be including the debt as an expense in the construction loan. In this case, the mortgage would then be refinanced and the owner would continue to pay obligations to service the previous debt.

<sup>24</sup> The appointment of a general contractor in advance is important as many lending institutions use the com-



general contractor and property manager.<sup>24</sup> These activities would be followed by an underwriting process conducted by the bank once all construction documentation is in place. A lending institution typically does not cover pre-construction costs as part of the construction loan, but the expenses could be covered by an additional bridge loan.<sup>25</sup> The residents however, could reduce some of their costs by engaging, for example, the fee-developer as an equity partner or minority shareholder in the holding company in lieu of paying for property development services outright.

Regardless of whether the structure is residential or commercial, each building would apply for a separate construction loan to manage risk and provide a more careful physical redevelopment of the area. The newly defined parcel on which the future structure would be built would be appraised and, if the appraised value of the cleared land is high enough, it could in many cases satisfy the equity portion on the construction loan. If however, the appraised value of the cleared land

pleted new development as collateral for a construction loan. If the borrower defaults while the project is in construction, a bank would want to ensure that contractors are in place to finish the development without interruption. In a similar vein, a property management company would maintain the properties professionally and oversee the operative, administrative and legal aspects of the business including tenant relationship, lease collection, maintenance, legal and administrative issues.

<sup>25</sup> Pre-construction costs would include fee developer services, architectural and engineering services and legal expenses related to arranging the homeowners in a cooperative.

<sup>26</sup> A revolving loan refers to a lending arrangement in which the borrower can withdraw, repay, and redrawn loan amounts in any manner and any number of times until the lending arrangement expires. [<http://www.businessdictionary.com>]

<sup>27</sup> Projected performance can be calculated by income multipliers and other indicators including operating, break-even and debt-coverage ratios.

is not high enough, an outside investor could be engaged as a minority shareholder to cover the equity requirements for that particular property. If the lending risk for a certain area is high and loan equity requirements rigid, residents may decide to sell their first newly built commercial property at market rate for a profit to raise capital in the holding company as well as to establish a stronger credit rating. The newly earned capital could then be used as equity in subsequent construction loans.

Separating the buildings into individual construction loans could also be more conducive to a possible revolving loan strategy<sup>26</sup> which would enable smaller amounts of capital to be reused as each building project successfully completes. Similar to micro-loans, a revolving loan approach could operate in a self-sustaining system, recirculating funds to new building projects as previous loans are repaid. The step by step approach would also allow room for planners and developers to make spatial adjustments and business changes as needed and respond better to changing market conditions. Since the funding of future projects depends upon the successful completion and repayment of previous loans, the revolving loan method would also bring more transparency and higher social accountability to the process.

The role of the lending institution would be very important as proper loan structuring would require a special understanding of the project and its associated risks. Depending on the economic viability of the redevelopment, a construction loan could come from either a commercial or non-commercial lending institution or a combination of the two. Commercial banks would apply a more rigorous underwriting process with a special emphasis on loan-to-value [LTV] ratios in addition to other factors.<sup>27</sup> A non-commercial

FIG. 8. RESIDENTIAL AND COMMERCIAL PROPERTIES ARE SEPARATED INTO SEPARATE LEGAL ENTITIES

SL. 8. STAMBENE I TRGOVAČKE JEDINICE ODVOJENE SU U ZASEBNA PRAVNA TIJELA

FIG. 9. EACH COMMERCIAL PROPERTY IS REPRESENTED BY A SEPARATE LIMITED LIABILITY COMPANY [LLC] UNDER A HOLDING COMPANY

SL. 9. SVAKA JE POSLOVNA IMOVINA PREDSTAVljena KROZ ZASEBNA DRUŠTVA S OGRANIČENOM ODGOVORNOSĆU (D.O.O.) U OKVIRU HOLDING KOMPANIJE

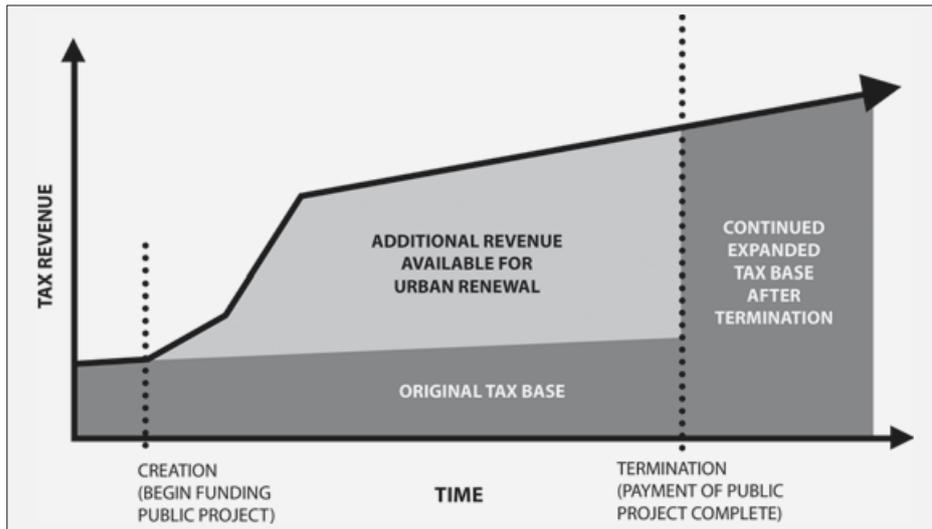


FIG. 10. TAX INCREMENTAL FINANCING [TIF] CAN COVER THE COST OF INFRASTRUCTURE BY THE INCREASED TAX BASE OF THE NEW ECONOMIC ACTIVITIES

SL. 10. POREZNO INKREMENTALNO FINANCIRANJE [TIF] MOŽE POKRITI TROŠAK INFRASTRUKTURE POVEĆANJEM POREZNE BAZE KROZ NOVE EKONOMSKE AKTIVNOSTI

loan<sup>28</sup> usually administered by a public government agency may be more favorable towards a neighborhood cooperative allowing for a range of softer financing terms including lower market interest rates, longer maturities, uneven or deferred payment schedules and under collateralization.<sup>29</sup> A non-commercial loan may also be an option to cover some of the additional administrative expenses and/or some of the pre-construction costs. Within the Croatian context, several options for this type of financing could be available through for example, the Croatian Bank for Reconstruction and Development [CBRD] or in some cases the European Bank for Reconstruction and Development [EBRD].<sup>30</sup> Now that Croatia has recently joined the European Union, other sources of EU funding may also be an option.

**3. Construction** – The bank provides payment directly to contractors and other professionals for materials and services during construction without having funds go through the borrower (the homeowners association or holding company). Lending institutions understand that the borrower can only begin repayment once construction is complete and the properties begin to generate income. Payment obligations<sup>31</sup> are usually minimized to interest

rate payments during construction and a lease up<sup>32</sup> period is often allowed before the loan enters permanent capital funding.

**4. Permanent capital funding** – Balloon payments<sup>33</sup> are common after construction is complete at which point the loan is refinanced and proceeds to permanent capital funding. This phase defines the standard amortized payments of the loan including both interest rate payments and loan principal until the loan reaches maturity. Overall, construction loan financing would be favorable to a community seeking urban redevelopment for a number of reasons. While the homeowner's association and holding company have no operating business history, one could argue that they are really not different from a first time developer seeking a construction loan. Residents already have title of the land and can bypass the property purchasing phase, decreasing both the capital needed and risk on the lending institution while increasing the capitalization rate of the overall project.

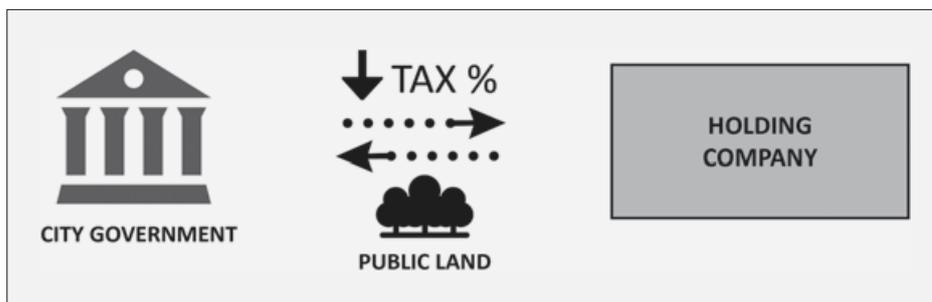
## APPLICATION TO CROATIA

### PRIMJENA U HRVATSKOJ

The case of coastal Croatia could provide interesting options for local residents given its already developed national and regional infrastructure, an already established tourism economy and different options in property ownership structures in the hospitality industry such as timeshare business models and condominium hotels that operate in a fractional ownership format. Untangling the urban environment in Croatia could begin with first determining how owners use their current properties – whether it is for residential and/or commercial purposes and then differentiating how residential owners and commercial property owners could use their private prop-

FIG. 11. CITY GOVERNMENT CAN ACQUIRE NEW PUBLIC LAND BY LOWERING CITY TAXES ON THE HOLDING COMPANY

SL. 11. GRADSKA UPRAVA MOŽE STECI NOVA JAVNA ZEMLJIŠTA KROZ SMANJENJE GRADSKIH POREZA NA HOLDING KOMPANIJU



<sup>28</sup> Over the decades, non-commercial lending institutions have become an effective way to put affordable capital into worthy projects that otherwise would not have received commercial funding. Unlike commercial banks, non-commercial lending institutions do not profit on loans, require only small administrative staffs and are intentionally designed to favor the borrower. Since the 1970's, non-commercial funding has grown rapidly in the United States creating a shadow banking sector. It is, however, considered a standard development tool used by many organizations including the US Economic Development Administration [EDA] and the US Department of Housing and Urban Development [HUD].

<sup>29</sup> Under collateralization may occur in cases where loan to value ratios (or risk) may be too high for a given project.

<sup>30</sup> While the European Bank for Reconstruction and Development is technically a commercial lending institution, it could provide some lending terms of a non-commercial bank.

<sup>31</sup> Interest rate payments can be realized by the sale of real estate prior to construction.

<sup>32</sup> A lease up period refers to the timeframe needed for a newly available property to find tenants and reach a stabilized occupancy.

erty entitlements [PPE] by setting general guidelines.

It would be ideal if all PPE could be dedicated to the rebuilding of residential properties only, meaning that current owners of commercial structures would not use their future PPE for the construction of new individually owned, commercial properties, but would transfer their PPE to the holding company, allowing for a more cohesive and commercially effective development, instead of repeating the same original commercial content all over again. In the case of Croatia, this would mean that owners of private accommodation facilities would transfer their PPE to the holding company, increasing their position as shareholders and bringing them stronger dividends than their current returns on their private accommodation facilities. This would greatly reduce the number of under regulated private accommodation units currently on the market, allowing for the construction of facilities with more competitive offerings, higher visitor capacities and year round services.

Local shareholders could also benefit from high profit-generating projects in the hotel and resort sector such as timeshare apartment units<sup>34</sup> directed to the foreign visitor market. The application of a timeshare format could have a dual purpose and be useful to control visitor and dwelling unit densities in locations sensitive to overcrowding, while also ensuring that there will be an ongoing stream of visitors not only in the summer months, but in other seasons as well. Other interesting property options for secondary vacation homeowners who chose, could be condominium hotels that operate under a fractured ownership structure.<sup>35</sup> These types of fractured property structures are managed by a professional management company and would provide both a vacation home to the resident, in addition to ongoing passive in-

<sup>33</sup> A balloon payment refers to a large, oversized payment to the lender once construction is complete and the property begins to generate income. Once a balloon payment is made, a lending institution can better define the second half of the construction loan including both principal and interest payments, also referred to as permanent capital funding.

<sup>34</sup> The timeshare business model allows an individual unit to be sold and resold on a specific time schedule usually on a week to week basis. Some developers of timeshare units have been able to maximize their profits by selling one dwelling unit 50 times in one year, allowing a two week maintenance period to service the unit and make repairs.

<sup>35</sup> A fractured ownership structure would enable secondary home owners to have real title to a condominium, while allowing a management company to lease out their unit when it is not in use by the primary owners.

<sup>36</sup> The sharing of resources in sectors that have high overhead costs such as medical or dental tourism, could significantly lower operating costs, resulting in a more price competitive product or a stronger profit margin for the tenant or operator.

TABLE IV PHASES OF URBAN DEVELOPMENT

TABL. IV. FAZE URBANOG RAZVOJA

Phase	Benchmarks	Main participants	Possible Financing
(1) Pre-development	Comprehensive urban analysis Revised Master Plan Appointment of private fee developer	Local City Government (Economic Development and Planning Boards)	Expense paid by: Public sector funds
(2) Pre-construction	Assembly of owners into legal entities Financial modeling Development of engineering and architectural plans to achieve pricing Appointment of General Contractor Appointment of Property Manager Submission of construction loan documentation Underwriting process	Private fee developer Cooperative Board of Directors Architects / Engineers Lending institution	Expense paid by: Bridge loan Fee developer and / or other professionals could also become minority stakeholder in lieu of payment of services
(3) Construction	Temporary relocation of affected residents during redevelopment Demolition of old structures and construction of new Lending institution pays contractors	Lending Institution General Contractor and related Building Professionals	Expense paid by: Construction loan (commercial or non-commercial)
(4) Permanent Capital Funding	Completion of construction Sale and lease of new properties Repayment of loan	Private fee developer Property Management Team	Income generated by: Sale or lease of properties

come through rentals from other users, when the unit is not in use by the original owner.

New activities could be introduced that extends the current summer tourism season throughout the year, attracting new business investment and more structured job opportunities. The model could allow for the creation of cluster economies which could create a stronger identity of place while also promoting the general sharing of resources among tenants and operators.<sup>36</sup> Public space acquired by the local government through tax incentives could provide more landscaped environments and public enhancements, while important environmental areas such as the immediate area around the coast line could also be reclaimed. Depending on the strength of the future economic activity, the introduction of TIFs could fund larger projects such as public transportation systems that would decrease automobile usage within the community core, adding more value to a tourism resort. The Master Plan could also incorporate empty parcels left intentionally open, allowing for the gradual development of other industries outside the tourism sector.

The success of the project however, would depend largely on the will and consensus among local residents. Heavy community engagement throughout the process would be essential to build good working relationships and manage expectations. Local perceptions that strongly emphasize individual ownership versus collective property ownership or the absence of a culture of cooperation could be an issue in some areas, but could also be addressed through financial education and training. Although not all homeowners would need to participate, a critical mass of geographically connected properties would be necessary to create a more coherent urban project. Each community would bring a spe-

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cific set of economic, legal and societal challenges. In Croatia, issues could be completing the legalization process as homeowners would not want to compromise their standing in the holding company.<sup>37</sup> A high backlog of title cases in the Croatian Land Registry<sup>38</sup> and complicated local ownership structures could also lead to a cumbersome land aggregation process. The context for each initiative would be community specific, making this type of land readjustment process perhaps more an art than a science.

## CONCLUSION

### ZAKLJUČAK

While it may not have been the desired outcome, unplanned urban development generally becomes part of the fixed urban fabric, causing irreversible spatial and environmental damage. It can place long term limits and challenges on communities, affecting the overall economic development of their immediate regions as a whole. Given the growing lack of urban space available and the accelerated pace of urbanism, consideration can be given as to how to reconfigure larger areas of unplanned construction in a more cohesive manner to create better functioning urban environments more responsive to urban needs.

A cooperative land readjustment model applied to a larger community scale aims to reverse some of the negative consequences caused by unplanned residential growth. The model incrementally changes the urban landscape over a series of predefined phases and enhances public space and infrastructure. The approach is a shift from traditional real estate development, allowing homeowners to become majority owners in a portfolio of larger scale commercial developments while also becoming individual owners of newly built private homes. The initiative would require broad consensus among residents and strong support from local municipalities in a planning intensive process. It could be applied in specific market conditions to improve urban conditions while financially empowering local residents and providing a sustainable platform for long term economic development and social growth.

<sup>37</sup> Illegal structures must go through a legalization process to be included in the legal aggregation with other legal properties.

<sup>38</sup> <http://www.state.gov>

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- FIG. 1-4 Photograph: Damir Fabijančić  
 FIG 5-6 Photograph: Josip Kevrić  
 FIG 7-11 Diagram: author

## SUMMARY

## SAŽETAK

## ZADRUŽNA KOMASACIJA

## BOTTOM-UP STRATEGIJA ZA REKONSTRUKCIJE PODRUČJA NEPLANSKE GRADNJE

Dok se regije i urbani centri sire i smanjuju tijekom vremena, brzo mijenjajuće ekonomije i demografije stvaraju novi sklop izazova uz fiksni urbani prostor. Mnoga područja stambene gradnje nize gustoće preuzela su značajne pozicije u gradovima, ali njihov daljnji rast spriječen je zbog prostornog ograničenja te ekonomske i društvene barijere stvorene neplanskom gradnjom. Budući da manje prostorne intervencije ili fragmentirani razvoj nekretnina možda i ne donose učinkovite promjene, mogle bi se uzeti u obzir drukčije metode agregiranja i rekonstrukcije većih dijelova ovih prostora u tržišnim okvirima.

Suprotno od tradicionalnoga razvoja nekretnina vođenog institucionalnim investitorima, zadruga komasacija je inkluzivna strategija vođena 'odozdo prema gore', koja omogućuje da lokalni stanovnici budu vlasnici nove izgrađene stambene jedinice i većinski dioničari portfelja vrijedne tržišne imovine. Inicijativa bi zahtijevala čvrstu podršku lokalne samouprave u procesu intenzivnoga planiranja vođenog od strane konzultanta – stručnjaka u razvoju nekretnina u koordinaciji s upravom zadruge. Nova imovina bila bi organizirana u sklopu dva zasebna pravna tijela: (1) društvo kućevlasnika, koje bi omogućilo kućevlasnicima privatno vlasništvo nove zasebne stambene jedinice i (2) holding kompanija, koja bi se sastojala od poslovnih nekretnina predstavljenih kroz pojedinačna društva s ograničenom odgovornošću (d.o.o.) za svaku poslovnu nekretninu. Kućevlasnici bi zaobišli etapu kupovanja imovi-

ne smanjujući kapital potreban za razvoj i tako smanjili rizik kreditiranja, dok bi se stopa kapitalizacije cjelokupnog projekta povećala. Namjene zemljišta bile bi redefinirane prema predviđenim stambenim potrebama, novim ekonomskim aktivnostima i novim potrebama za javne sadržaje i infrastrukturu. Stambena i poslovna imovina bila bi financirana kroz građevinske kredite koristeći komercijalne ili nekomercijalne izvore financiranja, dok bi javni sadržaj i infrastruktura bili financirani kroz efikasne porezne strategije, uključujući porezne poticaje i *Tax Incremental Financing* [TIF], što ne tereti javni proračun. Inicijativa bi postupno promijenila urbani pejzaž tijekom niza preddefiniranih kronoloških etapa u moguću revolving kreditni format kroz nekoliko ciklusa koji najbolje odgovaraju tržišnim uvjetima i urbanim potrebama.

Model bi dobro djelovao u područjima visoke zemljišne vrijednosti ili, specifično, gdje bi bankovna procjena zemljišta zadovoljila minimalan polog za dobivanje građevinskog kredita. Dok tržišni uvjeti trebaju biti specifični, model bi se mogao primijeniti na razne urbane izazove u razvijenim ekonomijama, kao i onima u tranziciji. Ovaj rad ispituje hipotetičnu primjenu na hrvatskoj jadranskoj obali u turističkim područjima ugroženim neplanskom gradnjom u cilju rehabilitacije urbanoga prostora te stvaranja konkurentnije poslovne okoline. Lokalni stanovnici bili bi stavljani u jaču financijsku poziciju kroz većinsko vlasništvo holding kompa-

nije, koja bi se sastojala od portfelja imovine za turističku namjenu visoke vrijednosti, i vlasništvo nove primarne ili sekundarne stambene jedinice. Inicijativa u Hrvatskoj značajno bi smanjila broj jedinica sadašnjega nereguliranoga privatnog smještaja na tržištu te bi nudila strukturne poslovne prilike za građane, dok bi istovremeno povećala poreznu bazu samouprave. Uspjeh modela ovisio bi najviše o volji i konsenzusu lokalnih stanovnika. U slučaju Hrvatske, inicijativa bi također ovisila o uspješnoj implementaciji nove porezne inicijative i drugih problematičnih stavki poput mogućih problema oko agregiranja zemljišta zbog kompliciranih vlasničkih odnosa u zemljišnim knjigama. Međutim, ako bi se navedene zapreke mogle svladati, dugoročan društveni i ekonomski ishod novoga naselja mogao bi biti značajan.

Model je vođen većom ekonomskom vizijom regije koja predviđa bolje funkcioniranje urbane sredine, dok istovremeno ojačava samoodrživost lokalnoga stanovništva. Proces postupno mijenja očekivani ekonomski razvoj od urbanih sredina prema perifernim područjima gradova. Također, usmjerava veći protok kapitala, tradicionalno dodijeljenog institucionalnim investitorima, siroj bazi lokalnih stanovnika. Model iziskuje visoko koordiniranu, integriranu strategiju planiranja koja ima društvenu dimenziju, u skladu s interesima pojedinačnih kućevlasnika, kao i sa ciljevima i težnjama zajednica i regija kao cjelina.

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