Legal structures and contractual frameworks in hybrid real estate development: a Finnish perspective

Journal of Property, Planning and Environmental Law

Mika Lehtimäki
Faculty of Built Environment, Tampere University, Tampere, Finland

Received 20 March 2025
Revised 16 June 2025
Accepted 14 August 2025

Abstract

Purpose – Hybrid real estate developments – projects that combine multiple property uses such as residential, retail and office spaces in connected buildings and constructions – pose complex legal challenges related to ownership, financing and risk allocation. The purpose of this study is to examine the legal and contractual structures governing these projects in Finland, focusing on land ownership, security arrangements, limited partnership law, co-operation agreements and debt covenants. This study explores how these legal mechanisms can improve project feasibility and mitigate financial risks of the parties.

Design/methodology/approach – This study combines legal analysis with qualitative research, incorporating insights from interviews with Finnish real estate investors. The findings of this study are further illustrated through a case study of a hybrid real estate transaction, demonstrating the practical application of legal and contractual frameworks.

Findings – This study identifies three key strategies for improving the success of hybrid real estate projects. These are: legal and contractual separation of different project components through vertical (between different floors) and horizontal (area) property segregation to optimise risk allocation; hybrid financing structures, incorporating tailored debt covenants and capital commitments within limited partnership agreements and capitalisation agreements; and governance provisions in co-operation agreements to define stakeholder roles and responsibilities clearly.

Practical implications – Hybrid real estate developments often face financial and legal uncertainties that can impact financing, ownership and parties' willingness to enter into such arrangements. This study highlights how legal structures and contractual mechanisms can enhance certainty, enforceability and investor participation, making hybrid real estate projects more viable under Finnish law and more generally in similar jurisdictions.

Originality/value – By integrating legal analysis with empirically analysed financial risks, this paper provides a structured examination of how legal and contractual tools can address optimisation of ownership structure, allocation of risk and management challenges in hybrid developments in a legally sound manner, addressing the impediments identified in the literature. The practices and solutions used in hybrid real estate transactions have not been previously mapped. This study provides a novel way of approaching the stated challenges and solutions to the impediments in such transactions.

Keywords Company law, Empirical analysis, Real estate finance, Real estate development, Financial law, Hybrid real estate

Paper type Research paper

1. Introduction

Hybrid real estate projects integrate multiple functions and buildings within a single property or a closely connected properties. It is characteristic for a hybrid real estate project that it can

Journal of Property, Planning and Environmental Law
Emerald Publishing Limited
2514-9407
DOI 10.1108/JPPEL-03-2025-0029

involve, for example, a mall, an apartment building, an office building and public spaces, all connected to a broader construction project where different uses of buildings and areas are physically, technically and operationally connected.

Hybrid real estate development may be economically beneficial, among other things, because it can lead to sustainable development in metropolitan areas, where higher population densities are likely to require more efficient use of urban land (Walker, 1997). Hybrid projects require sophisticated legal framework to manage ownership rights, financing structures and regulatory approvals. Financial viability aspects are pronounced because of fragmented financing and presence of different project parts, such as vertically connected underground parking area and an office building, which are often developed in stages, over several years and by different owners. This increases technical and financial complexity of the project and its economic risks.

Figure 1 depicts a hybrid real estate development that includes several uses of property and the division of the building area above ground and underground.

Hybrid real estate construction projects, such as the one presented Figure 1, present significant legal complexities because of various factors, including multiple ownership layers within buildings and extensive contractual obligations among stakeholders. Also, local regulations, neighbourhood opposition, financing and insufficient market interest are characteristic for such projects (Metzinger, 2021). One of the key legal challenges is establishing a clear framework for financing, ownership and governance. In Finland, this often requires creating distinct ownership structures on land plots.

Hybrid real estate transactions also involve several key agreements, such as statutory common use agreements (Fi: *yhteiskäyttösopimus*), which regulate legal relationships between multiple land plots; capitalisation and debt agreements, which regulate the financing of the construction; and limited partnership agreements (Fi: *yhtiösopimus*), which outline equity investments and governance structures.

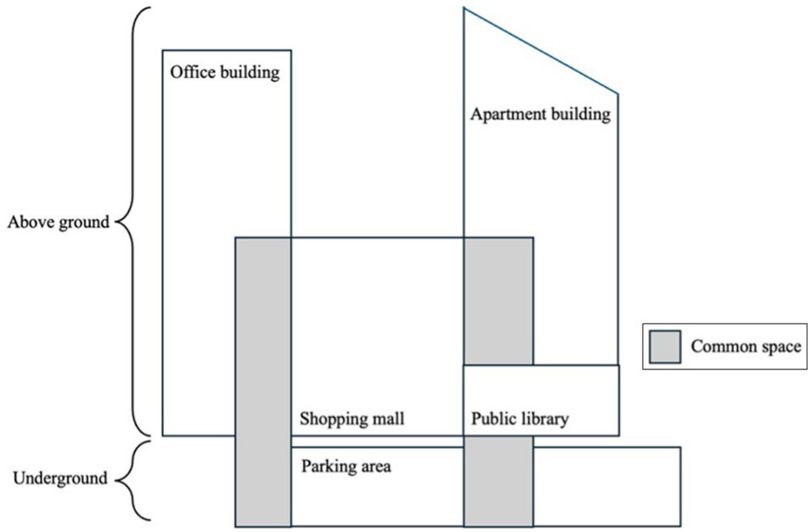

Figure 1. Typical hybrid real estate structure
Source: Authors' own work

However, the combination of these can lead to legal disputes, particularly regarding construction delays and changing market conditions affecting the sale of project components. Additionally, the involvement of multiple stakeholders requires a legal framework that balances their rights and responsibilities.

This creates a complex negotiation environment among project participants, including municipalities, developers, debt financiers and equity investors. The negotiation process is closely tied to incentives, bargaining power and how the project's overall value is distributed among stakeholders (Adriansyah Samsura and van der Krabben, 2012). This article explores the following legal and contractual questions:

- the legal structure of hybrid real estate projects, including ownership and security structure; and
- the financial and economic risks as well as contractual arrangements used to allocate these risks among investors, developers and financiers.

These questions are relevant and acute in hybrid real estate projects because:

- hybrid real estate projects often include dispersed ownership base of the assets (Nakamura *et al.*, 2018) that need to be financed separately;
- allocation of risk is complex (Rabianski *et al.*, 2009a) because of common areas, technical structures and risk of cost-overruns in different project parts increasing riskiness (Gyourko and Rybczynski, 2000); and
- projects are completed in stages (Munoz Cabanes *et al.*, 2020; Rabianski *et al.*, 2009b) requiring sequential funding that is divided to different creditor priorities (Lemont, 2014).

This article addresses the stated challenges and solutions to the impediments in such transactions, a topic that appears underexplored in the academic literature.

This study is based on legal analysis of the main aspects of a Finnish hybrid real estate development, qualitative research, including interviews with Finnish real estate professionals, and an analysis of an example hybrid transaction. Although the solutions may not be generalisable to international scenarios, they provide a novel view on central solutions relevant in a number of jurisdictions.

Section 2 provides an overview of three main economic and financial benefits and challenges of hybrid developments. Section 3 includes the economic questions of contracting about these. Section 4 includes the basic Finnish legal framework for contracting about hybrid transactions. Section 5 discusses insights from industry participants regarding the legal, contractual and financial risks in hybrid development. Section 6 examines an example Finnish hybrid financing transaction, and Section 7 concludes.

2. Hybrid projects, their benefits and challenges

2.1 Benefits of mixed-use property development and risk diversification

Although the literature on hybrid real estate development is limited, we can infer some benefits and challenges of hybrid projects from the mixed area and mixed-use property development literature (Geyer, 2024; Schwanke *et al.*, 2003). The definitions of mixed use and hybrid development are overlapping, but in hybrid projects, the integration between premises is taken further.

For example, in the US market, office and retail properties in mixed-use areas (commercial, residential and public buildings in the same area) have market values that are 37% and 48% higher, respectively, compared to properties in non-mixed-use areas, where no clear premium exists (Nakamura *et al.*, 2018). This indicates that investors may be willing to pay a premium price for such properties to capture the benefits they offer and create a dynamic community that drives long-term value and returns (Nakamura *et al.*, 2018). In mixed-use projects, a similar argument for additional benefits is also connected to pooling of land, resources and support for development (Geva and Siemiatycki, 2024). Although it may not hold with all mixed-use developments (DeLisle and Grissom, 2013), the potential premium supports the idea that mixed-use developments create value by optimising property use rather than simply benefiting from economies of scale (Childs *et al.*, 1996).

Optimisation of property use can also lead to better risk diversification strategy. Childs, Riddiough and Triantis note that mixed-use development can serve as a valuable risk diversification strategy for investors and combining different property uses and redeveloping underused land can significantly enhance its value, despite the associated costs (Childs *et al.*, 1996). This is particularly evident in oversupplied markets, where rents and prices are highly sensitive to fluctuations in supply (Childs *et al.*, 1996). For example, if building more apartments reduces their marginal sales value, then incorporating a shopping mall alongside residential units can make the project more profitable (Childs *et al.*, 1996).

The above means that the investors may have an incentive to engage in hybrid projects to benefit from diversification of risk and optimisation of use between different uses in urban plot development. However, there are gaps in the research on how to structure hybrid projects' financing in a way enabling better diversification and optimisation of use and how this can actually be achieved.

2.2 Equity requirements and management challenges

Despite benefits from optimisation of use and diversification benefits, legal and financial complexity of hybrid projects (Dubrasich, 2018; Nakamura *et al.*, 2018; Rabianski *et al.*, 2009a) and their inherent riskiness leads to more expensive development debt or equity in the first stages of the project – thus putting pressure on quicker generation of cash flow (Gyourko and Rybczynski, 2000). This may raise equity requirements and creates need for innovative financing techniques (Squires *et al.*, 2016). For example, Rabianski *et al.* (2009a) have found that equity requirements of such projects are likely to be higher than for single-use projects. This is because lenders may struggle to evaluate the financial synergies between different property types and accurately assess income streams (Coupland, 1997) that require sophisticated valuation methods (Valero, 2024).

Therefore, higher equity requirements in hybrids may necessitate use of investor consortia or joint ventures (JVs), which leads to the question how they should contract about capitalisation, their relationship and exit scenarios. As we will see, the governance of equity holders' relationship was also one of the key concerns of the interviewees discussed in Section 5.

Adding to governance challenges, it is important to note that different components are often owned or financed by separate entities with potentially divergent objectives, so legal, ownership and management issues must be examined thoroughly also between mixed-use project parts (Dubrasich, 2018). This is complicated by the fact that multiple owners, lenders and leases in such projects create high transaction costs and dilute transparency (Nakamura *et al.*, 2018) and require careful planning and oversight (Rabianski *et al.*, 2009a). Therefore, management issues both within an individual project part and between project parts face complex alignment challenges. There are gaps in the literature how to contract about these challenges. This work provides an analysis on what kind of solutions can be used to resolve the relationships between the equity holders and their ongoing management of the project.

2.3 Lending criteria and creditor relationships

Also, the creditor-base of hybrid projects may be dispersed, and the creditors may have different priorities to the project cash flows and assets, which requires intercreditor contracting. This is connected to the lending criteria and lenders' expectations of the hybrid development.

Rabianski *et al.* (2009a) conclude that the primary lending criteria are adequacy of the parties to deal with cost overruns, unleveraged yield on cost, the location's economic environment, project's risk profile and the developer's track record. However, as we will see in the interview section, financing structure and division of hybrid into different project parts is even more material to the lenders.

In addition, because hybrid projects tend to be large in scale, they often require multiple lenders, leading to complex intercreditor relationships. A fragmented lender base can make it difficult to control financing across different project components (Schwartz, 2017; Lehtimäki, 2023). Although having a single borrower entity simplifies lending, using separate legal ownership structures for project components offers a more flexible exit and sale strategy for developers and investors. This is especially relevant for hybrid projects with different investment cycles, such as an office building and a sports arena (Rabianski *et al.*, 2009a). This means that, if there is no single borrower entity, then hybrid projects may benefit from separate real-estate ownership units and security interests given to the creditors (Lemont, 2014). There is scarce literature on the contractual solutions that achieve this in hybrid projects.

3. Economic questions in hybrid development financing

To understand the above key issues of diversification and optimisation, equity requirements and management challenges as well as creditor relationships, we need to analyse further the economic questions connected with contracting about these. They concern hidden information and moral hazard problems, agency costs, real-option risk and contractual alignment between several parties.

3.1 Phased and flexible financing, hidden information and real option risk

Higher perceived risk of urban mixed-use projects requires more expensive financing, which Gyourko and Rubczynski have shown to lead to careful phasing of the project into separate components and lending against one product type per deal (Gyourko and Rybczynski, 2000; Schwanke and al., 2003). Furthermore, large hybrid projects often raise funds in tranches tied to construction milestones (Wilson, 2024). This is supported by theory, because, under the hidden information problem (Akerlof, 1970), the owners may not have a credible and cost-effective ways of signalling the true qualities of the construction project or its phase to the markets. Without proper knowledge, the investors may withdraw from the project. This supports the claim of funding the project in tranches.

In addition, real-option analysis reinforces this approach by treating each development phase as an option to continue or abandon the project and improves risk management (Munoz Cabanes *et al.*, 2020; Throupe *et al.*, 2012). For example, developers may intentionally delay construction to wait for a more favourable sales environment for apartments, which can create uncertainty and disrupt the project timeline (Throupe *et al.*, 2012). Therefore, structuring financing per project part and in stages directly addresses information asymmetry and the real option value of waiting or abandoning the project, by forcing transparency at each step and allowing exit if market conditions deteriorate.

The above also means structuring financing so that equity or debt can be raised sequentially, which, together with joint liability and active creditor monitoring, can solve the under-monitoring problem (Chowdhury, 2005). Phased financing logic was emphasised also by the majority of interviewees in Section 5. Also, rather than committing all funding upfront, sponsors retain the option to withdraw from later stages, adapting to changing market conditions.

3.2 Contractual and governance clarity and hidden effort (moral hazard)

Hybrid projects often involve complex partnerships, JVs or consortiums. By definition, different project parts may have different investors and management, whose interests are not fully aligned (Dubrasich, 2018). The problem also arises when a construction company cannot easily commit to maintaining a high level of effort over the duration of the project. As a result, managers of a project operating with the investors funding may exploit the venture once financing is secured (Jensen and Meckling, 1976). This is particularly relevant, for example, when an apartment building is scheduled for completion several years after a mall and parking space. The lenders' main concern is that another part of the project, financed by other lenders, is not completed, and the lender cannot, therefore, exercise its remedies against its debtor and the security (Lemont, 2014). However, if the management acts rationally, then the required effort levels can be secured through contractual mechanisms, such as sanctions for delays, loan withdrawals tied to milestones and binding equity commitments from the developer. In agency-theory terms, these measures, audited financials, performance guarantees and caps on managers' discretions constitute bonding and monitoring activities restricting agency costs (Jensen and Meckling, 1976). This can be seen in connection with the discussion of restrictive debt covenants in the example hybrid financing in Section 6.

3.3 Financial agency costs and creditor priority

Creditors also face financial agency costs problem, that is, costs both before and after a project secures financing (Kraakman *et al.*, 2017). Before funding is granted, creditors risk being misled about the true value of the hybrid project. After financing is secured, there is a possibility that the debtor could transfer assets out of the project or take on excessive additional debt, increasing financial instability (Kraakman *et al.*, 2017) and forming a material risk for the creditors. As Jensen and Meckling point out, higher leverage amplifies conflicts of interest, increasing the marginal cost of debt (Jensen and Meckling, 1976) (48).

In corporate law, the governance strategies to mitigate agency costs include appointment rights of the management, decision rights to overrule management decisions and incentive and reward strategies (Armour *et al.*, 2009). In hybrid development, on the investor side, these include, for example, veto and decision rights in investment agreements, incentive agreements for construction company management. On the creditor side, these include debt covenants that entitle acceleration of indebtedness and taking control over the project. Control of financial agency costs is connected to creditor priorities that also ensure pre-agreed control over indebtedness and debtor actions (Lehtimäki, 2023). Financial covenants and layering subordinated debt behind a senior loan balances this risk, because senior lenders get first claim, while subordinated creditors and equity take residual claim. If the priorities are unclear, then agency costs cannot be controlled. The mechanics of achieving this is discussed in connection with the example transaction is Section 6.

3.4 Contracting impediments

However, contracting in hybrid projects discussed above suffers from several "exchange hazards", because they involve complex governance across many stakeholders. Matthew Jennejohn's work advances relational-contract theory by identifying how contractual networks can self-organise to manage multiple risks and multiple exchange hazards, not just the hold-up risk by a party (Jennejohn, 2016).

For example, contracts must address spillovers (e.g. knowledge leakages) and entropy (coordination complexity) and opportunism. His "multivalent contracting" concept argues that unique formal provisions often target specific hazards directly. Also, variation in alliance design reflects differing mixes of these hazards. This can be coped, for example, with governance tools – formal terms, committees and norms (Jennejohn, 2016). This means flexible, layered governance that can also deal with problems exhibited in governance of hybrid projects, for example, between equity holders and creditors. In practice, this means embedding multilateral committees and veto points into the contract: for example, joint steering or management committees are often structured so that both the project company and the lenders must consent to any major changes. These mechanisms are material in overcoming the coordination challenges to multi-party contracting solutions proposed in Section 6.

3.5 The main propositions

The above analysis leads to four propositions about hybrid structuring evaluated in the following sections.

- how to the structure hybrid projects' financing in a way enabling better diversification and optimisation, that is, phased and flexible financing;
- how to resolve the governance alignment challenges within an individual project part and between project parts, that is, contractual and governance clarity; and
- how to carry out partitioning of hybrid project into distinct parts and how this affects financing and the relationship between creditors, that is, creditor priorities.

Analysing solutions to these, previously unmapped in the literature, can provide value and clarity to structuring hybrid real estate transactions more efficiently. I will next address the main legal solutions how these are dealt with under Finnish law.

4. The main legal solutions to deal with the challenges

4.1 Division of ownership, financing and security

Hybrid real estate projects often require dividing a single land plot into multiple uses, which can be done in two ways under Finnish law. The Finnish Real Estate Formation Act (Fi: *kiinteistönmuodostamislaki*, *REFA*) [1] defines as real estate as units registered into the land registry under the Land Registration Act (Fi: *kiinteistörekisterilaki*) [2] 2.2§. This facilitates division of the land plot into separate legal entities (REFA 20§). Another approach is to register proportions of a single plot into the land registry (Fi: *määräosa*) or divide a plot both horizontally and vertically, creating three-dimensional plots that allocate specific floors and areas as distinct real estate units of a building. This is possible if the municipal zoning plan (Fi: *asemakaava*) enables the use of such plots under the Finnish Area Usage Act [3] (Fi: *alueidenkäyttölaki*) 78§. These divided plots can then be used as security for loans, helping to finance different parts of a hybrid project.

In addition to the above alternatives, the Finnish Land Act [4] (Fi: *maakaari*) 14:3 enables the use of control division agreements (Fi: *hallinnanjakosopimus*) registered into the land registry as first priority easements in relation to a particular plot. This also enables division of the property into different floor levels and areas and use defined areas and floors as security for specific indebtedness. Such agreements also regulate the control and management of a buildings located on a particular piece of land. For hybrid projects, such agreements apply across multiple real estate units, provided they are owned by the same parties.

In practice, a control division agreement between owners of proportions of a real estate affords similar protection to using vertically and horizontally divided plots. However, they have several deficiencies. They are typically valid for a fixed period or until further notice, making them less adaptable to the long-term evolution of hybrid projects. Additionally, they usually require unanimous agreement among all parties for any modifications, making them inflexible in projects where ownership and financing change over time. Any material changes or termination generally requires approval of the secured lenders. Furthermore, these agreements also regulate technical installations, boundaries, maintenance, cost-sharing for shared areas and systems and property management. The agreement is often connected to a broader common arrangement agreement (Fi: *yhteisjärjestelysopimus*) governing relationship to neighbouring properties.

However, if the parties use horizontally and vertically divided plots, then they should also enter into a side agreement governing similar matters as regulated by a control division agreement. In hybrid real estate projects, such agreements should establish joint decision-making procedures for cost-sharing for repairs and maintenance of shared spaces. For example, in a development where a mall, apartment building and parking structure are combined within the same area, a side agreement would provide clarity on division of expenses and responsibilities.

4.2 Managing of capitalisation, management and exists of investors

Unless the hybrid project is owned by a single large investor, ownership arrangements are most of the time complex and the ownership dispersed. Therefore, ownership between different parts of the project is invariably segregated. Also, for any larger transaction, ownership of a hybrid part, such as a mall, is held by a limited liability company (Fi: *osakeyhtiö*) but also commonly, for tax reasons, by a limited partnership (Fi: *kommandiittiyhtiö*) incorporated under the Finnish Limited Partnership Act [5] (GLPA). Such a limited partnership is an accounting unit and a legal person under 3§ of the Act, but the income is often channelled to the limited partners (LPs) for their direct taxation. The capitalisation obligation and liability of the LPs are capped to the amounts set forth in the company agreement (GLPA 1§). The parties usually conclude a separate limited partnership agreement governing all the other matters not included in the registered company agreement (GLPA 4§). These broader agreements include, for example, accession of new investors, management matters, capitalisation options and exit scenarios. In a hybrid real estate project, this is a material document regulating the investors' relationship during the construction phase and thereafter.

4.3 Control and priority of creditors

In hybrid real estate projects, the financial structure is carefully organised to balance the interests of equity investors and debt providers. Equity commitments from investors are typically governed by a limited partnership agreement or capitalisation commitments made to lenders. Meanwhile, debt financing is structured through loan or syndicated loan agreements, which include general and financial covenants, for example, sufficient own capital, and operative restrictions on the borrower. If a covenant is breached, then creditors have the right to accelerate the loan repayment and enforce their security interests (Billington, 2017).

A key element in protecting the project's financial stability is the legal separation of its different parts. Creditors should only be able to enforce claims on the specific part of the project that is in default, rather than jeopardising the entire development. This ensures that financing for the unaffected parts remains secure. As evidenced by the interviews, in Finnish hybrid projects, it is also common for equity investors to provide fixed equity guarantees, that is, provide new capital, as safeguard.

In addition, the equity investors often provide to the project lower-ranking debt, contractually or generally subordinated to the secured lenders or more generally under 6§ of the Finnish Act on Creditor Payment Order [6]. In some cases, the equity holders may elect to fund the debtor through statutorily subordinated capital loan [7]. This effectively creates a priority system for the funding of the hybrid project. In such a case, the financing follows a hierarchy where secured creditors have the highest priority, followed by subordinated creditors and, finally, equity investors (Wood, 2007). Also, all of the interviewees emphasised the need for hierarchical financing.

Although the above-discussed legal regime provides the basic structure for dealing with the three propositions set out in Section 3.5 above, the financial and economic challenges in hybrid projects are more refined. I will discuss in the following the findings of the market interviews of the specific financial and economic risks of hybrid real estate projects that need to be resolved legally.

5. The market interviews

5.1 Methodology

The empirical analysis consists of semi-structured interviews of nine senior real estate finance professionals carried out in September–December 2024. The selection of interviewees followed a stratified sampling method. The interviewees selected based on industry seniority and expertise in hybrid real estate financing transactions.

A stratified purposive sampling method was used to ensure diversity in institutional perspectives and to mitigate the risk of sector-specific bias. Participants were selected based on seniority in their organisations and expertise in hybrid real estate financing. The stratification was conducted along industry lines, asset management, banking, insurance and real estate investment.

The categorisation of the interviewees is set out in Table 1.

The interviews were conducted as online meetings and lasted between 45 and 75 min. Each session followed a topic guide covering the objectives, structuring and challenges in hybrid real estate finance transactions. Open-ended questions were used to obtain detailed narratives while allowing flexibility for follow-up questions.

Table 1. Categorisation of the interviewees

No.	Date	Industry
1	14 October 2024	Asset management
2	18 October 2024	Banking
3	28 October 2024	Insurance
4	14 November 2024	Real estate investment
5	21 November 2024	Banking
6	21 November 2024	Asset management
7	28 November 2024	Insurance
8	28 November 2024	Banking
9	2 December 2024	Asset management

Source(s): Author’s own work

The interview transcripts were analysed using a thematic approach. First, transcripts were analysed to ensure familiarisation with the data. Second, thematic codes were generated to capture key concepts and patterns. These codes were then combined into broader themes (Sections 5.2–5.6), which were refined iteratively through comparison across interviews.

The analysis was not intended to be statistically representative because, instead of trying to capture the phenomena accurately, the objective was to reveal the meaning and perceptions of the participants on the challenges of financing in hybrid real estate transactions. To limit interpretive bias in analysis, an audit trail of coding decisions was maintained. However, potential limitations include selection bias and response bias, as participants may have presented their institutional practices in a favourable light.

5.2 Challenges in ownership and decision-making

Based on a broad consensus among all the interviewees, the diversity of ownership in hybrid real estate projects creates significant challenges in coordinated decision-making among multiple stakeholders. This difficulty was pronounced in long-term aspects of a project such as maintenance, major repairs and modifications to the property. A majority of the interviewees emphasised the need for clarity in ownership of project management and distinct roles for all parties involved, as overlapping functions often operate on different schedules and require decisions at various times.

The asset managers noted risks related to delays in earlier parts of the hybrid project as a major deterrent in investing in hybrids. Additionally, hybrid projects were considered by all interviewees sensitive to economic cycles, underscoring the importance of realistic timelines and adaptable solutions. It was repeatedly noted that different parties may share ownership of buildings in various ways, resulting in complex contract structures and ownership fragmentation. This means that complexity in hybrids becomes challenging when large investments are required over the property's lifecycle or when owners' interests shift because of evolving preferences and markets situation.

All of the interviewees pointed out that developers must ensure *clear agreements and ownership structures* from the start to prevent financing and operational challenges. For example, a well-integrated hotel and office building combination can raise the overall project's financial stability and appeal to investors. Also, all but one of the interviewees considered that *flexible contracts and clear overall process timeline* from start to finish will alleviate these concerns.

5.3 Financing challenges and solutions

According to bank interviewees, securing financing during the construction phase was seen to become increasingly difficult, with Basel IV [8] regulations raising banks' collateral requirements, implemented in the EU through CRR III regulation [9] in the EU. Furthermore, taking security over project assets was seen more difficult in hybrid structures. It was emphasised that a bank will need a valid real estate mortgage for a project part to be bankable. Also, separation of particular project part's assets from the other projects' assets and dividend and payment restrictions applying to the debtor was considered material to protect the relevant creditors repayment rights by the bank representatives. This has heightened the importance of financial covenants and bank control mechanisms over the project assets, which is directly connected to the key proposition 1 in Section 3.5.

Furthermore, the presence of larger investor, for example, a main investor of a shopping mall, was seen as key by majority of the interviewees because institutions with capital buffers are often better positioned to manage cost overruns during the construction phase. They emphasised the need for a financially stable developer.

Asset managers and investors noted that all domestic hybrid real estate projects require a fairly large size to make them feasible financially, operatively and administratively. The large size of hybrid projects demands significant capital, often requiring JVs or partnerships with institutional investors. For example, projects exceeding €50m become challenging without JV structures.

Bank interviewees pointed out that, for hybrid projects, financiers face difficulties predicting long-term returns because of the varying lifespans and market conditions of different such as a mall, apartment building and parking area. Changing interests among the investor consortium over time were seen by asset managers and insurance interviewees to pose challenges, particularly when parties no longer perceive the investment as equally profitable. This highlights the importance of selecting like-minded strategic partners.

A broad perspective of the entire project, supported by strong and clear project management, was seen to enhance the likelihood of early construction company investments in areas such as land acquisition, planning and municipal cooperation. Long-term investors, meanwhile, prioritised stable cash flows, preferring to join projects early on.

Asset managers and bank representatives noted that banks and *lenders often require equity to be used first*, with senior, first-ranking, loans made available in tranches based on benchmarks, such as leasing levels of a mall. Such requirements incentivise developers to secure high initial leasing levels to access additional financing.

Also, the bank interviewees noted that it is mandatory to divide the funding phases into *construction financing* covering the building phase with adequate comfort that the post-construction refinancing and sale of the project part is possible and *development financing,* that is, after the construction has been completed, when the bank loans have been repaid. Financing in the construction phase was considered by all interviewees difficult in the early stages without significant guarantees or collateral by the investor group. Banks extended construction financing to up to five years after which wither the real estate should have cash flow or be refinanced. Long project timelines (6–10 years) were generally considered to expose developers to market risks, interest rate rises, inflation and changes in demand. Furthermore, all interviewees considered that buildings were in all cases seen best *divided into their own separately financed parts*.

5.4 Municipality involvement and synergies

Municipal guidance and commitment to area development were identified by asset managers crucial for hybrid project success. While municipalities should approve the general plan at a high level, practical decisions and amendments should be delegated to operational levels to avoid political changes and potential deadlocks. A municipality's clear long-term strategy and defined role enable stronger private-sector commitment to hybrid projects. It was pointed out that hybrid developments often depend on favourable zoning and that local government dynamics can significantly impact feasibility.

Furthermore, municipal investments in public transport infrastructure were considered by majority of the interviewees to enhance synergies and overall project viability. Some interviewees pointed out that municipalities should engage more collaboratively with developers, enabling creative input rather than enforcing pre-defined designs.

5.5 Administration and risk management

It was noted by nearly all interviewees that the biggest risks are connected to long project timelines and unclear ownership or cost-sharing structures. Establishing fixed management structures, decision-making procedures and principles for cost-sharing was considered to mitigate the strategic and operational challenges in large hybrid projects.

From an administrative perspective, clearly defined boundaries and divisions of ownership and project components promote smoother transactions and reduce risks, particularly the risk of the main investor or the construction company withdrawing from the project. This is material, as such large projects require superior management skills (Gyourko and Rybczynski, 2000).

Furthermore, establishing a *clear and fixed funding base*, along with a *well-defined cost division*, was considered critical by majority of the interviewees to the progress of a project. Delays and cost overruns in earlier phases were considered to create a domino effect, amplifying financial risks across the project. This necessitates flexibility in company, debt and construction agreements to adapt to changing conditions.

Sequential contracting was highlighted by more than half of the interviewees as a means of accommodating such changes, although strict obligations for contractual capitalisation and commitments remain essential. Because, for example, insurance companies cannot in practice grant in Finland cost-overrun guarantees for situations in which project costs are exceeded, the markets had seen more capitalisation commitments instead, securing potential cost overruns. Two interviewees suggested that positive incentivisation, rather than burdensome contractual penalties, might more effectively ensure parties fulfil their obligations.

5.6 Economic viability and risk division

For hybrid projects, vertically connected buildings were considered to pose both operational and cost division challenges. Several interviewees emphasised the need for a realistic analysis of commercial viability and expected returns crucial for hybrid projects. A mechanism of dividing the monetary benefits obtained from the common development between the participants of, for example, mall, apartment building, office building and municipal areas was recommended.

Investing in smaller project parts rather than treating the hybrid project as a single large investment was deemed advantageous because of easier exit and sale possibilities. Some investors noted that they only invest in clear and contractually separate parts of the project, such as an apartment building part, often only at a later stage. It was considered that challenges arise when development decisions prioritise, for example, residential at the cost of real estate types, reducing commercial value.

Two interviewees noted that some parts of hybrid projects may be tied to variable income streams (e.g. event arenas) that may yield unpredictable returns, making them less attractive to risk-averse investors like pension funds. Sensitivity to homebuyers' payment ability and willingness was also noted as a critical factor. Effective risk management was pointed out by the asset managers to include attributing costs to the parties best equipped to bear them and maintaining flexibility in project cost plans. Diversified use-cases were considered to alleviate the risk embedded changes in market shifts. Overall, *adopting flexible yet reliable strategies, along with strategic partnerships and clear financial frameworks, was seen essential* for successful hybrid real estate projects by all interviewees.

5.7 Summary of the interviews

The material financial and economic findings arising from the interviews relevant to the legal structure of hybrid real estate development can be summarised into five findings. First, hybrid real estate projects face significant challenges primarily because of fragmented ownership structures, complex decision-making and financing difficulties. Coordination issues arise particularly in long-term management. Secondly, financing is hindered by regulatory constraints, such as Basel IV, and the need to secure collateral in hybrid structures, especially during construction. Third, large-scale investment requirements and long timelines further expose projects to market risks. Fourth, municipal involvement is crucial, particularly through supportive zoning and infrastructure investment. Fifth, risk management should prioritise fixed cost-sharing models, flexible contracting and early capitalisation commitments.

Solutions emphasised include establishing clear ownership and management structures from the outset, forming JVs with capital-strong partners, using phased financing mechanisms and segmenting buildings into independently financed components.

6. Legal and financing structure of the example project

6.1 General structure

I will discuss in this section an example structure of a large Finnish hybrid real estate project and how the risks identified in Sections 2 and 3 can be addressed legally and contractually in the example hybrid transaction. The example is based on personal professional knowledge and on online analysis of two comparable Finnish transactions [10].

The example hybrid project includes a residential apartment building, public sports facilities, a mall, office building and underground parking space. The project is completed in stages, and it is based on legal structure encountered in the Finnish markets.

6.2 Corporate and financing structure of the offices, mall and the apartments

6.2.1 Example structure. In this example, both the office building and the shopping mall are owned by separate real estate limited liability companies (RELLCs), which are established under the Finnish Limited Liability Companies Act [11]. For tax and capitalisation purposes, each RELLC is owned by a distinct tax-transparent limited partnership. These partnerships are funded by three to six investors and the construction company [12]. Each limited partnership is managed by a separate general partner, which is itself a limited liability company. This structure ensures a clear separation between investment ownership and management responsibilities.

The RELLCs are financed primarily through equity investments. Institutional investors, as LPs, contribute equity to the limited partnership, which in turn capitalises the corresponding RELLC with an equivalent amount. The terms governing these capital contributions, management provisions and exit strategies are set out in a limited partnership agreement between the LPs and the general partner, as well as a separate capitalisation commitment between the RELLC and the limited partnership.

Additionally, the LPs collectively provide each RELLC with a six-year institutional loan (Schwanke and Al., 2003), governed by a common loan agreement. These institutional loans are contractually subordinated (Wood, 2007) to a five-year bank loan, which is issued by one to four banks under a separate loan agreement. The bank loans have first-priority security rights, while the institutional loans are second in repayment priority. Both loan agreements include financial covenants (Morrison and Ross, 2001), such as:

- *loan-to-value ratio*: total loan amount divided by the property's value;
- *debt service coverage ratio*: net operating income divided by interest and debt repayments; and
- *interest coverage ratio*: earnings before interest and taxes divided by interest payments.

The loan agreements also contain general covenants that, if breached, can trigger loan acceleration. These include, for example:

- a negative pledge;
- restrictions on external financial indebtedness;
- limitations on asset transfers and asset acquisitions;
- adherence to the project schedule;
- requirements to maintain ownership, lease agreements and project contracts; and
- restrictions on mergers, structural changes and dividend distributions.

To coordinate the rights and obligations of all stakeholders, the limited partnership, RELLC, institutional investors and banks enter into an intercreditor agreement. This agreement establishes (Wood, 2007):

- a priority structure between senior debt, lower-ranking debt and intra-group indebtedness;
- a 90–365-day payment and enforcement restriction on lower-ranking debt in case of breach of loan covenants;
- turnover obligation of any receipts of lower-ranking debt after a default of the loan agreements; and
- control by senior creditor group to decide on security enforcement, company and project sales.

The property held by the office block company is formed on a larger plot by separating land areas and specific floors for the office block [13]. Therefore, these pieces of real estate are registered separately. This means that the real estate is capable of being mortgaged first to the banks and secondly to the lower-ranking creditors.

The mall's financing structure mirrors that of the office building, with both entities being legally separate. This separation allows for flexible exit strategies, investor diversification and the ability to sell different project parts independently.

6.3 Apartment building financing and ownership

The legal and financing structure of the apartment building company [14], which contracts for the building of the block, is different from that of the mall and office operating companies because apartment sales logic is different for the apartment building. Under Finnish law and practice, the apartments of the building are marketed and sold to residents that acquire a right to use a particular apartment and receive the shares attached to that apartment. They may either pay off the construction debt attributable to their shares or make periodic repayments over the loan term.

This means that the real estate apartment building company is initially owned by the construction company and financed by a bank loan granted by one to four banks and by equity injected into the apartment company by the construction company. The refinancing, that is, repayment of the loan, is made by the purchasers that acquire apartments from the construction company. This promotes bank funding during development, pre-sale to residents.

6.4 The sports arena and the parking area

In the example, the Sports Arena is held by a limited liability company is owned half and half by the local municipality and a separate sports facility management company held by private investors and a local sports team that has rented the arena with a long-term rental agreement enabling the use of the arena also for separate events arranged by the sports facility management company. The arena is financed 50% with equity investments from the limited liability company and 50% from a bank loan secured with a real estate mortgage and the receivables from the long-term rental agreement concluded with the sports team (see for general collateral structure: Lemont, 2014).

The parking area is owned by a local parking company. The construction is financed 60% with a bank loan secured over the underground area and registered a plot and long-term rental agreements of parts of the parking area concluded with the apartment block company, the mall company and the office company. The parking company's parent has provided the remaining 40% by means of equity.

6.5 Dealing with the perceived economic, financial and legal risks

6.5.1 Contractual flexibility for project companies' governance. The example Finnish hybrid real estate structure effectively addresses several concerns raised by market participants. Organising different project components into separately financed legal entities, each responsible for a distinct part of the hybrid project, supports investment diversification and staged financing. Additionally, because there are no cross-guarantees between project parts, it enhances the ability to sell or exit investments independently, which was a key priority for the interviewees. These solutions address directly the phased financing and creditor priorities parts of the research question in Section 3.5.

Because each project component carries layered debt financing, it is important to manage financial agency costs and real option risks – particularly the risk of intentional project delays by the construction company or investors because of market fluctuations or expected price increases. One way to reduce this risk is to tie external debt withdrawals to fixed project milestones and require that equity contributions and subordinated debt be used before senior debt. Major equity investors should also maintain sufficient financial buffers to meet more stringent equity requirements. Furthermore, capitalisation obligations for equity holders, as outlined in limited partnership agreements and capitalisation commitments, ensure that cost overruns, unmanageable by banks, are adequately addressed. To mitigate hidden effort problem, it is critical that at least the construction company, as one of LPs, provides a firm equity commitment to ensure progress at each project stage. These solutions clarify creditor and stakeholder priority regime, making securing financing easier.

Connected to the milestones, a clearly defined project timeline is necessary, as highlighted in the interviews. This would be strengthened by a municipality's long-term strategy and defined role, fostering stronger private-sector commitments to the example project. A municipal strategy can also reduce perceived hidden information problems face by the investors. Additionally, simultaneous public, committed infrastructure investments by the municipality would reduce real option risks especially when municipalities incentivise construction firms, through subsidies – within the legal constraints.

On the other hand, and supporting diversification and staged financing, limited partnership agreements should include redemption mechanisms that allow investors to exit under specific conditions. For example, fund agreements may include provisions that permit an investor to leave the group, even at a value lower than the fair market price. While this approach can be controversial, market participants emphasised its importance in adapting to long-term shifts in investor preferences, allowing for adjustments in the investor base over time. This solution reduces the governance alignment challenges within individual project parts.

6.5.2 Project-wide coordination for hybrid developments. Market participants underscore the necessity of contractual flexibility to accommodate evolving market demands, shifts in investor composition and the distribution of costs within hybrid projects.

While existing contractual frameworks address certain aspects, such as the rights of equity investors to object to project modifications, they may insufficiently account for broader operational, structural and market-related changes.

Although lenders often impose rigid contractual provisions for material alterations, such changes could in some cases be allowed through clearly defined procedural mechanisms for qualified majority decision-making by the equity holders. In this regard, limited partnership agreements should incorporate coordination provisions that facilitate effective project governance – such as a two-thirds vote – rather than requiring unanimous consent. This approach would alleviate the governance challenges commonly associated with managing mixed-use properties (Ploeger and Groetelaers, 2014).

Despite the objective of maintaining legal and economic separation between project parts, hidden information and hidden effort problems necessitate flexible mechanisms for disclosing delays and issues in one project part to stakeholders in other parts. This applies particularly to hybrid project-wide challenges, municipal decisions and cost overruns affecting multiple project parts. To address this gap, a project-wide coordination agreement would be beneficial in improving integration between different construction phases. Such an agreement should:

- require stakeholders in one segment of the project – including creditors – to be informed of material changes affecting other segments; and
- establish a project coordination committee with clearly defined decision-making procedures. This committee would facilitate alignment between various project components (e.g. commercial, residential, parking and public spaces) and oversee project-wide cost allocations and modifications based on pre-agreed procedures.

These solutions address directly the governance alignment challenges within an individual project part and between project parts.

To minimise monitoring and financial agency costs in the example project, procedural rules, some of the loan covenants should concern hybrid project-wide situations (such as material delays). This approach would facilitate earlier negotiations with lenders in situations involving material changes. Project-wide covenants or conditions precedent could provide further lender comfort. Nonetheless, these covenants must be carefully structured to preserve the legal and financial separation of project parts.

Ultimately, project-wide coordination and disclosure agreements, alongside complementary procedural provisions in limited partnership and shareholder agreements, mitigate potential deadlocks arising from shifting creditor compositions or significant structural changes during construction. Implementing such governance frameworks – particularly through a coordination committee – would offer lenders greater confidence in the ability of stakeholders to collaboratively address project-wide challenges. This, in turn, would facilitate redevelopment efforts, which are often complex in high-density urban environments (Easthope *et al.*, 2024).

This would also be more aligned with Matthew Jennejohn's view on multivalent contracting, where better coordination can be achieved by expanding the view on all significant relational elements. In such a case, the goal is to understand "how multiple hazards interact with one another, and how various governance institutions combine in turn" (Jennejohn, 2016). In hybrid development, this translates into topic-specific committees or subcontracts (e.g. one committee for financing decisions, another for construction or property management), coordinated by interface clauses as well as change-management clauses. This enables using fixed project specific contracts while reducing hazards by using more informal governance mechanisms, thus promoting coordination between and within project parts and overcoming multi-party contracting challenges.

7. Conclusions

Economic and financial risks inherent in hybrid real estate projects can greatly inhibit the use of such structures. These risks can be alleviated with their careful overall analysis and by dealing with the risks of hidden action, hidden effort, financial agency costs and real option risk legally by parcelling different parts of hybrid projects into distinct investable projects. This can be done by concluding a more comprehensive management and procedural agreement for disclosing and resolving material changes and challenges that arise in such long-term projects. This also requires positive incentivisation of, for example, the construction company and the development company to avoid build-up of any of the material economic and legal risks. However, especially the incentivisation and optimal management structures of hybrid projects warrant further research. Also, evaluation of the use of real estate option would require additional statistical analysis to assist decision-making in sequential hybrid projects.

Notes

[1.] The Finnish Real Estate Formation Act (554/1995, as amended.

[2.] The Finnish Land Registration Act (392/1985, as amended).

[3.] The Finnish Land Usage Act (132/1999, as amended).

[4.] The Finnish Land Act (540/1995, as amended).

[5.] The Finnish Act on General Partnerships and Limited Partnerships (389/1988, as amended).

[6.] The Finnish Act on Creditor Payment Priority (1678/1992, as amended).

[7.] Chapter 12 of the Finnish Limited Liability Companies Act (624/2006, as amended).

[8.] Basel IV rules are a part of the Basel Framework maintained by the Bank for International Settlements.

[9.] Regulation (EU) 2024/1623 of the European Parliament and of the Council of May 31, 2024 amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor.

[10.] www.yitgroup.com/fi/news-epository/porssitiedotteet/triplan-kauppakeskuksen-toteuttaminen-yhteisyrityksena-varmistui-hankkeelle-noin-300-miljoonan-euron-rahoituspaketti; and www.ramboll.com/fii/projektit/kiinteistot/nokia-arena-ja-tampereen-kansi

[11.] The Finnish Limited Liability Companies Act (624/2006, as amended).

[12.] The Finnish Act on General Partnerships and Limited Partnerships (389/1988, as amended).

[13.] Creation of a 3D lot is possible under 2§ of Finnish Real Estate Register Act (392/1985, as amended) and 2§ 1) of the Finnish Real Estate Formation Act (554/1995, as amended).

[14.] 2§ of the Finnish Limited Liability Housing Companies Act (1599/2009, as amended).

References

Adriansyah Samsura, A. and VAN DER Krabben, E. (2012), “Negotiating land and property development: a game theoretical approach to value capturing”, *Journal of European Real Estate Research*, Vol. 5 No. 1, pp. 48-65.

Akerlof, G.A. (1970), “The market for ‘lemons’: quality uncertainty and the market mechanism”,

Armour, J., Hansmann, H. and Kraakman, R. (2009), *Agency Problems, Legal Strategies, and Enforcement*, John M. Olin Center for Law, Economics, and Business. Harvard Law School.

Billington, D. (2017), "Syndicated lending", in Shutter, A. (Ed.) *A Practitioner's Guide to Syndicated Lending*, 2nd ed. Sweet and Maxwell, London.

Childs, P.D., Riddiough, T.J. and Triantis, A.J. (1996), "Mixed uses and the redevelopment option", *Real Estate Economics*, Vol. 24 No. 3, pp. 317-339.

Chowdhury, P.R. (2005), "Group-lending: sequential financing, lender monitoring and joint liability", *Journal of Development Economics*, Vol. 77 No. 2, pp. 415-439.

Coupland, A. (1997), *Reclaiming the City: mixed Use Development*, E and FN Spon, London.

Delisle, J.R. and Grissom, T.V. (2013), "An empirical study of the efficacy of mixed-use development: the Seattle experience", *Journal of Real Estate Literature*, Vol. 21 No. 1, pp. 25-58.

Dubrasich, P.N. (2018), "Legal agreements for mixed-use projects", available at: www.naiop.org/research-and-publications/magazine/2017/winter-2017-2018/development-ownership/legal-agreements-for-mixed-use-projects

Easthope, H., Crommelin, L., Gillon, C., Pinnegar, S., Ruming, K. and Liu, S. (2024), "Redeveloping the compact city: the challenges of strata collective sales", *Journal of Property, Planning and Environmental Law*, Vol. 16 No. 1, pp. 51-67.

Geva, Y. and Siemiatycki, M. (2024), "Finding mutual benefit in urban development: lessons from Toronto's creative mixed-use real estate partnerships", *Journal of the American Planning Association*, Vol. 90 No. 1, pp. 144-158.

Geyer, H.S. (2024), "The theory and praxis of mixed-use development - An integrative literature review", *Cities*, Vol. 147, p. 104774.

Gyourko, J.E. and Rybczynski, W. (2000), "Financing new urbanism projects: obstacles and solutions", *Housing Policy Debate*, Vol. 11 No. 3, pp. 733-750.

Jennejohn, M. (2016), "The private order of innovation networks", *Stanford Law Review*, Vol. 68, pp. 281-366.

Jensen, M.C. and Meckling, W.H. (1976), "Theory of the firm: managerial behavior, agency costs and ownership structure".

Kraakman, R.H., Armour, J., Hansmann, H., Davies, P.L., Enriques, L., Hertig, G., Hopt, K.J., Kanda, H. and Rock, E. (2017), *The Anatomy of Corporate Law: A Comparative and Functional Approach*, Oxford University Press, Oxford.

Lehtimäki, M.J. (2023), "Intercreditor agreement and contractual restructuring of LBOs", *European Company and Financial Law Review*, Vol. 20 No. 3, pp. 547-590.

Lemont, E.D. (2014), "Key issues in financing mixed-use developments", *Probate and Property*, Vol. 28, p. 61.

Metzinger, J. (2021), "Differences in experiences with the development of Mixed-Use projects from 2004 and 2017", *Frontiers in Built Environment*, p. 7.

Morrison, P.O. and Ross, P.B. (2001), "Financial and business covenants and bankruptcy remote structures in real estate loan transactions (with forms)", *The Practical Real Estate Lawyer*, Vol. 17, p. 7.

Munoz Cabanes, A., Herrero DE Egana, A. and Romero, A. (2020), *Real Option Analysis. The Viability of Real Estate Projects. Investment Management and Financial Innovations*, Vol. 17, pp. 271-284.

Nakamura, S., Peiser, R. and Torto, R. (2018), "Are there investment premiums for Mixed-Use properties?", *The Journal of Real Estate Research*, Vol. 40 No. 1, pp. 1-40.

Ploeger, H. and Groetelaers, D. (2014), "Managing multi-owned, mixed-use developments in The Netherlands: the opinion of professional managing agents", *International Journal of Law in the Built Environment*, Vol. 6 No. 3, pp. 271-285.

Rabianski, J.S., Gibler, K.M., Clements, I.I.I.J.S. and Tidwell, O.A. (2009a), "Mixed-use development and financial feasibility: part I - economic and financial factors", *Real Estate Issues*, Vol. 34, p. 11.

Rabianski, J.S., Gibler, K.M., Clements, I.I.I.J.S. and Tidwell, O.A. (2009b), "Mixed-use development and financial feasibility: part II–physical, phasing, design and public policy factors", *Real Estate Issues*, Vol. 34, p. 17.

Schwanke, D. and Al, E. (2003), *Mixed-Use Development Handbook*, ULI-the Urban Land Institute, Washington, D.C.

Schwartz, A. (2017), "Bankruptcy related contracting and bankruptcy functions (October 10, 2017)", Yale Law and Economics Research Paper No. 553.

Squires, G., Hutchison, N., Adair, A., Berry, J., Mcgreal, S. and Organ, S. (2016), "Innovative real estate development finance – evidence from Europe", *Journal of Financial Management of Property and Construction*, Vol. 21 No. 1, pp. 54-72.

Throupe, R., Stephen, S., Zhong, J. and Chen, H. (2012), "Real option analysis: a switching application for mixed-use real estate development", *Pacific Rim Property Research Journal*, Vol. 18 No. 3, pp. 277-291.

Valero, A. (2024), "Appraisal of mixed-use developments through multiple criteria decision making: insights from Shanghai's megacity context", *Cogent Business and Management*, Vol. 11 No. 1.

Walker, H. (1997), *Mixed Use Development as an Agent of Sustainability*, 1 ed.: Routledge.

Wilson, S. (2024), "Property development finance: a simple guide", available at: www.linkedin.com/pulse/property-development-finance-simple-guide-stan-wilson-kn15c/

Wood, P. (2007), *Project Finance, Securitisations, Subordinated Debt*, Sweet and Maxwell, London.

Corresponding author
Mika Lehtimäki can be contacted at: mika.lehtimaki@tuni.fi