6. MANAGING THE STATE'S ASSETS AND LIABILITIES

- The State's balance sheet remains strong, with net debt projected to be negative for the fourth consecutive year (negative $8.8 billion as at June 2019). This is the lowest of all States and Territories across Australia.
- New South Wales' net worth surpassed a quarter of a trillion dollars in June 2018 and is expected to reach $311.0 billion by June 2023 – the largest among all States and Territories by a significant margin.
- New South Wales is the only Australian state with a dedicated debt retirement fund, the NSW Generations Fund, which has delivered returns of 8.5 per cent since its inception in November 2018 with a balance of $10.8 billion at April 2019.
- The Government also has $18.1 billion invested in the New South Wales Infrastructure Future Fund, which enables the Government to get more from its asset recycling proceeds by investing them until they are required. The Fund has delivered returns of 4.6 per cent for the 10 months to April 2019. The Government made its first drawdown of $2.3 billion in 2018-19 to fund Restart NSW infrastructure projects.
- As the Government continues its record infrastructure program, non-financial assets are projected to grow to $289.5 billion by June 2023. This has been funded through a mix of budget surpluses, asset recycling proceeds and manageable levels of borrowing.
- This Budget builds on the Government's balance sheet reform agenda to continue supporting the State's triple-A credit rating and further optimise the use and mix of State assets and liabilities.

6.1 Reforming the State's balance sheet

The Government is continuing its strategy of balance sheet reform, following the successful creation of specific purpose funds such as the NSW Generations Fund (NGF), the NSW Infrastructure Future Fund (NIFF) and the Social Affordable Housing Fund (SAHF). These reforms of the State's financial assets are complemented by further improvements in the management of the State's borrowings, cash balances and associated financial risks. The Government's reform agenda aims to increase balance sheet resilience, further improve financial risk management and ensure New South Wales remains well positioned into the future. Key balance sheet reforms include:

- diversification of funding sources. The Government issued its first green bond in November 2018 raising $1.8 billion in funding. This was the largest green bond issuance in Australia, providing funding towards projects such as Sydney Water's Lower South Creek Treatment Program
- implementing a new whole-of-government cash management policy, which complements the whole-of-government foreign exchange risk management policy

- enacting the *Government Sector Finance Act 2018* which supports balance sheet reforms, including a centralised approach to cash management. Building on $3.6 billion in cash centralised to date, Treasury aims to establish a new cash management framework in 2019-20 to facilitate further cash management reform
- entering into a multi-provider banking services contract that covers all Government transactions including payments, receipts, cross-border banking and purchasing cards.

Overview of key changes since the 2019 Pre-election Budget Update

Key balance sheet movements since the 2019 Pre-election Budget Update (see Table 6.1) include:

- a decrease in estimated net debt as at June 2019 from negative $8.0 billion at the 2019 Pre-election Budget Update to negative $8.8 billion. This has been driven by better than anticipated market returns
- a decrease in estimated net worth as at June 2019 from $270.7 billion at the 2019 Pre-election Budget Update to an estimated $262.0 billion in this budget. This reduction is primarily due to an increase in the valuation of unfunded defined benefit superannuation liabilities resulting from a lower Commonwealth Bond rate (which is used to discount these liabilities under AASB 119 *Employee Benefits*). By June 2023, the superannuation liabilities are projected to reduce to $40.9 billion (see Box 6.4 for more details).

Table 6.1: Key balance sheet aggregates of the general government sector

	June 2018 Actual	June 2019 PEBU	June 2019 Revised	June 2020 Budget	June 2021	June 2022 Forward Estimates	June 2023
Total Assets ($m)	383,564	402,327	403,925	420,280	435,854	451,205	470,419
Financial Assets ($m)	173,228	174,011	168,935	169,454	170,493	172,367	180,902
Non-Financial Assets ($m)	210,336	228,315	234,990	250,826	265,361	278,838	289,518
Total Liabilities ($m)	129,385	131,627	141,903	153,334	155,038	157,705	159,406
Net Worth ($m)	254,180	270,700	262,022	266,946	280,816	293,500	311,013
Net Worth as a per cent of GSP[a]	42.1	43.2	41.8	41.1	41.4	41.3	41.7
Net Debt ($m)	(11,195)	(7,966)	(8,818)	12,354	22,973	32,884	38,640
Net Debt as a per cent of GSP	(1.9)	(1.3)	(1.4)	1.9	3.4	4.6	5.2

(a) Gross State Product (GSP) for NSW from 2018-19 to 2022-23 is forecast by NSW Treasury

6.2 Net debt remains low despite changing accounting standards

New South Wales' general government net debt remains the lowest of all States and Territories. This is due to the Government's successful asset recycling program and strong fiscal management. Changes in accounting standards relating to leases will result in a one-off increase in the State's reported borrowings and net debt. However, these are reporting changes and do not reflect an underlying change in the State's fiscal position (see Box 6.3).

Net debt is projected to grow as asset recycling proceeds (which are recognised as financial assets on the State's balance sheet) are invested in the State's record infrastructure program. The program is also being funded by budget surpluses and manageable increases in borrowings.

Box 6.1: Whole-of-Government balance sheet management strategy

NSW Generations Fund (NGF)

The NGF was established in late 2018 as a $10 billion sovereign wealth fund to help maintain debt at sustainable levels. The NGF had a balance of approximately $10.8 billion as at 30 April 2019, performing well above expectation since its establishment in November 2018. The total NGF balance is treated as an offset to the State's gross debt by Moody's and S&P Global in their credit rating assessments. Therefore, the NGF plays an important role in supporting the State's triple-A credit rating and sustainable debt position. The funds held in the NGF grow as returns are generated. The growth in the value of the fund is also used to offset debt and has a compounding effect over time. In this way, the NGF is a highly effective balance sheet management tool, reducing debt balances over a time.

NSW Infrastructure Future Fund (NIFF)

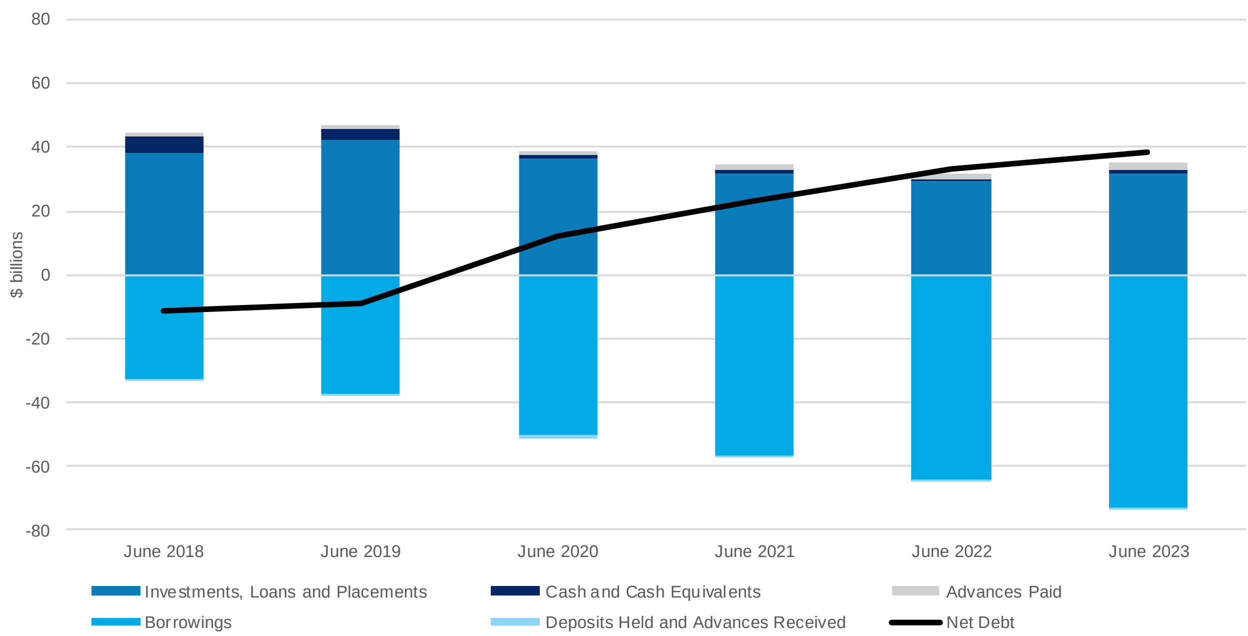
The NSW Government established the NIFF in December 2016 as a vehicle to invest the net proceeds from its successful asset recycling program.

The NIFF generated a return of 4.6 per cent for the 10 months from July 2018 and had a balance of approximately $18.1 billion as at 30 April 2019.

Investments within the NIFF are aligned to the required spending profile of Restart NSW infrastructure projects. $2.3 billion was drawn from the NIFF during 2018-19 to fund Restart NSW projects (see Budget Paper No. 2 *Infrastructure Statement*).

Financial assets included in the calculation of net debt[1] are projected to be $46.8 billion at June 2019 (see Chart 6.1). These assets primarily consist of the NIFF, NGF, SAHF and the Treasury Managed Fund (the Government's self-insurance fund). Balances held in the NIFF are projected to fall to $6.7 billion over the forward estimates in line with scheduled drawdowns for infrastructure projects. Funds held in the NGF are forecast to increase to $16.5 billion over the forward estimates in line with projected investment returns (see Box 6.1).

Chart 6.1: General government sector net debt



[1] The asset side of net debt calculations consists of the sum of cash and deposits, advances paid and investments, loans and placements.

Liabilities included in the calculation of net debt[2] are projected to be $38.0 billion at June 2019 (see Chart 6.1), broadly in line with 2019 Pre-election Budget Update estimates. Over the four years to June 2023, these liabilities are projected to increase to $73.9 billion driven by the adoption of AASB 16 and a manageable increase in borrowings to fund infrastructure investment.

The Government is taking advantage of the historically low interest rate environment to lengthen its debt maturity profile. The average debt maturity is now eight years, reducing interest rate risk and refinancing risk for the State (see Box 6.2).

Box 6.2: Helping fund infrastructure at record low interest rates

The strength of New South Wales' credit rating and the global economic environment led to yields on NSW (TCorp) ten-year bonds trading below 2.0 per cent for the first time in history in May 2019 – see Chart 6.2 below.

Chart 6.2: NSW bond yields are at historic lows

In an environment of record low interest rates, the State has been lengthening the maturity profile of its debt portfolio to approximately eight years in order to lock in these low rates throughout the forward estimates period and beyond. While State governments borrow at higher rates than the Commonwealth, the New South Wales triple-A credit rating and disciplined approach to financial management (including its liabilities) ensures this spread is as tight as possible.

Beyond accessing funds through traditional debt capital markets, the Government is actively seeking to broaden its range of domestic and international investors through innovative offerings such as the Sustainability Bond Programme.

2 The liability side of net debt calculations consists of the sum of deposits held, advances received, loans and other borrowings.

Box 6.3: Balance sheet impact of new lease accounting standard

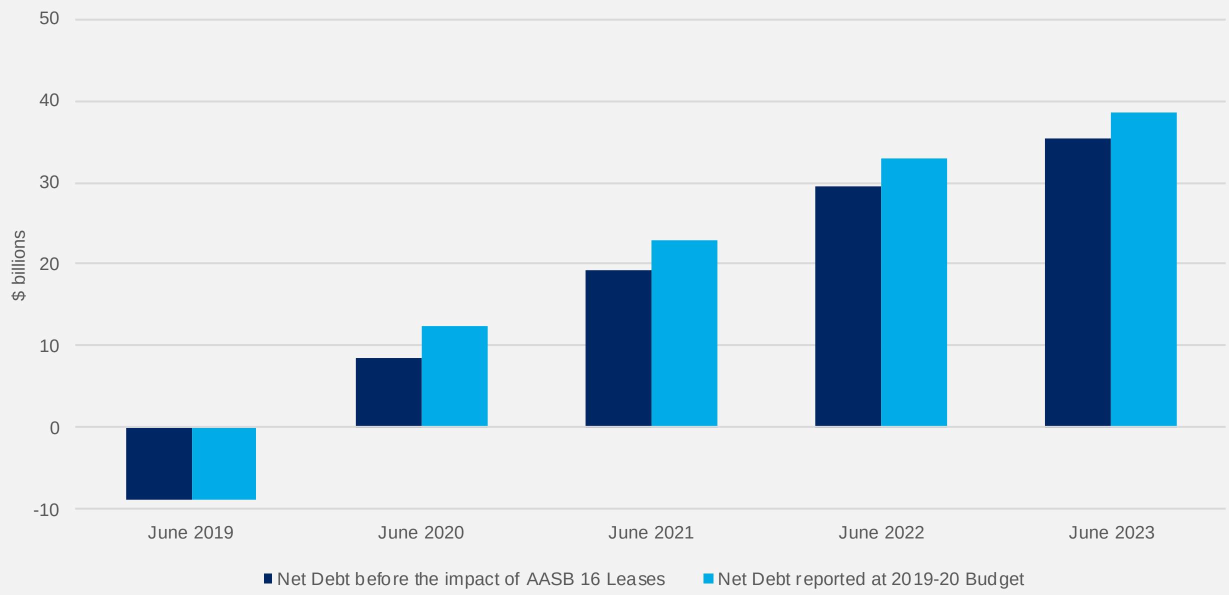
The Australian Accounting Standards Board (AASB) released AASB 16 *Leases* as a new accounting standard to apply from 1 July 2019.

AASB 16 sees most operating leases, except short-term and low-value leases, now recognised as finance leases (i.e. borrowings) on the Government's balance sheet. This has had a significant impact on net debt, see Chart 6.3 below.

The vast majority of leases relate to office space, which were previously recognised as an expense on the operating statement. The introduction of new accounting standards for leases will increase reported borrowings by $3.2 billion by June 2023.

For a full reconciliation of all the accounting standards impacting the 2019-20 Budget, see Table A2.5 in Appendix A2 *Statement of Significant Acounting Policies and Forecast Assumptions*.

Chart 6.3: General government sector net debt before and after impact of AASB 16 Leases

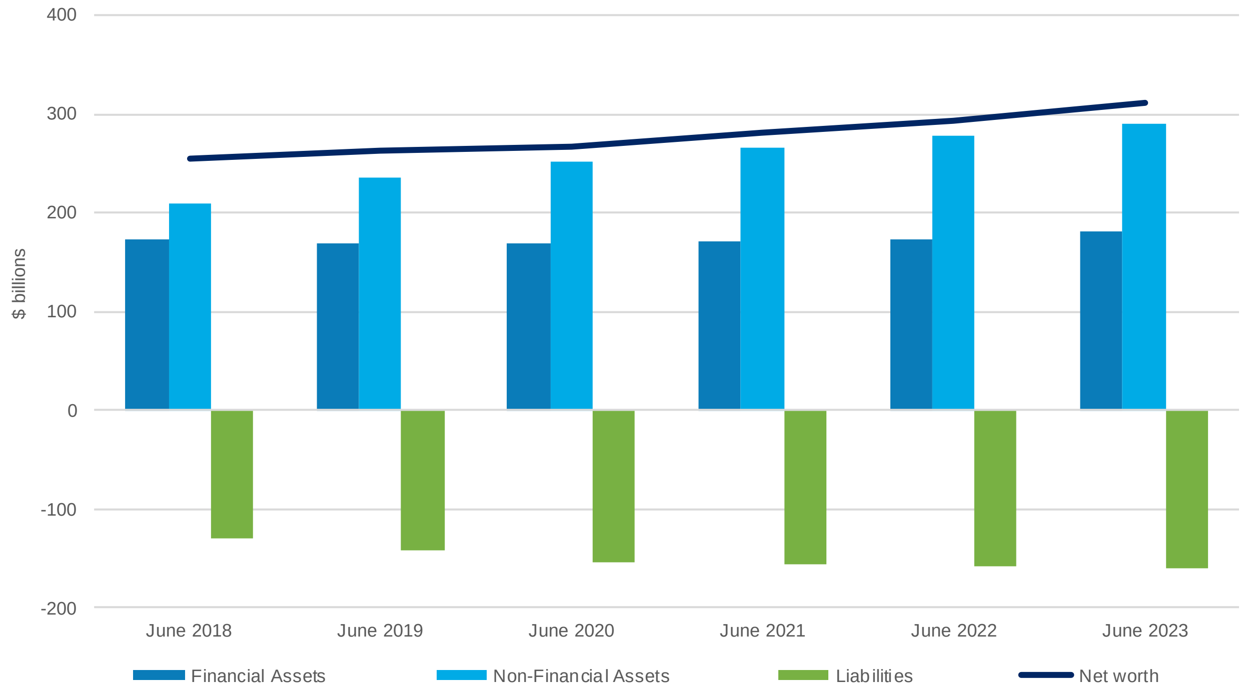


6.3 Highest net worth of all States and Territories

The net worth of the general government sector has surpassed a quarter of a trillion dollars and is expected to reach $262.0 billion as at June 2019 (see Chart 6.4). Net worth is forecast to continue to grow to $311.0 billion by June 2023, even with the Government's asset recycling program. The State's net worth is the highest of the States and Territories and around $100.0 billion higher than the next largest State (see Chart 6.5)[3].

3 Net worth measures the overall wealth of the State and is calculated by taking the difference between total assets and total liabilities.

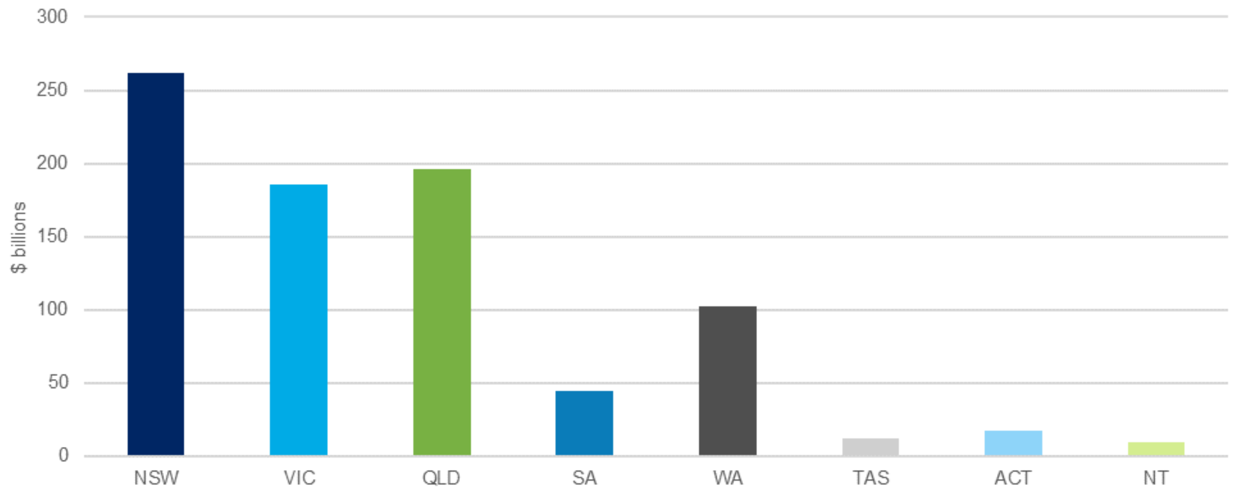
Chart 6.4: NSW general government sector net worth to increase by $49.0 billion over the next four years



New South Wales' net worth is projected to increase further over the forward estimates, driven by growth in the State's non-financial assets. Most notably:

- the value of property, plant and equipment is expected to grow from $224.8 billion at June 2019 to $274.8 billion at June 2023, due to the Government investing net operating cash into infrastructure, asset recycling and asset revaluations
- the Government's equity investments are expected to increase from $113.2 billion at June 2019 to $135.5 billion by June 2023, driven by strong growth in the public non-financial corporations sector (see Chapter 7)
- the expected $35.8 billion increase in borrowings over the four years to June 2023 to fund the Government's record infrastructure investment is largely offset by a $20.1 billion reduction in projected superannuation liabilities. The State is making annual contributions to ensure it meets its commitment to fully fund its superannuation liabilities by 2030 (see Box 6.4 for more details).

Chart 6.5: General government sector net worth of Australian States and Territories in 2018-19[(a)]

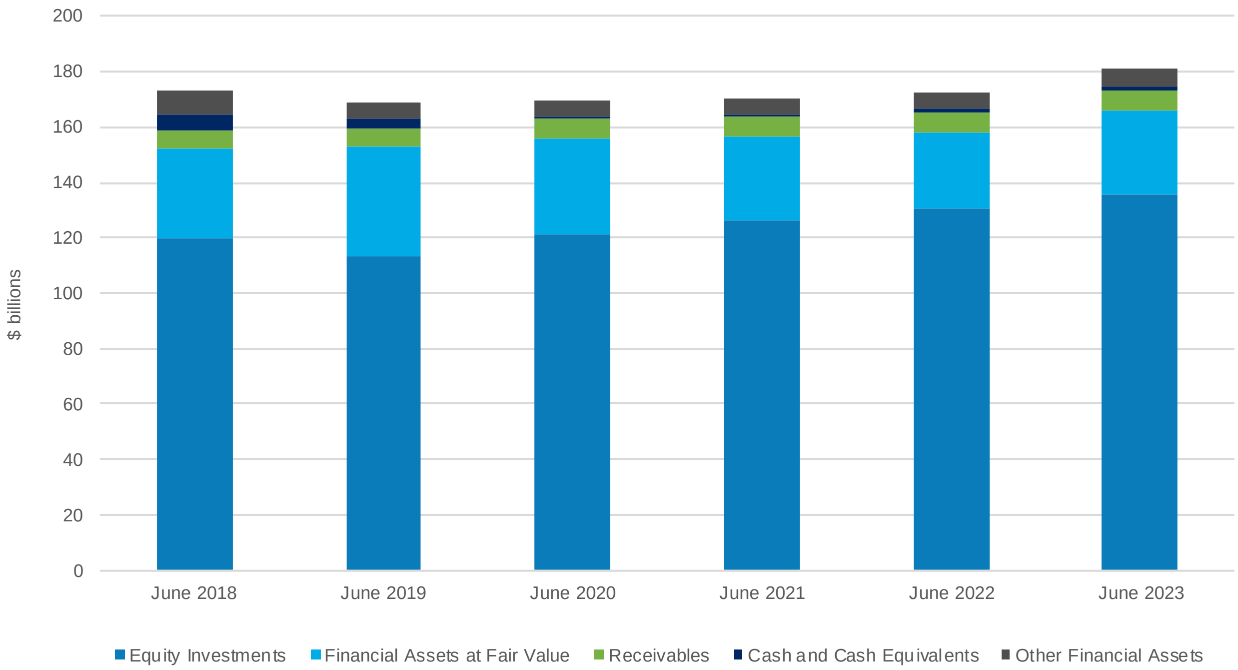


(a) Net worth for SA at 2018-19 Mid-year Budget Update and all other States and Territories at 2019-20 Budget

Financial assets

The State's total financial assets are projected to be $168.9 billion at June 2019, increasing to $180.9 billion by June 2023 (see Chart 6.6). Growth in the value of the State's equity investments partially offsets the gradual reduction in the NIFF balance, as scheduled payments are drawn to fund infrastructure projects.

Chart 6.6: General government sector financial assets reflect asset divestments and cash management reforms



The State's equity investments in other public-sector entities[4] make up the majority of financial assets held by the State, and have decreased by $6.6 billion relative to the 2019 Pre-election Budget Update estimate as assets were transferred between sectors. This decrease was offset by strong investment returns increasing financial assets at fair value, resulting in a $5.1 billion decrease in the total financial assets at June 2019 compared to the 2019 Pre-election Budget Update estimate.

Non-financial assets

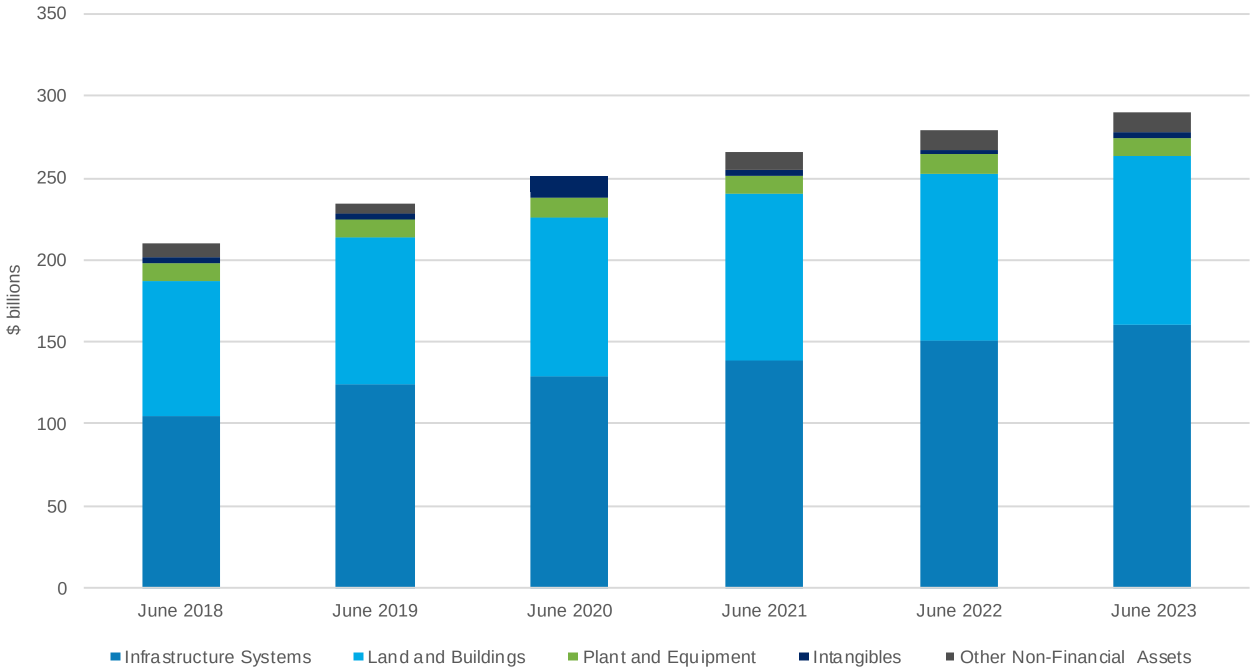
The State's non-financial assets are projected to reach $235.0 billion at June 2019, a $6.7 billion increase relative to the 2019 Pre-election Budget Update. This is largely driven by a transfer between sectors. This figure is expected to further increase to $289.5 billion by June 2023, due to the Government's ongoing infrastructure investment and asset revaluations (see Chart 6.7).

Investment in infrastructure systems (e.g. public transport infrastructure) is forecast to increase over the forward estimates from $123.7 billion at June 2019 to $160.3 billion in June 2023 as a number of high profile infrastructure projects are delivered during this period.

To ensure continued effectiveness and value of the procurement and delivery of the Government's infrastructure program, the Government has released the NSW Government Action Plan (see Box 4.1 in Budget Paper No. 2 *Infrastructure Statement*).

Land and building assets are projected to grow from an expected $89.7 billion at June 2019 to $103.1 billion in June 2023, driven by the Government's record investment in schools and hospitals, as well as asset revaluations in the education sector.

Chart 6.7: General government sector non-financial assets increasing over time

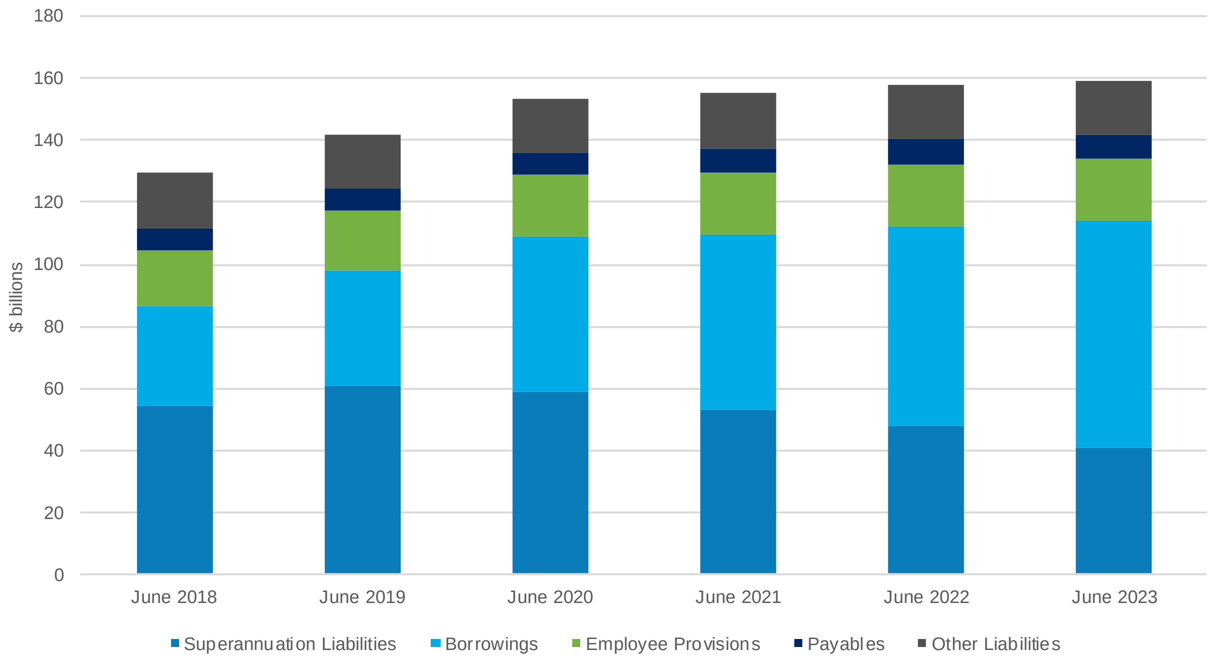


[4] Equity investments in other public-sector entities represents the general government sector's interest in the public non-financial corporation and public financial corporation sectors reflecting, in the absence of fair value, the carrying amount of net assets of those sectors (before consolidation adjustments), in accordance with AASB 1049 *Whole of Government and General Government Sector Financial Reporting*.

Liabilities

Total liabilities are projected to be $141.9 billion at June 2019, and are expected to increase to $159.4 billion by June 2023 (see Chart 6.8). This revision is mostly driven by a decrease in unfunded superannuation liabilities that have been offset by an increase in borrowings as the State progresses its record infrastructure program.

Chart 6.8: Liabilities stable over the forward estimates



Unfunded superannuation liabilities remain the largest category of liability on the general government sector balance sheet at June 2019, but are forecast to decrease from $61.0 billion at June 2019 to $40.9 billion at June 2023 as the Government makes progress on its commitment to fully fund superannuation liabilities by 2030 (see Box 6.4).

Employee provisions, including long service leave, are projected to increase slightly over the forward estimates from $19.4 billion in June 2019 to $20.1 billion in June 2023.

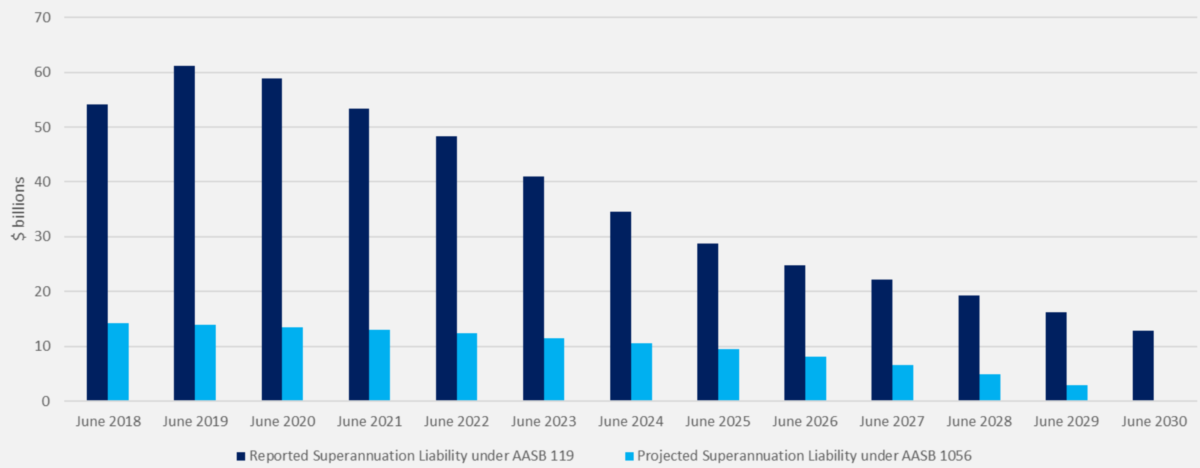
Box 6.4: On track to fully fund the State's unfunded superannuation liabilities

The Government remains committed to fully funding its superannuation liabilities by June 2030, consistent with the *Fiscal Responsibility Act 2012*. To achieve this, the long-term funding program involves an annual contribution – $1.7 billion in the 2019-20 financial year – increasing by 5 per cent per annum until 2030.

Management of the State's superannuation liability undergoes a triennial review, which takes into account demographic changes and economic drivers such as inflation and investment returns. The most recent triennial review, completed in October 2018 by an independent actuary (PwC Australia), concluded that the Government's current contribution plan is appropriate to deliver full funding by 2030.

The superannuation liability reported on the State's balance sheet is the unfunded part of the liability and is governed by AASB 119 *Employee Benefits.* AASB 119 reports a much more volitile and larger liability[5] than under AASB 1056 *Superannuation Entities*[6] which is used for determining funding of the superannuation liability towards the 2030 target. Chart 6.9 below shows the difference between the two accounting standards.

Chart 6.9: General government superannuation liabilities – AASB 119 vs AASB 1056



5 AASB 119 requires the reported superannuation liabilty to be calculated using the ten-year Commonwealth bond rate as the discount rate to determine the present value of future payments. This approach can result in large fluctuations in the reported value of the liability: e.g. the decrease in this bond rate from approximately 2.6 per cent to approximately 1.7 per cent over the past eleven months has resulted in reported unfunded liability increasing from $53.9 billion at June 2018 at the 2019 Pre-election Budget Update to $61.2 billion at June 2019 in the Budget.

6 For funding purposes, AASB 1056 Superannuation Entities allows the expected long-term return on the fund's assets to be used as the discount rate, resulting in a more appropriate measure of the present value of future payments. On this basis, the unfunded liability is estimated to be $13.9 billion at June 2019 and is projected to decrease to $11.5 billion by June 2023. The FRA target of fully funding the State's superannuation liabilities by 2030 is determined on the AASB 1056 basis.