

Project Credit Information

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| <i>Structural Engineers</i> | Ross Bryan Associates Nashville, Tennessee |
| <i>Civil Engineers</i> | Wilbur Smith Associates Knoxville, Tennessee |
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| <i>Acousticians</i> | Kirkegaard Associates Chicago, Illinois |
| <i>Seating Layout</i> | Mariuca Design Studio New York, New York |
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***The New Markets Tax Credit program is a natural match with the federal historic tax credit as so many of the nation's historic properties are found in older, disinvested commercial areas," said Richard Moe, president of the National Trust. "We are very excited about this new financing vehicle because it will help the Trust achieve its mission of using historic preservation as an economic development tool in those neighborhoods that need it most."

-- From "Early NMTC investment made to historic projects," by Donna Kimura, Affordable Housing Finance, March 2004, page 11.

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Funding the Tennessee Theatre: *Design, Variability, and Tax Credits*

Paul E. Westlake, Jr., FAIA - Westlake Reed Leskosky

Presented in conjunction with the historic theatre tour of the Strand-Capitol Performing Arts Center for the 2004 Annual Conference of the League of Historic American Theatres, Philadelphia, Pennsylvania



Funding is the critical determinant in the restoration of our landmark theatres. Private philanthropy is seldom sufficient to cover all of the expenses required to save, restore, and modernize an historic theatre for today's performance expectations. Facing a downturn in the economy, a decline in private donations, and increasing economic pressures, it is imperative that owners of historic theatres understand the various funding mechanisms that can be applied to a restoration project, and the architectural, financial, and legal issues that impact those mechanisms.

The restoration of the landmark Tennessee Theatre in downtown Knoxville, Tennessee serves as an exemplary project in terms of its financing strategies. The rehabilitation of this 1928 movie palace, a superb example of Spanish-Moorish architecture, could have stopped at a \$14 million project, merely restoring it as a movie house. Instead, in

January 2005, the theatre will debut a new stage house for symphony, opera, and a variety of performing arts groups through a dramatically expanded project topping \$30 million -- due to public and private support and the critical windfall of \$6 million in tax credits. As one of the pioneering ventures through a partnership of the National Trust for Historic Preservation and the Banc of America Historic Tax Credit Fund, it is a national model of investment in moderate-size projects eligible for federal historic tax credits.

The funding of the Tennessee Theatre involved architectural and design review issues; financing strategies to manage variability; the development of enhancements; business case decisions; an ownership framework leading to the application for historic and New Market tax credits; and the determination of eligible expenditures that combined to make this project ground-breaking.

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A Crossroads Decision Defining the Project and Budget

Originally designed as a movie palace for vaudeville presentations by Chicago architects Graven & Mayger for the Paramount Studio group of theatres, the Tennessee Theatre opened in 1928 as one of the grandest theatres in the South, embellished by an eclectic mix of styles, predominately Spanish-Moorish, but with Czechoslovakian crystals in French-style chandeliers, Italian terrazzo flooring in the grand lobby, and Oriental influences in the carpeting and draperies. It featured a recessed oval-domed ceiling over a wide seating area, and a custom-built Wurlitzer pipe organ which is still in place. Primarily a movie house, it also served as the stage for such celebrity entertainers as Fanny Brice, Glenn Miller, and Desi Arnaz. The Tennessee operated continuously as Knoxville's key venue, until the growth of the suburbs in the 1970's put an end to its movie operations of almost one-half century.

The Tennessee was purchased by Dick Broadcasting in 1981, and it was listed on the National Register of Historic Places. Honored as the Official State Theatre of Tennessee, "Knoxville's Grand Entertainment Palace" became the city's premier performing arts venue and the home of the Knoxville Opera and Symphony Orchestra. Through the vision of James Dick, the primary benefactor, the Tennessee was donated to the Historic Tennessee Theatre Foundation, a nonprofit organization created in 1996 for the purpose of inheriting the theatre in its entirety, and supporting other nonprofit entities such as the city's symphony and opera companies. AC Entertainment was brought in to operate the theatre for live productions.

By the late 1990's, the formerly sumptuous Tennessee was dated and tired, and its entire stage and support were



inadequate for modern performances and touring productions. Among the constraints, its bronze-based paint had deteriorated, the roof leaked, carpet and seating were in poor condition, balcony sightlines were obscured, there were no elevators for passengers or equipment, and the orchestra pit was insufficient for most opera productions.

With a volunteer Board of Directors of thirty people, discussions began to focus on forming a long-range plan for the theatre. An early feasibility study in 1998, soon after the Tennessee Theatre was donated to the Foundation, put forward two options: a \$14 million restoration of the magnificent Tennessee to its former grandeur, but with its existing shallow stage and limited acoustics; or a \$20 million expansion project transforming the Tennessee into a major performing arts facility. (These two levels of rehabilitation did not include land, financing, fundraising and other indirect costs.) Clearly, the larger project would require a completely new stage house, acoustical system, and mechanical system to support the expansion – work that would put the theatre in the dark.

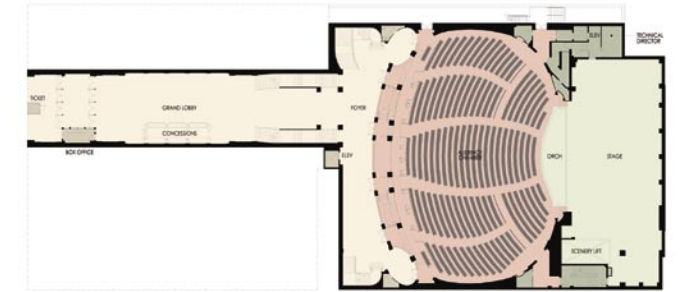
Through a competitive selection process, national architect/engineer and theatre specialist Westlake Reed Leskosky of Cleveland, Phoenix, and Washington, DC, was commissioned as historic architectural consultants, teamed with McCarty Holsaple McCarty, Inc. of Knoxville as prime architect on the project. Westlake Reed Leskosky was also asked to serve as the project's theatrical, mechanical/electrical, plumbing consultants. And, in addition, Westlake Reed Leskosky brought to the table their ideas and assistance in securing additional funding, including the concept of pursuing rehabilitation tax credits.



time we had questions. He prepared the application for the credit, guiding us through the critical issues related to historic rehabilitation and the historic design issues. He knew how to work with the State Historic Preservation Office," adds Ms. Smolik. There was also ongoing and invaluable dialogue with Doug McCarty, CEO and Scott Webb, Project Manager from McCarty Holsaple McCarty.

This close collaboration allowed the agencies to be familiar with the design drawings and for all parties to work through issues, adjusting and modifying the design, and interacting on a daily basis. Adding enhancements required a high degree of control and coordination to align the design, construction, and economic impact. For example, the purchase of an adjacent, two-story building to make space for balcony level amenities and bathrooms required extensive work to save the façade of the existing structure. This was coupled with designing a third-story restroom addition that was recessed from the façade in order to minimize the visual impact. Both of these aspects were also accepted by the State Historic Preservation Office, and are included as operational requirements of the theatre.

Managing Financial Strategies and Funding Variability



TENNESSEE
Theatre
ORCHESTRA LEVEL

Implementing financial strategies and managing the funding variability were constants throughout the project. Each step required complex financial negotiations with the investors, refining the design and phasing construction, continually moving the project forward.

As financing, design, and construction proceeded, so did fundraising efforts, including a telethon, a challenge grant of \$1 million and significant additional gifts from benefactor Jim Dick, a wide base of public support and donations, and municipal funding from the city, county, state levels, and ultimately the federal government.

"Several things were going on simultaneously," explains Darlene Smolik. "We were pursuing tax credits with the Trust, developing a model for operations, and furthering design. We were continually buying more time to raise more money. Communication with all of our stakeholders was critical."

"The historic tax credits made the difference and enabled the project to go forward. It allowed us to cover costs and provided real money that we would not have been able to raise. It gave us the credibility for other investors. But it also required us to be very thorough in thinking about our operations and to be very sound in our financial planning. The process forced us to think about our staffing, rent, attendance, and the full spectrum of our operations, and we are better for that process."

"We may even end up with an endowment fund from the contingency when the compliance period is over that we can redirect into future major maintenance and be a benefit to us from here forward." |

amenities would be improved and expanded, such as additional toilets, concessions, and lounges. Interior work would involve the historic restoration of plaster and paint surfaces throughout the lobby, lounge, foyers, and auditorium.

The architectural team put forward design concepts for an expanded stage house that reflected the historic design features of the Tennessee Theatre. Situated on an urban block, the Tennessee was adjacent to a mix of uses including retail and office. The upstage wall of the theatre extended to the property line on a major thoroughfare, State Street, which adjoins a neighboring cemetery. The daunting challenge was that any stage house expansion that would also incorporate proper "load-in" and staging areas, would need to preserve the traffic flow along State Street, be sensitive to the cemetery and its magnificent plantings, and address compatibility concerns with adjacent historic architecture and the larger urban context.

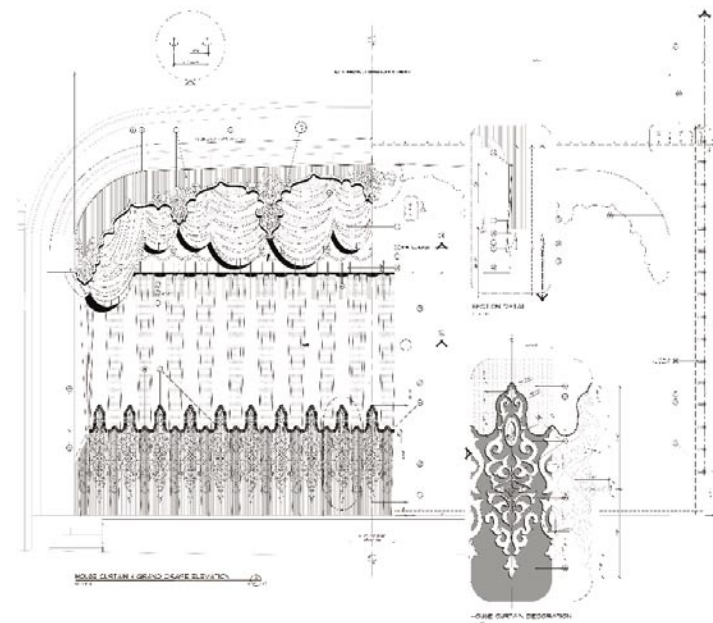
Ms. Smolik cites the benefits of having the initial plans. "We needed to complete design development and affirm that we could go forward with the whole theatre project – even if that involved two phases. This would require that we would be shut down longer than anticipated but would need to continue to raise money."

Tailoring the Design to Meet Funding Variability and Capacity

Given the variability of the funding, the project needed to be precisely tailored to the funding capacity requirements for an

operational theatre, while allowing for enhancements only if funding opportunities would permit. The project's design had to satisfy minimum requirements for a complete and functional facility while identifying some actions as "add alternates" to provide flexibility to incorporate new sources of monies that might arise. In no case could the project's basic cost exceed anticipated funding limitations or projected budgets and fundraising expectations. Design development and value engineering became an exhausting and rigorous process to meet these significant challenges.

A base level project budget of \$20 million was ultimately determined because of projected financial expectations. However, there several remaining elements that really needed to be included in the project to bring it to the desired level of performance. Items such as audiovisual, furniture, stage rigging, draperies, concession stands, major terrazzo repairs, the orchestra shell, balcony bathrooms, shop space and added administrative areas were pulled out of the base project. Initially, the team considered whether to delay closing the Theatre until more funds could be assured. The Theatre Manager, A C Entertainment was asked to develop a list of essential work items required to keep the theatre in operation. Becky Hancock, the general manager, and Tim Burns, the technical director, working for A C Entertainment on the Theatre responded with a list that totaled approximately \$3 million in necessary repairs and upgrading to stay open as well as additional fixed operating costs that would be incurred until the delayed shutdown occurred. Everyone decided that it would be better



to spend this money on the renovation than on temporary fixes and delayed shutdown. It was decided that by applying a "plug and play" strategy, the items excluded from the base became add alternates that could be purchased/built out as the project progressed if funds allowed.

The theatre was shut down June 1, 2003, to proceed with the first phase construction. Demolition began in July, concurrent with environmental remediation for mold, asbestos and lead base paint. The plan was to move directly into the construction phase on an expedited schedule as soon as all the architectural work and permitting processes were completed. As it turned out, this schedule would include approval of the historic tax credit application in March of 2003.

Utilizing Historic Tax Credits and New Market Credits

The real financial momentum for the larger expansion would come from the "windfall" of \$6 million in Historic and New Market tax credits garnered through a ground-breaking ownership transition and a careful interpretation of eligible expenses applicable to the tax credit calculations. However, the ownership entity was a non-profit organization which did not want to permanently release control of the theatre. At the outset, the Tennessee Theatre was owned entirely by the Historic Tennessee Theatre Foundation, a 501(c)(3) nonprofit entity created for that purpose. Fortunately, the Tennessee Theatre was already listed on the National Register of Historic Places and the project was approved as conforming to the Secretary of the Interiors Standards for Rehabilitation, including acceptance of the design for the expanded stage house.

In order to receive benefit from the tax credits, the Foundation had to create additional, for-profit entities that would own the Theatre, lease and manage it. Tennessee Theatre Restoration I, Inc. was created as a wholly-owned, for-profit subsidiary with a Board structured to meet independence rules, but comprised of people who understood the spirit of the Foundation's intent. An LLC owned 90% by this Subsidiary and 10% by the investor became the actual owner of the Theatre and improvements. Lease mechanisms provided the investor the opportunity to receive the credit and a manager to operate the Theatre under the oversight of the Subsidiary. The key was to bring the Theatre back as an essentially entrepreneurial business, producing sufficient revenue from performances and concessions over the six year tax credit and New Markets credit period to provide the priority return the investor would require, cover operating expenses and maintain a renewed, viable economic presence in the community. Ultimately the Tennessee Theatre project became one of the first investments made through a pioneering partnership of the National Trust for Historic Preservation and the Bank of America Historic Tax Credit Fund using both the New Markets and Historic Rehabilitation Tax Credits.

The initiative of applying for tax credits moved forward in the fall of 2002, with the formal Part 2 application submitted to the National Park Service in January 2003. In addition to the amount of money that would be secured through the traditional historic tax credits, the opportunity for additional funds through the newly created "New Markets" tax credits was presented. Fortunately again, the Tennessee Theatre was located in a federally-designated Entitlement Zone, as required for "New Markets" credits.

The key to the tax credit "windfall" was the interpretation that the new construction -- including a stage house, rigging and lighting -- was documented as essential to putting the theatre back into productive use, and thus deemed eligible costs. A new orchestra shell would serve not only the Symphony but also other performing arts groups. The cost of the new stage house was the most considerable of the entire theatre project, due to the requirement of cantilevering the stage over the street. This posed the construction challenges of erecting caissons and working in an area known for poor soils, caves and the relics of older buildings lying under the city. Items such as rigging and stage lighting, while seemingly luxurious by other building standards, are likewise essential for theatre operation.

By demonstrating that the new construction was critical to functional use, the stage house was qualified as an \$8-9 million expense, of which 20% would be available as tax credits that would eventually be sold to raise the additional capital.

Darlene Smolik recounts the key factors that influenced the tax credit initiative. "We had the recommendation of our legal counsel for the Rehab Tax Credit structure and compliance, William F. Machen with Holland & Knight, LLP, who presented extensive due diligence on the process and is said to have "written the book" on rehab tax credits, Jerry Breed with Powell, Goldstein, Frazer & Murphy LLP representing the investor, and the rehabilitation tax credit accounting and tax counsel of Ronald DeGrandis of American Express Business and Tax Services/Hausser & Taylor, LLC, a leading business/tax/ accounting authority in the country. Westlake Reed Leskosky was familiar with the process and the historic compliance issues."

She continues, "Another key factor in the decision to leverage tax credits was the involvement of the National Trust for Historic Preservation, who was selected to consult on the ownership structure and serve as the investor source. The National Trust had a long history and presence, a strong track record of success, and is a good partner. They had a 'ready made' investor in their partnership with the Bank of America Fund. Christine Fedukowski with the Trust helped the Foundation understand the intricacies of complying with historic tax credit requirements. She also brought in Reznick, Fedder and Silverman, who provided well structured and sound models under JoAnn Clipp to evaluate the investment offering. Finally, we generated operations cash flow models that demonstrated that the theatre could be viable through the compliance period."

"Getting good people is paramount – people who are experts in

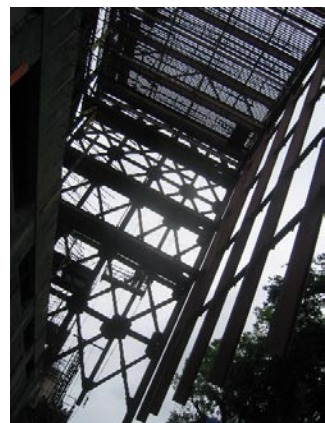
the field and with whom investors are comfortable having on the building team," concludes Ms. Smolik. "Paul Westlake and his firm are not only knowledgeable in this area, but also brought tax experts to the table who fit with our personalities. And our consultant, the National Trust, brought the best in the structured offering arena. It made for a strong team."

Incorporating Design Review Issues Throughout the Application Process

Having architects who were familiar with the requirements of the National Park Service for historic tax credits, and who could understand the implications of the process on design was pivotal. Westlake Reed Leskosky worked closely with Louis Jackson, Historic Preservation Specialist II with the Tennessee Historical Commission, the State Historic Preservation Office Representative (SHPO) assigned to our project, and the National Park Service to address historic/architectural issues, and respond to any concerns early in the conceptual design phases.

Roger Brevoort, Director of Historic Preservation for Westlake Reed Leskosky, provided assistance with the application for historic tax credits as part of the integrated services of the architectural firm. He stated that "The reason the Tennessee Theatre project worked so well is that, in this case, the consulting architects served an interactive role, writing the application, defining the issues, working with staff from our firm and local architects McCarty Holsaple McCarty, meetings with the State Historic Preservation Office and local preservation officials, and working one-on-one in the field."

"Westlake Reed Leskosky has an expert that has been invaluable to us. Roger Brevoort has been there for us every



The general contractor for the project, Denark Construction of Knoxville, was selected in a similar stringent process due to their capabilities, and also applied their efforts in encouraging and raising gifts in kind to assist in moving the project forward. Kirkegaard & Associates was hired as the project acousticians.

In early 2000, the Board worked with a professional fundraiser to kick off a structured and phased fundraising campaign that continued through 2002. Through a combination of federal and local support, an initial \$13.2 million in funds were raised. About 450 people from the private sector participated in the campaign, drawing just less than \$10 million in private monies.

Darlene D. Smolik, Project Coordinator for the Tennessee Theatre Restoration, recalls, "We could have a \$14 million museum with beautifully restored finishes. Or we could stretch to \$20 million and do the whole project at a base level. The options led us to the crossroads driven by intent and money." Ms. Smolik, who has been involved with the Tennessee Theatre project since pre-design, was hired as an owner's representative by the Foundation to provide fiscal management.

Darlene Smolik recounts the decision making process. "If we did the \$14 million project, we would only be rehabilitating the existing facility. We would still need to replace the HVAC, put in new seating; new control panels, and re-rake the balcony. The recommendation of the building committee was to design the whole theatre as it should be, with a complete set of plans, even if we needed to phase it and shut the theatre down. This helped us move forward."

The Board of Directors continued to struggle with the recommendation of the building committee to realize the full potential of the theatre and undertake the larger project. They had raised \$13 million, but did not see how they could raise the additional funds to meet the expanded scope. An application to the Kresge Foundation, for example, proved to be too late in the Tennessee's funding efforts for the Kresge's capstone grant.

The Tennessee Theatre Foundation tapped various consultants for expert advice and counsel. The general contractor, Denark Construction, Inc. was brought in early under a preconstruction consulting contract. They and the McCarty Holsaple McCarty design team with Westlake Reed Leskosky specialty consultants were asked to assess the feasibility of a guaranteed maximum

price at design development. Mary Ann Smith, former president of the Friends of the Coronado Theatre in Rockford, Illinois, lent her advice and the experience she had in shepherding the revitalization of the Coronado through a public private partnership. The Coronado project, designed by Westlake Reed Leskosky, had resulted from an extraordinary fundraising effort - exceeding initial projections and allowing for enhancements that created a nationally-recognized project.

Leveraging the Full Potential of the Tennessee

Westlake Reed Leskosky prepared initial design recommendations to fully leverage the potential of the Tennessee Theatre as a significant landmark and icon in Knoxville. The architectural vision focused on adapting the theatre to a performing arts facility with the capability of hosting a diverse array of performance types and uses, including symphony, dance, musical theatre, opera, and non-performance events such as lectures, social, and business functions.

Adequate theatre support spaces, including dressing rooms, wardrobe, crew and storage, would require consideration of alternatives such as adapting existing retail space along Clinch Avenue, which runs along the north side of the theatre. Plans also included acoustic and audio improvements, and the correction of deficiencies in the shaping of the original audience chamber while preserving essential historic features. Upgrades would encompass theatrical systems required for contemporary productions, including new rigging, theatrical lighting and control and soft goods; modifications for accessibility within the audience chamber and support areas; and mechanical, electrical, plumbing and fire protection systems. Patron

