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Public Recreation Facility Financing Trends: Taxpayer Backlash Causes New Models to Emerge

Matthew T. Brown
Mark S. Nagel

University of South Carolina

Abstract

With the recent economic downturn, some constituents have begun to meticulously analyze government spending priorities. In many cases, public recreation facilities and programs have experienced significant spending cuts. The paper details traditional public funding sources, discusses the impact of various state tax “revolts” on public funding mechanisms, and investigates selected funding models that may become prevalent in the future.

Public Recreation Facility Financing Trends: Taxpayer Backlash Causes New Models to Emerge

The nationwide economic downturn that began in 2007 has heightened worldwide attention on government spending and outstanding debt. The recent economic collapse and subsequent financial bailout of Greece has spurned discussions regarding the fiscal responsibility and proper role of all levels of government (Becatoros, 2010; Boone & Johnson, 2010). In the United States, recent federal spending on bank bailouts and economic stimulus packages, combined with expanded federal commitments to health care and other social programs has resulted in constituent concern (Carroll, 2010). At the state and local levels, unsustainable spending commitments, primarily for social programs and government employee pensions, have resulted in numerous states and local governments investigating methods to curtail spending to avoid potential financial disaster (McNichol & Johnson, 2010). For instance, the state of California has a budget deficit of $6.6 billion and projects to have a $20 billion shortfall if dramatic financial changes are not implemented (Steinhauer, 2010). In New Jersey, newly elected governor Chris Christie must attempt to lower a $10.7 billion dollar deficit (Stoddard, 2010). After years of dramatic spending increases, even some of the most liberal of California and New Jersey residents and government officials have recently admitted that their states are under significant financial duress and that spending cuts must be made to maintain the state’s solvency (Anderson, 2010).

Amid these federal, state and local government fiscal crises, parks and recreation agencies face heightened scrutiny regarding their expenditures. However, though there has been a political backlash at all levels against spending, most constituents still desire their government to provide recreation opportunities as they are typically perceived as beneficial to a wide cross-section of the entire community. In addition, the increased focus upon healthy living has spurred an increase in the use of public recreation facilities. The Statistical Abstract of the United States: 2008 shows that a considerable amount of tax payer dollars are spent on parks and recreation. The U.S. Census Bureau (2007) report indicated that state and local governments spent $30.5 billion in 2004, which was an increase of $5.4 billion from 2000.

Local governments must balance the need to cut expenditures while appeasing constituent demands for state-of-the-art recreation facilities (Brayley & McLean, 2008). Unlike 35 years ago where the majority of parks were fields of grass or wooded areas, today’s parks and recreation users typically expect a variety of program offerings including interactive playgrounds, sporting courts and game fields, and advanced trail systems (Brown, Rascher, Nagel, & McEvoy, 2010). Community centers that once were little more than open gym space and meeting rooms now have often evolved into large multi-purpose facilities. These venues often contain aquatics facilities, open gym space, running tracks, fitness centers, multipurpose rooms, and nursery/babysitting areas.

Compounding the problems generated by the present economic conditions, is evidence that the amount of revenue that public recreation agencies can generate from user fees may have peaked before the recent economic downturn began (Bynum, 2006). Approximately one-third of revenue used to pay for public recreation programs comes from user fees. In a time of economic uncertainty, it is unlikely that those fees will be able to be sustained (let alone dramatically increased). With diminished government expenditures occurring simultaneously, the need for new financing methods are paramount, especially for mandated or highly desired programs. The purpose of this paper is to investigate and discuss public recreation facility finance trends that are emerging in the “new” political and economic environment. The paper details traditional public funding sources, discusses the impact of various state tax “revolts” on public funding mechanisms, and investigates selected funding models that may become prevalent in the future.

Public Funding Sources

Unlike private businesses that exist to generate profits for shareholders by creating and selling products and services to customers, governments and government agencies exist to provide services that better the lives of their constituents. In regards to recreation, a government's primary goal is to provide sport facilities and programs that enhance the quality of life for members of the community while benefiting the common good rather than generating a specific profit margin. This often results in sport facilities, programs and services being offered that have to be subsidized by tax revenues because fees charged for programming often do not fully cover operational costs.

Primary Revenue Sources

Traditionally, the revenue source most often utilized to fund the construction or operation of recreational sport facilities has been property tax receipts (Brayley & McLean, 2008; Sawyer, Hypes, & Hypes, 2004; Sherman, 1998). Property taxes generated 32% of all state and local tax revenue in 2004 (U.S. Census Bureau, 2007). Sherman (1998) reported that 73% of recreation construction or operation funding involved property taxes. While this percentage is likely lower today, it can be assumed that property taxes still provide a majority of public recreation funding.

Most states collect two types of property taxes. Real property taxes are taxes on land and all structures built on or improvements made to the land, while personal property taxes include taxes on other items of value (automobiles, boats, etc.). The property tax rates are established by a variety of public entities including counties, school districts, and recreation districts. Though 45 states have experienced decreased tax revenues due at least partially to the financial crisis (Berr, 2010), in most cases property taxes are unlikely to be increased, particularly for recreation programs or facilities.

After property tax revenue, the second most used revenue source is sales tax revenue (Brayley & McLean, 2008; Sawyer, Hypes, & Hypes, 2004; Sherman, 1998). Sales taxes generated 36% of all state and local tax revenue in 2004 according to the U.S. Census Bureau (2007). A majority of this revenue, however, funds services at the state level, not the local level. For example, Sherman (1998) reported that only 26% of all recreational sport construction or operational funding involved sales taxes. This is compared to the 73% funded through property taxes. Sales tax regulations vary by state but for most these taxes are collected at the time goods and services are purchased. Sales tax rates range from zero in Montana to almost ten percent in several states (Tax Foundation, 2010).

Missouri is one of a few states where sales taxes are used to fund recreation programs and projects. At the state level 0.1% is designated for Missouri state parks. A resident in St. Louis County pays an additional 0.1% in sales tax to fund the county's park and recreation programs. If this resident lives in the City of Fenton, he or she will pay an additional 0.5% to fund the city's recreation and park programs. Overall, this individual will pay 0.7% in sales tax to fund state, county, and city park and recreation facilities and programs ("Welcome to Fenton," 2009).

While sales taxes are levied on goods and defined services in a state, excise taxes on select goods and services may be imposed within a city, county, or state. These excise taxes can benefit parks and recreation services and facilities. For example, an excise tax was used to fund a variety of sport, entertainment and recreation venues in Orange County, Florida (Brown, 2008). A 6% hotel tax was added to generate revenue for the $1.1 billion project. This funding will provide construction revenue for renovation of the Citrus Bowl ($175 million), construction of a new performing arts center ($375 million), construction of a new sport and entertainment arena ($480 million) that will become the home of the National Basketball Association's Orlando Magic, and construction of five new recreation centers ($25 million) to be operated by the county.

Primary Funding Mechanisms

Regardless of the tax revenue utilized to build and operate recreation facilities, most capital projects use either short-term or long-term debt to immediately fund the venture. Issuing debt places less of an immediate financial burden on taxpayers. However, the municipality commits to pay for the project over extended periods of time. For governmental entities, bonds are the traditional source of capital improvement debt issued to generate funds for projects.

In order to issue bonds, the municipality or district has to receive approval to borrow money from either the voters or the appropriate legislative entity. If voter approval is received, either revenue bonds or general obligation bonds will typically be issued to fund capital projects for community recreation programs (Bynum, 2003). Revenue bonds are secured by future revenues generated by the project being funded or specific tax revenue sources whereas general obligation bonds are secured by a municipality's tax revenues and the issuing entity's ability to impose new taxes (Brown et al., 2010).

General obligation bonds have been the most common method of recreation facility financing. "General obligation" means that the issuer has a commitment to repay the principal plus interest through whatever means are necessary. This includes "borrowing" from the municipality's general fund or increasing rates of taxation to offset the obligations. General obligation bonds, as they have no default risk (except in extreme cases of municipality bankruptcy), carry less risk as compared to other bond types. Therefore, given the lower risk, interest rates are reduced allowing for smaller debt payments. This in turn decreases the total cost of the project (Brown et al., 2010).

Revenue bonds are paid solely from specific, well-defined, sources of revenue such as hotel taxes, sales taxes, other sources of public funding, or funding generated by a project itself. Revenue bonds retain higher risk as they are not backed by the full faith and credit obligation of the issuing municipality. Therefore, if the source of funding does not meet expectations, default will occur. As a result of the heightened default risk, interest rates are higher for revenue bonds as compared to general obligation bonds. Revenue bonds often do not require direct voter approval prior to issue by a municipality. Montgomery County, MD, built a swim center using revenue bonds paid for by a lease between the County and the financing authority established to manage the facility. The County's lease payments covered the principal plus interest on the bonds (Brown et al., 2010).

When selecting the type of bond to use to fund a project, the municipality or recreation agency must first determine if the project will generate enough revenue to retire debt, operate the facility, and maintain the facility. If the recreation facility is likely to generate sufficient revenue, then issuing revenue bonds is appropriate as it minimizes a municipality's risk. However, if a revenue shortage is projected, the municipality must determine if there is sufficient supplemental revenue from an existing general fund or another recreation revenue source to pay for the project. If those sources are not available, a general obligation bond backed by other tax sources will likely be utilized. Frequently, the other tax source is an increase in real property taxes. However, it is not uncommon for increases in sales tax to be used as well.

Restrictions on Tax Revenue Increases

During the 1970s, a significant reevaluation of federal, state, and local taxation began. Many constituents were disenfranchised with current tax policy and sought significant change (Crompton, 1999). Though there were minor tax limitation laws passed in 1976 and 1977, the 1978 passage of Proposition 13 in California signified a new era in tax policy. Proposition 13 set property taxes at one percent of the 1975-1976 assessed value. It further required that assessed values could not increase more than two percent per year unless property changed hands. It also required that to approve new taxes the state legislature would require a two-thirds majority. It also prevented local governments from imposing new taxes without a two-thirds majority vote of the electorate (California Const. art. XIIIA.). The impact of Proposition 13 was extensive as by 1982 20 states had adopted a variation of tax limitation legislation (Stansel, 1994).

Missouri was one state that followed California's lead. In 1980, the Hancock Amendment was approved by the state's voters. The Hancock Amendment mandated that state and local budgets could not grow faster than a resident's ability to pay for the growth. In essence, the amendment keeps state and local governments from increasing taxes without direct voter approval (Hembree, 2004). Taxes that are imposed by the state's general assembly were limited to 5.6359% of the 1979 personal income of Missourians. State revenue growth is therefore tied to the growth of personal income in Missouri. At the local level, the amendment required direct voter approval before any new tax, license, or fee could be levied or before an existing tax, license or fee could be raised. Restrictions on the growth of the assessed value of property, excluding new construction and renovations, were enacted as well (Missouri Const. art. X.).

Most recently, Florida enacted tax limitations when Amendment 1 was passed by referendum. In 2008, voters in the state approved an increase to the homestead exemption, allowed homeowners to transfer their homestead exemption, created an exemption for tangible personal property, and restricted the growth on the assessed value of non-homestead property to 10 percent per year (Florida Const. art. VII.). It is estimated that $32 billion in property taxes will be cut over five years (Bynum, 2007).

Given the current state of the U.S. economy and the continued examination of government expenditures, there are likely to be other referenda targeting tax limitations. In particular, limiting potential tax revenues will have an impact upon public recreation facilities and operations. Since many local municipalities fund recreation through discretionary funds, these areas are likely to be cut before "essential" services. For instance, the City of Vallejo, California had 74 percent of its yearly budget allocated to fire and police personnel and pensions which limited its ability to fund recreation programs and other "non-essential" services (Greenhut, 2010). Other municipalities likely face similar circumstances as tax revenues decrease due to the economic slowdown or taxpayer revolt.

Emerging Trends

With the dramatic downturn in the economy and restrictions on tax revenue increases, municipal recreation programs have had to become creative to fund new venues and projects. For some, the need to collaborate with partners to finance a project has become a necessity. Whether the collaboration is a joint use agreement between two public entities like a recreation district and school system or a public-private partnership between a non-profit or for-profit organization and a municipal recreation department, cooperation is becoming increasingly common.

There are many examples of joint use agreements between public school districts and municipal parks and recreation programs. These formal agreements between parties outline how facilities will be shared once they are constructed. In addition to field and/or facility usage, the responsibility for construction costs, operational costs, maintenance and management are included in these agreements. For example, a 32-acre public park opened in San Marcos, California that contained a skate park, softball fields, and a soccer field. A nearby high school will use the park as a practice facility. In Broomfield, Colorado, revenues from new construction impact fees have been funneled from the city to the school district for construction of new gymnasiums and athletic fields, which are shared by the district and local community members (Brown, 2008).

The joint use agreement between county and school officials in Anne Arundel County, Maryland provides an example of the partnership (Brown, 2008). Three new synthetic turf fields were installed each year at county high school stadiums over a four year period at a total cost of $10.7 million. Seventy-five percent of the funding for the new fields came from the county's recreation department. The department was able to secure a portion of its funding through a grant from Program Open Space, which is a Maryland Department of Natural Resources initiative. Program Open Space provides funds for the development of parks, conservation areas, and recreation areas. The county provided the funding to the schools for the updated fields because it would not have been able to buy the needed property for its own fields, then build the fields and install lights, bleachers, concessions and restrooms if it had acted alone. Through the partnership with the school district, the recreation department was able develop new fields at less than $1 million per field.

The joint use agreement grants school programs exclusive use of the fields on weekdays until 7:00 pm (later on football Fridays), and until noon on Saturday. The recreation department uses the fields for three-to-four hours during the week, 10 hours on Saturday, and all day Sunday. This access alleviates the overcrowding the recreation district was facing in its other programs. In lacrosse alone, there were over 400 teams in county recreation leagues. Field maintenance is the responsibility of the school district as is operation of the concessions stands (Brown, 2008).

Cooperation in the form of a public-private partnership can also be seen in Altamonte Springs, Florida. The Altamonte Springs leisure services department outsourced the operation of its recreation leagues and events in an effort to cut expenses and generate additional revenue (Bynum, 2007). Through a bid process, the department has contracted with private companies for sports instruction and league and tournament play. The leisure services department provides the facilities and the marketing for recreation events and tournaments. For municipal sports programs, the city receives a percentage of registration fees. Additionally, the city receives 15% of registration fees and ticket sales from events. Sporting events are held an average of 45 weekends per year as the department bids for AAU tournaments, American Softball Association (ASA) regional and national tournaments, and other similar events. In addition to the previously mentioned revenue sources, depending on the size, scope, and type of event, the city may receive a percentage of merchandise sold at the event as well.

In some instances, creative financing, rather than collaborative financing, is preferred or required. By exploiting loopholes in laws enacted to restrict the financial growth of state and local government, some municipalities are able to circumvent restrictions on increases in tax revenues and governmental expenditures. The City of Fenton, Missouri provides an example of how the state's Hancock Amendment can be sidestepped. The city used two different types of bonds to finance two capital recreation projects. For the first capital project, land was purchased for future park and recreation use (Fabick Property). In 2009, the city made $620,000 in payments on the project. The city's second capital project was for its new recreation center, RiverChase. For the recreation center, the projected payment in 2009 was $1.3 million. Each of these projects used different forms of bond financing (Brown et al., 2010).

For the purchase of the Fabick property, public facility authority (PFA) bonds were used. Essentially, the PFA Bonds issued by the city initially appear to be similar to revenue bonds. However, there are some differences. For the city, the PFA bonds were issued by the Fenton Public Facility Authority, a non-profit corporation established according to Internal Revenue Service ruling 63-20. PFAs can hold title to a project, secure financing for the project, and later hand over the project to the city. In this case, the Fenton PFA holds title to the land, issued bonds to finance the purchase of the land, receives payment from the City of Fenton for use of the land through a long-term lease agreement, and will give the land to the city once the project's debt obligations have been eliminated. The city pays for the project through the operating revenues in its parks fund. Payments are made directly to the trustee of the Fenton PFA. In turn, the trustee makes the principal and interest payments on the bond (Brown et al., 2010). For Fenton and many other cities in Missouri, PFAs are used to fund parks and recreation projects because a public referendum is not needed to issue bonds via a PFA under state statute. The PFA has no taxing authority and the city is under no obligation to levy any form of tax to pay for the bonds. Risk is therefore assumed by the bondholders rather than the city if the project does not generate the anticipated revenues needed to repay the bonds.

For the RiverChase recreation center, certificates of participation were utilized. Certificates of participation were issued to a trustee overseeing RiverChase by a lending institution. The city pays a lease fee to this trustee who then pays the bond back. As discussed by Crompton (1999), the use of certificates of participation has been increasing, especially in states where there are strict limits on borrowing funds (Brown et al., 2010).

As with the PFA bonds, a corporation was formed to handle the financing of the RiverChase project. The city created a corporation to construct the new facility. The corporation then acts as a public trustee while issuing certificates of participation to finance the project. Through the certificates of participation, a lending institution provides funds to the corporation/trustee for the project's construction. The trustee holds the title to the project for the benefit of the certificate holders. The city pays a lease fee to the trustee who in turn pays the financial institution its principal plus interest (Crompton, 1999). One important note to both methods of financing used by the City of Fenton is that the bonds/certificates used to fund the projects were non-guaranteed. They were not backed by the full faith and credit of the city but by operating revenues generated from the city's parks fund. Therefore, risk is transferred to bond holders if revenues are not sufficient to repay debt obligations and offset operating expenses.

Conclusion

As the economic slowdown that began in 2008 continues, constituents and politicians will continue to encounter difficult spending decisions. Many recreation facilities that were opened, remodeled or expanded since 2008 had already been financed prior to the economic slowdown. As the economy continues to remain stagnant, new spending priorities are being established by state and local municipalities. In some cases, those priorities do not include enhancement of existing or creation of new recreation opportunities.

As constituents continue to demand services while also insisting upon greater fiscal responsibility on the part of various government entities, the need for creative financing, particularly for recreation facilities and programs, will likely grow. "Creative" financing is not only often required by statute, but is also sometimes the easiest way to finance a project without having it appear in the municipality's budget. Though constituents have increasingly been asking questions about government spending over the past two years, much of those questions do not investigate the meticulous manner in which many recreation facilities and programs are creatively funded. Creative financing methods are therefore likely to continue, even if the economy recovers.

Public-private partnerships and public entity partnerships are also likely to increase in the future. Greater constituent involvement means that government agencies must be able defend their practices and cross agency use of land and other resources is an easy method to assuage constituent fears of government waste. Joint use agreements between various entities not only can limit expenses, but may also offer a greater opportunity for participants in various recreation programs.

Ultimately, it will be interesting to see how constituents in various areas of the country prioritize government spending and if the "holding government accountable" trend that began in the 1970s and has generated tremendous attention since the economic collapse of 2008, continues beyond 2010.

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