Financial Sustainability

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Contents of Presentation

 Reasons for producing a Financial Sustainability Model

 The Whelan Model – approach taken, framework

• Results produced by the Model

Meaning of Financial Sustainability

Variety of interpretations – no standard definition

Financially sustainable council *should be able to*:

- Provide & fund service needs of community
- Ensure an equitable imposition of rates & charges
- Maintain operational viability
- Preserve intergenerational equity

Components of Financial Sustainability

Comprehensive analysis of financial sustainability involves three perspectives;

- 1. Financial Performance
- 2. Corporate Performance
- 3. Sustainable Capacity

Financial Sustainability Pyramid

Financial

Performance

The financial result of Corporate Performance and Sustainable Capacity Measured by financial indicators

Corporate Performance

The effectiveness and efficiency of service delivery – involves quality of decision making & resource management Assessed by annual reports, audits, KPI's and service reviews

Sustainable Capacity

The impact of Inherent structural characteristics on the capacity of councils to raise revenue and contain costs

Determined by modelling geographic, demographic and financial factors Fundamental to financial sustainability – governs capacity to perform

Why Determine Sustainable Capacity?

- Sustainable capacity is a critical foundation of financial sustainability
- Recent major studies acknowledge impact of;
 - low incomes,
 - large areas
 - low populations, etc on performance capacity
- No steps taken to quantify & apply them for assessing capacity

This is the objective of the Whelan Model

Emphasis on Sustainable Capacity

 Assessing capacity is completely different to assessing performance

 Concerned solely with impact of structural characteristics on capacity to raise revenues and contain costs

Sources of Data

- Data provided by:
 - ATO
 - ABS
 - VGC
 - Commonwealth Depts.
 - Council Annual Reports
- Accuracy & objectivity of data is critical

Council Classifications

- Councils classified into 8 groups, each with similar inherent characteristics;
 - Population size
 - Density
 - Dispersion & Remoteness
 - Size & number of urban centres
- Metro Higher Density, Lower Density, Fringe
- Regional Cities, Rural Centres
- Rural Large, Medium, Small

The Sustainable Capacity Model

- Purpose:
 - Objectively determine the relative sustainable capacity of each council
- Achieved by
 - Quantifying the impact of inherent structural characteristics on capacity
- These characteristics are not subject to council control
- Main product of the Model is the *Sustainable Capacity Ratio*

Sustainable Capacity Ratio

SCR (Sustainable Capacity Ratio)

$= \frac{C2P}{OSRR}$

- C2P (Capacity To Pay) Relative capacity of community to pay, that is, councils ability to raise own source revenue (OSR)
- OSRR (Own Source Revenue Required) Nominal (predicted recurrent) costs less Recurrent Government Grants

Capacity of the Community to Pay

Two methods consistently proposed to assess it:

- 1. Property valuations (CIV)
- 2. Net disposable community income (NDCI)

"The higher the aggregate income of a community, the higher the potential for its local government to raise revenue" (Australian Government Productivity Commission)

• Whelan Model uses community income as the basis

Community Income

- Comprises:
 - Individual disposable income (after tax & mortgage payments)
 - Commonwealth pensions & benefits
 - Company income after tax
 - Partnership/trust income distributed to individuals & companies
- Council accesses this income by raising:
 - rates & charges
 - fees, fines & user charges

Rates & Charges

- NDCI adjusted to allow for unoccupied dwellings (additional NDCI available to Council)
- Total NDCI is allocated to property types;
 - Residential
 - Commercial/Industrial
 - Rural

To derive:

NDCI available for each Residential / Commercial / Rural assessment

Capacity to Pay Rates & Charges

NDCI available for each property type are combined to determine:

Capacity to pay rates & charges per assessment

The calculated capacity to raise rates & charges explains 97.8% (r²) of the variation in actual rates & charges across all 79 councils (i.e. a highly reliable measure).

Fees, Fines, User Charges & Other Revenue

Derived from:

- Resident individuals
- Corporations
- Non-resident owners of unoccupied dwellings
- Commuting workers
- Shoppers
- Tourists
- Users of recreational facilities
- Passive investment

NDCI is adjusted to account for the impact of these revenue sources

Fees, Fines, User Charges & Other Revenue - Cont.

Fees & fines capacity per head

The calculated capacity to raise fees & fines explains 97.7% (r²) of the variation in actual fees & fines across all 79 councils (i.e. a highly reliable measure).

C2P Index

 The C2P Index is a weighted combination of the capacities calculated for rates & charges and fees & fines

That is:

Relative capacity to raise own source revenue

Capacity To Pay Comparison



Cost Factors

- Calculation of 'Nominal Cost' (predicted recurrent) is required to maintain objectivity & accuracy
- Costs are modelled using *inherent factors* i.e. independent variables of councils
- Key attributes of these variables:
 - Causation direct causal relationship with recurrent costs
 - Objectivity beyond the influence of council decision making
 - Comparability facilitates reliable comparison across councils
 - Materiality statistically significant impact on costs

Independent Variables Used In The Model

- Six General Variables:
 - 1. Population size
 - 2. Population density
 - 3. Concentration of service activity (CSA)
 - 4. Average traffic volumes (ATV)
 - 5. Dispersion of population into townships & rural areas
 - 6. Remoteness of the municipality from major population centres

Independent Variables Used In The Model - Cont.

Four Cost Specific Variables:

- 1. Aged population
- 2. Infant population
- 3. Bridges
- 4. Other road cost factors
- Some variables have a significant impact on the costs of all councils (e.g. Population size & density)
- Some variables have a significant impact on certain councils (e.g. Road cost factors, bridges & CSA)

The Cost Model

Regression Model constructed to predict recurrent costs (nominal) per head using the ten independent variables

- This facilitates comparison of costs between councils servicing different environments. It removes the influence of individual council policies & decisions
- The nominal costs predicted by the Model explains 96.5% of the variability in actual recurrent costs (r² = .965) – a highly reliable Model

Nominal Cost Comparison



Recurrent Government Grants

Tied grants (for specific services) and untied grants (VGC) comprise 18% of council recurrent revenue

- Provide reliable & consistent source of recurrent income
- Have a direct impact on sustainable capacity, reducing net operating cost per head

Recurrent Government Grant Comparison



Sustainable Capacity Ratio Calculation



Sustainability Capacity Ratio Comparison



Sustainable Capacity - Major Components

CLASSIFICATION AVERAGES	CAPACITY TO PAY INDEX \$	NOMINAL COSTS \$	RECURRENT GOVERNMENT GRANTS \$	OWN SOURCE REVENUE REQUIRED \$	SC RATIO
Small Rural	33,200	2,406	923	1,472	23.6
Medium Rural	43,981	1,699	493	1,205	36.9
Large Rural	50,822	1,394	307	1,070	47.8
Rural Centre	47,505	1,534	447	1,066	45.1
Regional City	64,341	1,239	268	956	68.7
Fringe Metro	60,624	850	144	700	89.1
Low Density Metro	72,372	800	133	667	110.2
High Density Metro	86,878	959	105	853	102.8
State Median	52,547	1,378	250	1,009	57.3

Broad Conclusions

 Strong correlation between council classifications & sustainable capacity

Metropolitan councils highest; small & medium rural councils lowest

Changes In Sustainable Capacity

• Average council sustainable capacity reduced on average by 3% p.a. from 2007 to 2010

- Main reasons
 - drop in corporate income due to GFC; &
 - Increasing costs (over 5% pa)

Sustainable Capacity Ratio Summary

- Measures relative sustainable capacity of councils
- No precise point at which a council becomes unsustainable
- Four years modelling indicates that a SC Ratio of below 40 raises sustainability concerns
- <u>Does not measure financial or corporate</u>
 <u>performance</u>

Issue of Reports / Models

- Initial Report issued May 2010
- Approach accepted;
 - by both sides of State politics
 - by local government generally
- Used to support rural council funding applications
- Second Report issued November 2012
- Models produced for financial years 2007 to 2010

Reliability of Model

- Logically constructed
- Supported by empirical evidence
- Accurate predictor of costs & revenue raising capacity
- Statistically sound appraisal by highly credentialed statistician & economist concluded
 - "the methods used are appropriate & thorough for the purpose of this analysis"..."the statistical results and interpretation of the data are sound"