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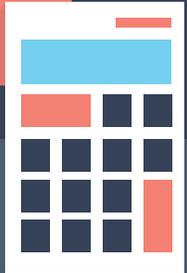
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The Value of Due Diligence for Developers Embarking on Historic Tax Credit Projects



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In real estate development, there is a significant amount of work that goes into a development before a hammer is lifted. In fact, there is an equally significant amount of work that goes into defining a project before ink is placed on paper.

Before an architect provides a concept, before land or a building is purchased, developers should complete due diligence to ensure the ultimate viability of a project. For development projects that incorporate historic tax credits (HTCs), completing due diligence related to that specific process is paramount in identifying threshold issues and anticipating design challenges. Further, project financing likely would require some level of due diligence to be completed.

Oxford Capital Group LLC, an international real estate development firm headquartered in Chicago, undertook an ambitious rehabilitation of Chicago's historic London Guarantee Building, transforming this underused 1920s office building into the LondonHouse Chicago hotel. The building stands as one of four 1920s commercial skyscrapers built along the Chicago River's Michigan Avenue Bridge. In addition to its high-style Beaux Arts design, the building holds a prominent position along the river within the Chicago skyline. This development serves to illustrate how a challenging HTC project benefited from thorough due diligence at the outset of the project.

Rehabilitation of the London Guarantee Building

Among those integral to seeing the rehabilitation of the London Guarantee Building through to completion was Brad Mulvihill, chief development officer at Oxford Capital Group and a partner in Oxford's affiliated hotel management company Oxford Hotels & Resorts LLC. When looking for a potential new project, Mulvihill explained that Oxford makes it a point to locate buildings that could be rehabilitated using HTCs.

"Oxford has historically focused on high value-add real estate investments, which often include a physical redevelopment of a property," he said. "In the instances, where historic tax credits are available as part of those investments, utilizing HTCs is a priority for us."

Oxford's rehabilitation of the London Guarantee Building, now known as the LondonHouse Chicago, successfully transformed the former office building into one of Chicago's premier hotels. Highlighted by its location at the corner of North Michigan Avenue and Wacker Drive alongside the Chicago River, Mulvihill

asserted that the building's historic features, including its rooftop cupola, are what truly makes it stand out among its local competitors. As he explained, "LondonHouse Chicago's iconic rooftop cupola serves not only as a beacon for the property amongst the city's skyline, but following the rehabilitation, guests of the property's rooftop bar and lounge can now mix and mingle around the cupola and take in the stunning views of the city and river."

In addition to rehabilitating the historic elements of the building, the development also involved the construction of a 19-story addition.

The development might not have been as successful without initial due diligence into the building's history and evolution, documenting which features were historic and what changes occurred over time, and the identification of potential challenges in the HTC review. Mulvihill explained the importance of these initial steps, noting, "the initial opinion from historic consultants is a very important part of the initial due diligence stages, providing valuable information that we use to make early threshold decisions."

HTC Due Diligence at Chicago's London Guarantee Building

At its essence, HTC due diligence provides a development team with critical information gleaned from a consultant's knowledge and experience of the program that informs decision making on a development's viability. HTC due diligence specifically revolves around the historic elements of a building as they relate to local historic design review, state level design review and incentives, and federal HTCs. Specifically, HTC due diligence involves three primary components: 1) identification of existing or potential historic designations and understanding any limitations brought on by designations; 2) identification of significant features and finishes that will likely be required to be retained through the HTC process; and, 3) anticipation of potential scope of work challenges to allow for informed early design decisions.

The first step in HTC due diligence is to confirm existing historic designations at the local, state and federal levels to understand whether action is required to designate or whether there is existing review jurisdiction and the extent of that jurisdiction. In many communities, individuals have the ability to designate buildings without owner consent, which may result in local design review restrictions. Initial due diligence, therefore, should inform owners not only of the potential to designate, but the potential implications of designation.

In order to use HTCs, a building must be considered a "certified historic structure," meaning the building must be listed in the National Register of Historic Places. A building can be listed in the National Register either individually or as a contributing resource to a larger historic district. Initial due diligence should confirm a building's designation status or the viability of designation. In the case of the London Guarantee Building, the building's National Register status was confirmed, allowing the development to proceed with HTCs.

Early due diligence on the London Guarantee Building further confirmed that the building was locally designated a City of Chicago Landmark. This local designation applied not only to the building's exterior, but carried into the interior, with local review jurisdiction over the vestibule and main lobby. With this information, the development team avoided unnecessary delays that could have occurred if extensive changes to this lobby were proposed. Identifying restrictions early in the process is a critical aspect of HTC due diligence. Additionally, identification of the local designation enabled Oxford to use the city of Chicago's Class L Property Tax Incentive which provides a property tax assessment reduction for locally designated buildings.

For buildings that are already designated, such as the London Guarantee Building, developers tend to not want to expend dollars for historic research, but this research can be critical to helping make the case for

future changes. If it can be proven that a particular feature or space has been changed over time, more latitude for future change is generally afforded by the NPS. Knowing the history of the building can prove invaluable in providing opportunities for new design concepts.

In addition to confirming the building's designation, initial due diligence informed the Oxford team which building elements were original and which changes had occurred over time. This step was crucial to avoid unnecessary delays that could have occurred during the Part 2 process if reviewers were uncertain of the feature's authenticity. At London Guarantee, the building contained some easily identifiable features that the National Park Service (NPS) would undoubtedly have required to be retained. First and foremost, as Mulvihill noted, was the building's prominent rooftop cupola, but other elements included historic storefront elements, windows, vestibule and lobby, and upper-floor elevator lobbies and corridors, among other interior features. Research informed which features had been altered over time to support a case for further change.

Initial due diligence identified that the building retained original windows. Knowing early on that the NPS would require submission of a conditions assessment documenting the extent of deterioration at the windows, allowed the development team to get an early jump on an issue that often results in delays in the Part 2 review. This process allowed the design team, including the architects and historic consultant, to consult with the state historic preservation office about the window proposal, which resulted in a mutually beneficial strategy that retained historic windows on the lower levels and replacement windows at the upper floors.

Perhaps the most important aspect of HTC due diligence for a developer, however, is anticipating potential scope of work challenges. Understanding the requirements of an upscale hotel during due diligence can save considerable time and money in the design

phases. For example, anticipating that the hotel will have a restaurant, and anticipating that the restaurant will need adequate fresh air and ventilation, will inform design decisions before infrastructure changes become costly or structurally prohibitive.

Similarly, anticipating in due diligence that an upscale hotel will likely want a rooftop amenity space, particularly when the subject building assumes a very prominent and visible location in the city, allows for early resolution of what can be a very complicated and prolonged issue. The process of preparing site-line studies and constructing physical mockups is best addressed upfront, as there can be considerable back-and-forth with HTC reviewers. On the London Guarantee project, this required tying the rooftop amenity space into the building's iconic cupola, which remained the primary component of the roof level.

Furthermore, on the London Guarantee project, it was identified in due diligence that the office areas had been changed over time with no significant remaining historic features. The design team knew that significant changes to the office areas would be possible and the due diligence provided the parameters that the NPS typically applies in such spaces. This included the NPS requirements for addressing mechanicals and ceilings. Early understanding of these parameters informed the design team at a stage where design decisions could be made up front, before design changes have schedule and pronounced cost implications.

Arguably the most challenging aspect of the London Guarantee Building project was obtaining approval for the adjacent 19-story addition. Knowing that the reviewers will have jurisdiction over the new construction and understanding how the reviewers apply the program standards to new construction resulted in an efficient negotiation with the reviewers to obtain ultimate approval of this critical element of the project.

The rehabilitation of the London Guarantee Building was a very challenging, and in the end extremely rewarding, project for Oxford. The project resulted in the building's transformation from underused office space to a prominent upscale hotel. The specific issues faced on this development were among the most challenging faced by developers that use the HTC incentive. Engaging an experienced team, including HTC-specialized consultants, in due diligence is critical to apply knowledge and experience to an inherently subjective process. On London Guarantee, due diligence played an integral role and allowed for informed early decisions and the streamlining of the HTC process.

Conclusion

As many developers know, due diligence plays a critical role in early assessment of project viability.

The importance of completing due diligence on HTC developments is no different. At the outset of any project, it is imperative that developers and their project team have an in-depth understanding of the nuances of the HTC program. Perhaps the most critical step in this is making sure that the developer has the necessary members of the project team in place who can offer sage advice. There is an implicit need for qualified, experienced consultants.

The keystone of a successful due diligence report is that those completing the report have knowledge of the HTC process and program, and interpretation of the standards to identify issues before they arise. In doing so, developers can avoid costly and time-consuming pitfalls and streamline the process. ❖

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