8. COMMERCIAL PERFORMANCE IN THE BROADER PUBLIC SECTOR

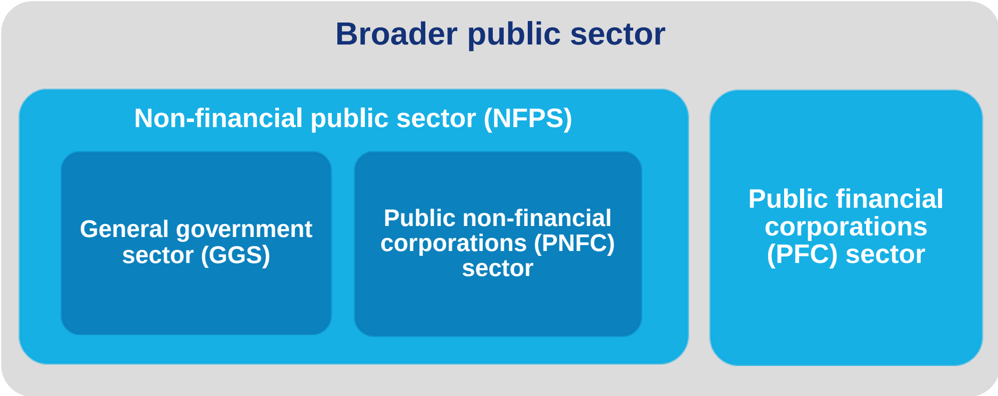
- The broader public sector comprises the total state government in New South Wales and includes the general government sector (GGS), public non-financial corporations (PNFC) sector and public financial corporations (PFC) sector.
- The PNFC and PFC sectors are guided by a Commercial Policy Framework (CPF), which applies private business disciplines to government businesses and supports them to operate efficiently and in consumers' best interests. The NSW Government continues to align the CPF with best practice.
- The total dividends and tax equivalent payments received by the GGS from the PNFC and PFC sectors in 2017-18 are $1.5 billion, which is $106.5 million lower than estimated at the 2017-18 Budget. This is a result of lower dividends and tax receipts from the energy as well as property and resources sectors.

8.1 Overview of the broader public sector

The broader public sector is made up of entities within the public financial corporations (PFC) sector and non-financial public sector (NFPS). The NFPS is comprised of the general government sector (GGS) and the public non-financial corporations (PNFC) sector:

- entities within the GGS are funded mainly by taxation revenue and provide services such as health, education and emergency services
- entities within the PNFC sector operate on a more commercial basis and are able to recover most of their costs by charging consumers for services such as transport, water and electricity distribution
- the PFC sector provides financial management services to the government and insurance services to the people of New South Wales
- entities in the PNFC sector include State Owned Corporations (SOCs) set up under the *State Owned Corporations Act 1989* to operate with a greater degree of commerciality and autonomy than entities in the GGS.

A full list of NSW public sector entities according to their classification as a GGS, PNFC or PFC entity is provided at Appendix A3 of this *Budget Statement*.



8.2 Reform of government business

Review of the Commercial Policy Framework

The Commercial Policy Framework (CPF) is a suite of policies that set expectations for government businesses in the PNFC and PFC sectors. The CPF aims to replicate in government businesses the drivers and characteristics of an efficient private sector business.

The Government continuously reviews and updates the CPF to ensure it reflects commercial best practice and to incorporate changes in government priorities and the regulatory environment. The CPF is currently under review in order to:

- support the delivery of services at lower cost
- enable more consistency and transparency in funding social and community programs
- strengthen the monitoring of major capital investments made by government businesses
- ensure commercial objectives are balanced with improved customer outcomes.

The review of the CPF will support government businesses to perform comparably with efficient private sector businesses, putting downward pressure on cost of living expenses and helping contribute to the growth of the NSW economy.

Changes to the CPF in 2017-18 included:

- updating governance principles to align government businesses with ASX-listed companies
- introducing best-practice guidance for CEO appointments
- updating reporting requirements to support transparency and accountability
- strengthening assurance processes for capital projects.

NSW Treasury Corporation (TCorp) and NSW Treasury have developed a whole-of-government Foreign Exchange Risk Policy to manage exposure to foreign currencies when Government agencies and businesses purchase, sell, or intend to purchase or sell goods and services either from or to overseas providers. The Policy is designed to improve project cost certainty and provide a cost-efficient arrangement for managing foreign exchange risk. TCorp is supporting the State's focus on financial risk management to manage foreign exchange risk transparently, consistently and at lowest cost and/or risk to the State. The Policy will take effect 1 July 2018.

In line with private sector best practice and Commonwealth government businesses, the NSW Government has updated its policy regarding how ‘for-profit’ public sector entities measure long-term employee liabilities such as superannuation. Going forward, these liabilities will be discounted using the High Quality Corporate Bond rate.

The *Government Sector Finance Bill* (GSF Bill) will enable the State to centralise liquidity management by including PNFC entities within the centralised banking system. This means that the State can improve balance sheet efficiency by reducing borrowing and finance costs. Refer to Box 2.2 in Chapter 2 of this *Budget Statement* for more details on the GSF Bill.

These initiatives will enable more efficient use of capital thereby supporting the funding of the Government’s infrastructure program.

Water

Sydney Water is updating its wastewater infrastructure to support an additional 500,000 people in Sydney’s West by 2040 under the Lower South Creek Treatment Program, providing significant improvements to the quality, capacity and reliability of the wastewater system in the area. This includes investing $117 million to increase the capacity of the Riverstone wastewater treatment facilities, as well as investing $300 million for a new biological nutrient removal plant at Quakers Hill and enhanced wastewater treatment facilities at St Marys.

Since September 2017, Sydney Water has been progressively rolling out a new Customer Hub to provide a stronger and more seamless customer experience. This includes providing, in real time, service disruption and planning information to customers via electronic customer communication tools as well as real time proactive web and phone feedback channels.

Sydney Water is also investing in the Customer Experience Platform (CxP), an information technology project due to begin rolling out in mid-2019 and to be completed in 2020, which will deliver a new billing and data management system to improve the customer experience.

Box 8.1: Sydneysiders save more on water compared with other major cities

Water and wastewater customers in Sydney have gone from paying among the highest of any major city in Australia to the lowest as a result of the NSW Government’s strong financial management, prudent investment decision making and focus on operational efficiency.

This has resulted in a 10 per cent decrease in annual water bills for Sydney Water customers between 2015-16 and 2016-17. This was the largest decrease among all major utility groups nationally, with a typical household seeing savings of around $100 per year (see Chart 4.4).

The Government has committed to securing the long-term water supply to the Broken Hill community by constructing a 270 km pipeline from the Murray River. Water NSW is managing the construction, which is scheduled for completion by December 2018.

In May 2017, the NSW Government released Resilient Valley, Resilient Communities – the Hawkesbury-Nepean Valley Flood Risk Management Strategy. The Strategy, which was developed by Infrastructure NSW, concluded that raising the Warragamba Dam wall height by approximately 14 metres would be the best option to reduce flood risk from the Warragamba River. WaterNSW, which owns and operates Warragamba Dam, is currently undertaking an environmental assessment for the project. The NSW Government has allocated $58 million to deliver the first stage of the Flood Strategy, which includes $30 million for planning, environmental assessments and community consultation for raising the Dam wall as well as $28 million for better flood forecasting, emergency planning and improved evacuation signage.

The project is scheduled to be built by 2024 subject to completion of environmental assessments and other planning and government approvals.

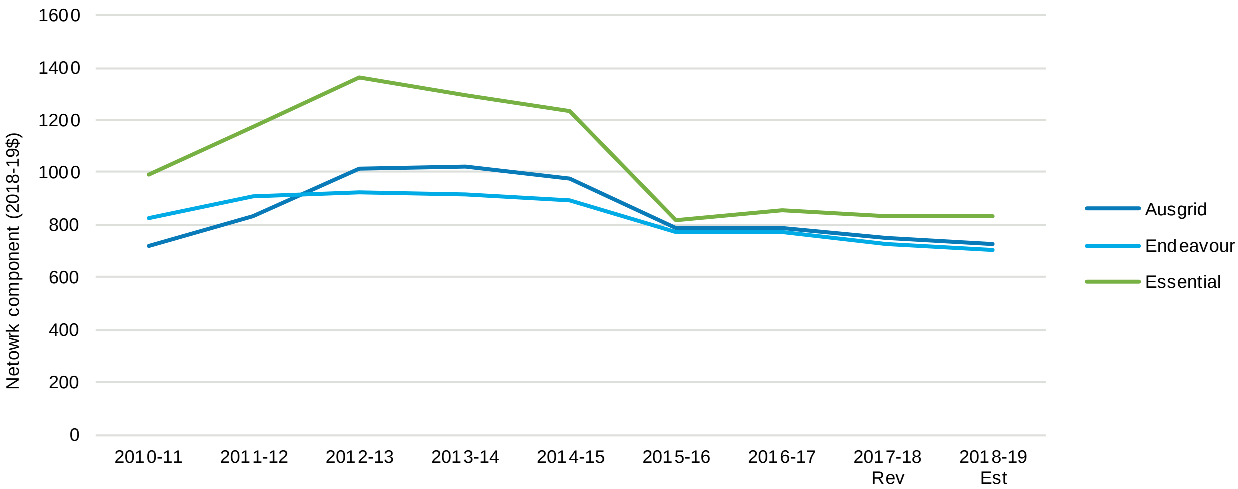
Hunter Water is undertaking technology improvements to transform how the business interacts with customers and the community. Hunter Water is refreshing its billing system, redeveloping its website to include enhanced account management and transactional capability, introducing customer support tools including web chat, and increasing visibility and management of water usage with new data analytics. Digital technology will also be used to improve operating performance and revenue and risk management.

Energy

Reforms to the electricity transmission and distribution network reduced average customer network charges for residential customers by 30 per cent in real terms in 2017-18 compared with 2013-14.

According to the Australian Energy Regulator, a typical Essential Energy residential customer will see network charges fall by 40 per cent in real terms between 2012-13 and 2018-19, and average residential customer network charges in 2018-19 will be lower than they were in 2009-10. This has put downward pressure on prices as Essential Energy continues to streamline its operations and invest in innovative and enabling technologies to deliver a safe, reliable and efficient electricity network to its customers. While electricity generation, and wholesale and retail price increases have contributed to overall price rises in recent years, greater electricity network efficiencies have significantly moderated these price increases.

Chart 8.1: More efficient and lower cost electricity networks in New South Wales [(a)]



Source: Australian Energy Regulator, NSW Treasury

(a) Estimated network component of a typical residential customer's bill over time adjusted for inflation (GST included).

Transport

The Port Authority of NSW is proposing to build a multi-user terminal to import bulk materials through Glebe Island. This will play a vital role in Sydney's concrete supply chain. Currently, most materials involved in concrete production are delivered to Sydney by road. With demand for concrete in Sydney expected to continue to increase as a result of large infrastructure projects including WestConnex and Sydney Metro West, the new facility will improve supply chain efficiency and lower the number of trucks on the road, helping to reduce congestion on the road network. The terminal is forecast to be operational in the third quarter of 2019.

The number of cruise vessel visits to Sydney has increased nearly three-fold over the past decade, with 346 visits expected in 2017-18. Growth is expected to continue and the Port Authority continues to explore opportunities to improve the operational efficiency of its cruise terminals. For example, the Port Authority is replacing the gangways at the Overseas Passenger Terminal in order to improve the flow of passengers from 500 to 1,200 passengers every 30 minutes.

The Transport Asset Holding Entity will optimise the existing transport asset base to enable a more effective, efficient and commercial approach to asset management. The Government continues to develop the final operating model and expects it will be in operation from 2019.

Tourism

Sydney Opera House is undergoing a $202 million upgrade for Stage 1 Renewal works funded by Restart NSW. The Concert Hall upgrades will modernise the Opera House's largest and most popular venue, greatly improving acoustics, theatre machinery systems and wheelchair accessible seating, as well as extending and automating stage configuration. These improvements to this world class venue will enrich the experience for the eight million tourists who visit the global icon each year.

The entry and foyer upgrades will enhance the visitor experience by increasing pedestrian accessibility under the Monumental Steps, and upgrading the main box office. A new Creative Learning Centre will repurpose the north-western corner of the building, currently used for offices, into a multi-purpose space for education and creative activities. A new premium function centre within the building envelope on the north-eastern end of the building will have one of the world's best views and will allow the removal of the existing function marquee. A $36.2 million security system upgrade is also being implemented to maximise protection for the public and staff at the Sydney Opera House.

The 10-year Visitor Experience capital program at Taronga Zoo, Sydney and Taronga Western Plains Zoo, Dubbo commenced in 2016-17. The $165 million program will enhance the capacity of the organisation to offer impressive visitor experiences through its unique collection of animals and related educational exhibits.

Forestry

The Government has approved a $71.8 million forestry package to support an innovative, thriving and sustainable forestry industry. The package includes:

- **Innovation fund**: $34.0 million over four years in loans and related expenses to assist the State's forestry industry to adjust to local wood supply changes through innovation
- **Plantation investment**: $24.0 million to the Forestry Corporation of NSW to invest in plantations. This will help increase supply and support sustainable timber harvesting
- **Mapping and environmental monitoring**: $9.2 million over four years in world-class forest mapping and environmental monitoring to underpin a sustainable forestry industry
- **Training**: $4.6 million over four years for a training and accreditation scheme for forestry industry contractors in safety and environmental practices, and governance.

Property

Landcom has shifted its focus to improving the supply, diversity and affordability of new housing in Sydney and regional New South Wales. This follows the reallocation of the Major Urban Transformation Projects from Landcom to UrbanGrowth NSW Development Corporation and Hunter Development Corporation in the second half of 2017.

Landcom is also focused on delivering its existing projects, which are primarily located in Western Sydney. These projects will contribute to its target of delivering 20,000 new home sites over the four years to March 2019. As at 31 May 2018, 16,860 new home sites had been delivered and Landcom is on track to achieve its target.

Box 8.2: Landcom: delivering affordable housing across New South Wales

In November 2017, Landcom released its Housing Affordability and Diversity Policy, under which it has committed to deliver 5-10 per cent of all new housing as affordable housing provided by Community Housing Providers.

Landcom has commenced a program of Demonstration Projects to test housing affordability solutions that are replicable, commercially viable and meet a range of demographic needs. These projects will adopt innovative approaches to design, planning and finance, and play a key role in demonstrating to the industry that new approaches can improve housing affordability and diversity.

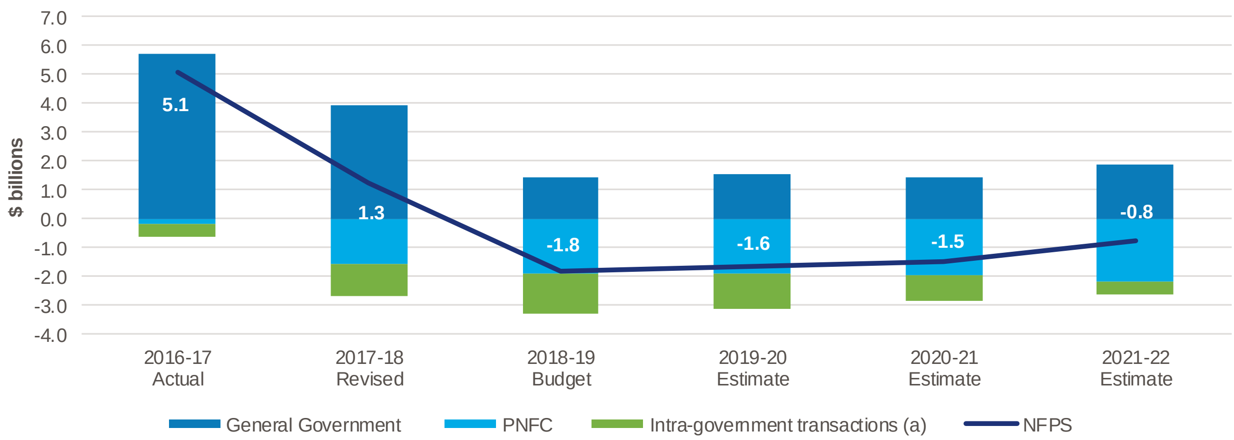
The program of Demonstration Projects will be ongoing, with the first tranche of four projects to be launched later this year. The four demonstration sites will provide affordable housing options for first home buyers, downsizers and renters and will test different design options including micro lots, vertical villages and compact apartments. Three of the demonstration sites will be located in Greater Sydney and one will be located in regional New South Wales.

8.3 Non-financial public sector

For the NFPS, the $1.3 billion net operating balance in 2017-18 is $1.2 billion higher than forecast in the 2017-18 Budget. This is due to a stronger result for the GGS. The NFPS net operating balance is lower over the forward estimates than forecast in the 2017-18 Budget due to lower revenue forecasts in the GGS and PNFC sectors.

Further details on GGS performance are in Chapters 5 and 6 of this *Budget Statement*.

Chart 8.2: Components of the non-financial public sector net operating balance



Dividends and tax equivalent payments

Dividends received by the GGS from PNFCs and PFCs are based on the operating performance of those businesses. To ensure competitive neutrality with private sector businesses, PNFCs and PFCs also make tax equivalent payments and pay debt neutrality charges (government guarantee fees). In 2017-18, the dividend and tax equivalent payments are forecast to be $1.5 billion and government guarantee fees to be $287.5 million. Over the budget and forward estimates, dividends and tax equivalent payments are forecast to be $5.5 billion.

Dividends and tax equivalent payments from the electricity sector over the budget and forward estimates are forecast to be $252.7 million, $35.3 million lower than estimated at the 2017-18 Budget, primarily due to lower earnings resulting from the current and next regulatory determinations. Of this total amount, $186.2 million are tax equivalent payments fulfilling the Government's competitive neutrality obligations.

The asset recycling initiative saw the partial long-term leases of Ausgrid and Endeavour during the 2016-17 financial year. Distributions from the retained interests in Ausgrid and Endeavour are now accounted for as distributions from equity investments and so fall within the GGS.

PNFCs in the water sector have increased distributions by $24.4 million from the forecast in the 2017-18 Budget. This improvement is a result of reduced debt costs as well as capital restructuring initiatives undertaken by Sydney Water. This is partially offset by a further decline in consumer prices expected in the next round of determinations commencing 1 July 2020.

Distributions have declined from the property and resources sector mainly due to movement in Landcom's revenue profile. Change in its land release strategy and timing of the major project settlements have contributed to changes in distributions over the forward years.

The Port Authority declared a dividend of $200.0 million in 2017-18 to move in line with the updated Capital Structure and Financial Distribution Polices, thereby improving capital efficiency and returns to the Government.

The PFC sector's distributions over the budget and forward estimates are $91.2 million higher than in the 2017-18 Budget due to increased funds under management.

Table 8.1 shows the dividend and tax equivalent payments of the PNFC and PFC sectors over the 2017-18 to 2021-22 period.

Table 8.1: Dividends and tax equivalent payments from public non-financial corporations and public financial corporations

	2017-18	2018-19	2019-20	2020-21	2021-22
	Revised	Budget	Forward Estimates		
	$m	$m	$m	$m	$m
Electricity	32	46	44	66	97
Water	937	1,318	1,212	805	481
Property and Resources	318	307	264	272	69
Ports	203	9	31	34	46
Public Financial Corporations	25	143	89	94	97
Total Dividends and Tax Equivalent Payments	1,514	1,823	1,641	1,271	791

Capital expenditure

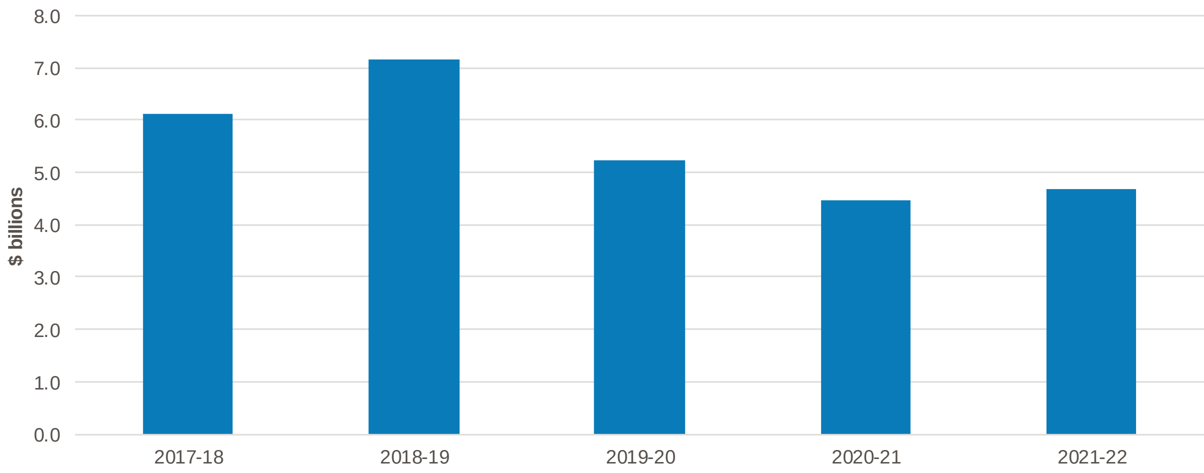
In 2017-18, capital expenditure within the PNFC sector is forecast at $6.1 billion, $1.6 billion lower than forecast in the 2017-18 Budget. This result was driven by updates to the capital spend profile by Rail Corporation New South Wales and Sydney Motorway Corporation.

Capital expenditure within the PNFC sector over the budget and forward estimates will be $21.5 billion. This is $1.5 billion lower than forecast in the 2017-18 Budget for the period 2017-18 to 2020-21. The main reason for the reduction is the fact that in 2017-18, $2.0 billion was spent on the WestConnex project, and this spend is not included in the current budget and forward estimates period (2018-19 to 2021-22).

Chart 8.3 shows capital expenditure in the PNFC sector from 2017-18 to 2021-22. Box 8.3 provides information on the building and financing of the $16.8 billion WestConnex project.

Further details on the Government's capital expenditure strategy is provided in Budget Paper No.2: *Infrastructure Statement*.

Chart 8.3: Capital expenditure of the public non-financial corporations sector



Capital expenditure falls from a high of $7.1 billion in 2018-19 to $4.7 billion in 2021-22 reflecting completion of Stages 1 and 2 of the WestConnex project and lower spend on Stage 3, the completion of current train acquisition projects and the completion of the $360 million Western Sydney Stadium by Venues NSW.

Box 8.3: WestConnex

WestConnex is the largest road project in Australia under construction, providing 33 kilometres of motorway, two thirds of which will be underground.

More than 1,000 contracts have been signed with NSW-based suppliers and 10,000 direct and indirect jobs will be created during construction and delivery, delivering more than $20 billion in economic benefits for New South Wales.

Sale process

On 16 August 2017, the Government announced it would proceed with the sale of 51 per cent of WestConnex (including Sydney Motorway Corporation) to help fund the M4-M5 Link.

The binding bid phase of the sale commenced in March 2018, with the sale to be completed around mid-year. Once the transaction is complete, the future minority interest in WestConnex will be included in the NSW Generations Funds, a world-first sovereign fund established for the people of New South Wales for today and tomorrow (refer to Chapter 1 of this *Budget Statement* for more information).

In line with private sector best practice and Commonwealth government businesses, the NSW Government has updated its policy regarding how ‘for-profit’ public sector entities measure long-term employee liabilities such as superannuation. Going forward, these liabilities will be discounted using the High Quality Corporate Bond rate.

8.4 Public financial corporation sector

The PFC sector includes NSW Treasury Corporation (TCorp) and Insurance and Care NSW (icare).

TCorp is the State’s central financing authority and funds management agency. TCorp has been the central financing authority for New South Wales since its inception in 1983. TCorp accesses cost-effective funding from the domestic and international capital markets utilising the NSW Government’s triple-A rating, which delivers significant economies of scale.

These funds are then on-lent to NSW Public Sector Agencies. In the last year, TCorp has worked with its borrowing clients to lengthen their debt profiles. The lengthening was achieved through issuing a new 2029 bond and a new 20-year bond (which is the longest dated TCorp bond issued in the domestic market). TCorp and NSW Treasury have also developed a whole-of-government Foreign Exchange Risk Policy to manage currency exposure when Government agencies and businesses buy or sell goods and services to or from overseas. Further information on this reform can be found in Chapter 7 of this *Budget Statement.*

TCorp is a top 10 Australian investment manager and manages funds on behalf of icare, State Super and the NSW Infrastructure Future Fund (NIFF), among other clients. TCorp’s total funds under management have increased by $13.6 billion to $92.9 billion over the past year, largely due to new funds flowing into the NIFF, which reached $19.3 billion on 31 May 2018.

TCorp continues to benefit from the centralised funds management model implemented in 2017, where core funds management activities were amalgamated in TCorp. In 2017, $52 billion in TCorp, icare and State Super assets under custody were successfully transitioned to a single custodian, JP Morgan. This allowed TCorp to achieve recurring annual cost savings of $34.2 million for the State through lower external provider fees, operational efficiencies and consolidated investment capabilities.

As part of the Government’s Fit for the Future package, local government councils were given the opportunity to borrow from TCorp to invest in new community infrastructure and upgrade existing assets. TCorp’s participation in local government lending provides a range of benefits including increased competition resulting in lower borrowing costs.

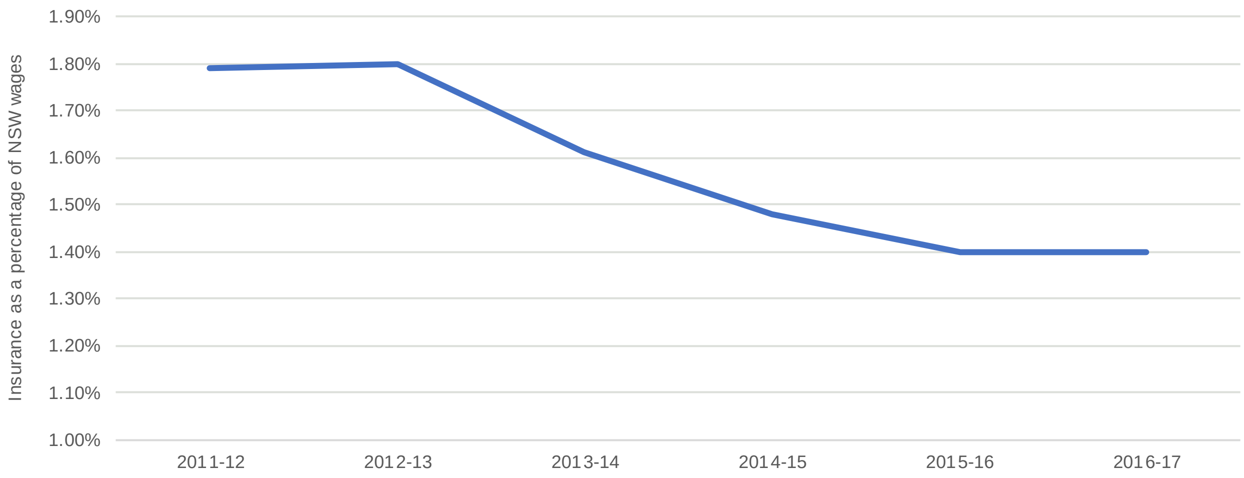
Local councils are also investing in TCorpIM Funds, which provide competitive returns at lower fees than equivalent products available from commercial financial institutions. Since it began offering services to councils in 2015, TCorp has provided approximately $300 million in debt funding to local councils and now has just under $450 million in council assets under management (as at 31 May 2018). The local government lending program is forecast to deliver significant savings to NSW rate-payers.

The PFC sector also includes icare, the Government's social insurer operating with a commercial mind and a social heart and a purpose to protect and insure the State's people, businesses and assets. Over the past 12 months, icare has:

- improved customer experiences by digitising policy and billing to interact directly with employers and NSW Government agencies
- designed and delivered a segmented claims service model that prioritises injured workers according to their needs
- simplified the eligibility process for people with a dust disease, with applicants now supported through a simple and personal phone-based interview
- designed and implemented the Medical Support Panel which has reduced return to work times from around six weeks to less than six days for referred claims
- established the Workers Care program, ensuring severely injured people receive leading care services irrespective of the scheme under which they are insured
- committed $26.3 million in funding through the icare Foundation to prevent injury and help injured people return to work and life.

Since 2011, the NSW Government has undertaken significant reforms tackling the prevalence and severity of workplace injuries. At 1.4 per 100,000 employees, the rate of workplace fatalities is the lowest in New South Wales since Safe Work Australia began reporting in 2003. Coupled with organisational and operational efficiencies, such as the creation of the State Insurance Regulatory Authority, SafeWork NSW and icare, the NSW workers compensation system is now working for NSW workers and businesses creating safe and productive workplaces, with lower workers compensation insurance premiums and better return to work outcomes (see Chapter 4).

Chart 8.4: Workers compensation insurance premiums as a share of wages



Source: State Insurance and Regulatory Authority