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Saving Mark Twain

New Chicago law rescues landmark SRO hotel

By Bendix Anderson

Developers planned to tear down a historic Chicago affordable housing property to build a new, luxury residential tower.

"The other people offering to buy the Mark Twain Hotel wanted to raze the building," says Mecky Adnani, Vice President of acquisitions and development for the NHP Foundation (NHPF).

In another city that might have been the outcome. Instead, NHPF bought the Mark Twain Hotel in May with a $54 million plan to renovate its single-room occupancy (SRO) apartments without displacing the people who live there, thanks to a new ordinance in Chicago designed to preserve SRO properties as affordable housing.

Chicago's new law for SROs

Between 2011 and 2014, developers demolished 2,200 SRO apartments in Chicago. That added up to a huge loss of housing affordable to low-income people. It was also a loss of historic buildings – many of those demolished SROs were originally built as fancy hotels in the early 1900s. As these hotels later fell on hard times, their small rooms were perfectly sized to operate as SRO apartments. For-profit residential developers are currently very interested in sites in urban neighborhoods, near amenities and transit options. The land under many SRO buildings has suddenly become very valuable.

The Mark Twain, built in 1932, is steps away from a mass transit stop in Chicago's Gold Coast neighborhood. "At one point, these hotels were the center of the neighborhoods," says Adnani.

Even though it is a historic building, the Mark Twain Hotel was not designated as a historic landmark. A profit-minded developer would be free to knock it down to build a larger, luxury high-rise.

"The owner has wanted to sell this property for a while, and they had a couple of really big offers," says Adnani.

For example, just across the street from the Mark Twain, a 34-story residential tower is rising, with a Jewel/Osco supermarket on the first floor. The Sinclair will open in 2017.

At the end of 2014, Chicago passed a new law to protect SRO properties. The Single-Room Occupancy Preservation Ordinance requires the owner of an SRO building, like the Mark Twain, to notify Chicago officials of any plan to sell. Then the owner must wait 180 days – about six months – to see if a buyer who plans to preserve the SRO property as affordable housing is able to sign a contract to acquire the property at a reasonable price.

The SRO law pushed "pause" on the plans to demolish the Mark Twain Hotel – and innumerable other SRO buildings. In April 2015, the owners of the Mark Twain announced their intention to sell and NHPF immediately began its plan to buy. The nonprofit would need short-term financing.

"Time was of the essence," says Stuart Boesky, CEO of Pembrook Capital Management, which helped finance the acquisition. "The seller had no particular dog in the fight over whether to preserve the property. He was just motivated to get the best price as quickly as possible." The banks that typically provide short-term financing to acquire and rehabilitate apartment buildings often hesitate to lend to SRO properties. "Many lenders assume this is not a stable population of residents," says Adnani. "That makes SRO properties not so bankable."

Instead of a bank, the nonprofit found financing from Pembrook, a private equity fund manager that provided a $16.6 million, interest-only acquisition loan with a 6.38% interest rate and a term of up to three years.

NHPF also received a $5.25 million, interest-only acquisition loan from the Chicago Community Loan Fund, with a 6% interest rate.

The seller asked $22 million for the old hotel. NHPF responded with an offer of $21 million – and enough financing lined up to close the deal quickly.

In August 2015, months before the deadline, NHPF signed the contract to buy the Mark Twain Hotel and closed the deal to buy the property in May 2016.

The project to buy and rehabilitate the Mark Twain also received $749,000 from the sale of Illinois Affordable Housing Tax Credits (also known as Donations Tax Credits) issued by Chicago's Department of Planning and Development. The Donation Tax Credit is equal to 50% of a qualified donation in an affordable housing project that must remain affordable for a minimum of 10 years.

In the case of the Mark Twain, the "donation" came from the seller in the form of the $21 million, below-market price NHPF paid for the property, which appraised for $23

Chicago's new SRO law saves the Mark Twain.

million. The $2 million difference made the property eligible for $1 million in Donation Tax Credits, sold to U.S. Bank.

When NHPF made its deal with the seller, it negotiated that the Mark Twain Hotel could keep any Donation Tax Credit. The seller also received $1 million in other tax benefits from the sale that the seller was able to keep.

Long-term residents

In the months since taking control of the Mark Twain Hotel, NHPF has discovered some surprising things about its residents, who range from students to seniors.

The people who live in SRO buildings have a reputation for being transient. But more than 70% of the residents at the Mark Twain have lived there for more than a year. Also, more the 70% are employed. "They are working people," says Adnani. "The majority of tenants have been there for a long time: sometimes 10, 15, even 20 years."

The Mark Twain also had a reputation in its neighborhood for crime – but the problem wasn't the people who live in the old hotel.

"We have found out from the City that there is no such thing as criminal activity in the residential part of the property," says Adnani. "What is really creating the problem is the retail. Some criminal activities or exchanges are happening in the retail spaces."

The Mark Twain has more than 9,000 square feet of retail space on the ground floor, including a cell phone shop and restaurants. NHPF is now working to upgrade the retail spaces, changing retail tenants when necessary.

The Mark Twain is fully-occupied. Its apartments now rent for $650 to $725 a month. "That rent is below market for a studio apartment," says Adnani. To manage the property, NHPF partnered with Heartland Housing, a company of the Heartland Alliance.

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The renovation to come

NHPF plans to start work in 2017 on a $50 million renovation for the small apartments at the Mark Twain.

"Our plan is to gut the units," says Adnani. That includes new bathrooms and full kitchens. The apartments at the Mark Twain Hotel range from 175 to 200 square feet in size. In Chicago, apartments that small will qualify as SROs, even after NHPF adds kitchens. "The small size of the apartments will be offset by the quality."

To create enough apartments accessible to handicapped residents, the developer will need to alter a few floorplans. The finished building will have 148 SRO apartments – four less than the current number of 152 SRO units.

More than two-thirds of the apartments will be affordable to very low-income people. NHPF has applied to the Chicago Housing Authority for project-based Sec. 8 vouchers for 104 units. "We have been working with them for months," says Adnani.

Most of the rest of the apartments will be affordable to low-income residents. A handful will rent without any restrictions on their affordability. That will allow NHPF to renovate the building without displacing a smaller number of the current residents who earn more than 60% of the area median income.

The developers plan to pay for the renovation with a tax-exempt construction loan and permanent financing provided by the Federal Housing Administration. The developer has also applied to city agencies for soft financing.

The tax-exempt bond loan would come with 4% Low-Income Housing Credits. NHPF also expects to use Federal Historic Rehabilitation Tax Credits to help pay to fix up the landmark building.

"We are already getting letters of interest from potential tax credit investors," says Adnani. "The LIHTC investors are not worried about the SRO. People are getting more and more comfortable with these small units... We certainly hope that we, and all the other developers, will be changing minds. Not every apartment has to be really big." TCA

Sources of Funding for Acquisition

$16.6 million, Pembrook Capital Management (interest-only acquisition loan)

$5.25 million, Chicago Community Loan Fund (interest-only acquisition loan)

$21 million, total acquisition costs