6. MANAGING THE STATE'S ASSETS AND LIABILITIES

- The Government is continuing its efforts to stabilise the State's gross debt trajectory, strengthen the balance sheet against future economic shocks, and keep the State's interest expense manageable.
- Following the Upper House review of the NSW Generations' Debt Retirement Fund (DRF)[1], previously budgeted contributions have been suspended. This will avoid unnecessary borrowings and interest expenses. The Government is also implementing a new DRF management framework to ensure any future contributions align with the State's fiscal position.
- To help strengthen the balance sheet, the Government is implementing OneFund (a more integrated approach to financial asset management) by pooling several of the State's investment funds together. At a value of $46.7 billion[2], OneFund will result in a more efficient and diversified investment portfolio, with improved risk adjusted-returns over the long-term (see Box 6.1).
- Insurance for NSW (IfNSW) schemes will now be considered within a new contributions and transfers framework. A contribution of $925 million in 2023-24 will be the last under the existing Net Asset Holding Level Policy (NAHLP), to ensure there are sufficient assets to meet expected liabilities.
- The Government is undertaking other reforms, including developing improvements to valuation processes for property, plant and equipment, to better manage the impact of the State's balance sheet on depreciation expenses.
- The Government is projected to return to a net cash operating surplus of $4.9 billion in 2024-25. The first net cash operating surplus since 2020-21.
- Looking across the balance sheet:
  - The State's total assets are projected to be $636.5 billion at June 2024 and are projected to grow to $686.4 billion by June 2028
  - By June 2027, gross debt[3] is projected to be $188.5 billion, which is $1.4 billion lower than at 2023-24 Half-Yearly Review. This is primarily driven by the suspension of NSW Generations Fund (NGF) contributions offset by additional investment in health, housing and education.
  - Net debt to GSP is projected to be 11.9 per cent by June 2024, broadly in line with the 2023-24 Half-Yearly Review. Over the forward estimates, net debt to GSP is projected to grow broadly in line with most other states, but well below the projection for Victoria at 25.1 per cent by June 2028.
  - Net worth is projected to be $365.8 billion at June 2024 and remain broadly the same by June 2028.
- New South Wales is one of the largest government issuers of Green and Sustainability Bonds in Australia, with $11.4 billion in net proceeds raised across five bonds since 2018.

1 New South Wales Parliament Legislative Council, Standing Committee on State Development Report no. 50 Debt Retirement Fund, tabled August 2023.

2 Value as at 30 April 2024.

3 Gross debt comprises the sum of deposits held, borrowings and advances received.

6.1 Stabilising the State's debt trajectory

One of the key fiscal principles adopted in the 2023-24 Budget was to stabilise the State's debt position.

Stabilising gross debt helps manage both the State's interest expenses and interest rate risk/refinancing risk. It helps take pressure off the State's operating position, freeing up fiscal capacity to support service delivery across the state.

In the 2024-25 Budget, the State's gross debt levels are projected to be $188.5 billion by June 2027, which is $1.4 billion lower than the 2023-24 Half-Yearly Review projection. The Government has used the debt capacity from ceasing DRF contributions to help support additional investment in housing, health and education, including investment in social housing ($5.1 billion) and establishing 100 new public pre-schools.

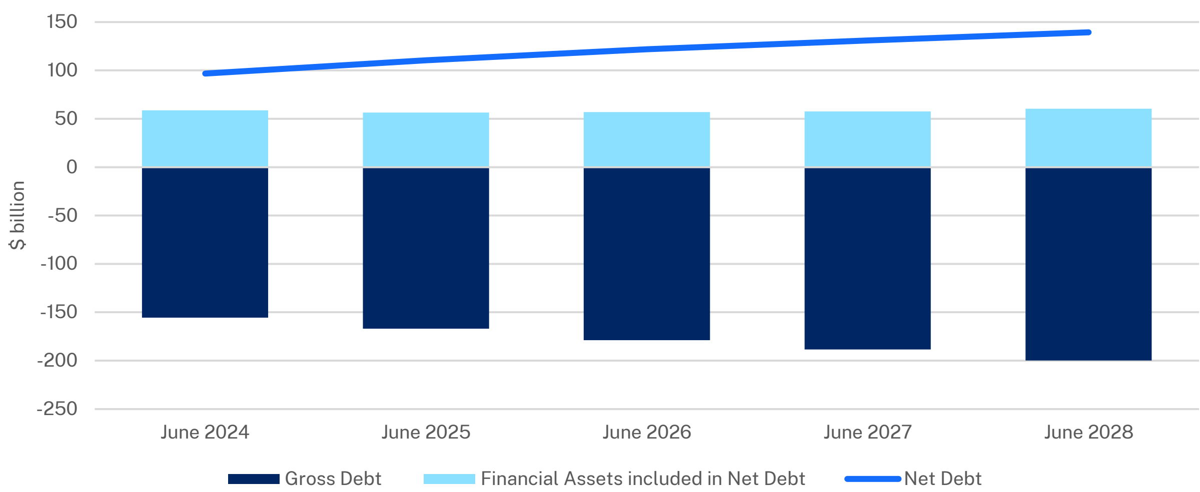
The Government is building upon previous reforms to help stabilise gross debt, including suspending DRF contributions in 2023-24, restructuring the Transport Asset Holding Entity (TAHE), and undertaking a Strategic Infrastructure Review.

In this Budget, the Government has taken a number of steps to invest the State's funds more efficiently and better manage interest revenues, including:

- ceasing $16.3 billion in previously budgeted DRF contributions, while introducing a new framework for contributions, or redemptions to pay back debt
- implementing OneFund, and developing an associated contributions and transfers framework (see Box 6.1)
- bringing IfNSW schemes into the new contributions and transfers framework
- more efficient management of the State's interest revenues, which will allow the State to retain $851 million of interest income over the forward estimates.

The main driver of the borrowing program is the State's infrastructure program (see Budget Paper No. 3 *Infrastructure Statement* for further information). Gross debt is now projected to rise from $155.5 billion by June 2024 to $199.9 billion by June 2028. Net debt (which is the sum of gross debt and selected financial assets) is projected to reach $139.5 billion or 14.2 per cent of GSP by June 2028 (see Chart 6.1).

Chart 6.1: General government sector net debt[4]



[4] The estimates of net debt at June 2025 and beyond do not include the impact of the recycling of the investment for developing the Central West Orana transmission project (CWO). The anticipated cash payment will be recognised upon finalisation of the CWO project contract. The estimates also do not include the recently approved finance facility from the Clean Energy Finance Corporation for the CWO, which will also be recognised upon finalisation of the CWO transaction.

Financial assets included in net debt

Except for the DRF[5], the State's investment funds generate returns that can either be spent or reinvested. As part of this Budget, the Government is reforming its approach to managing the State's financial assets, through the OneFund initiative (see Box 6.1).

Box 6.1: Improving the management of the State's investment funds

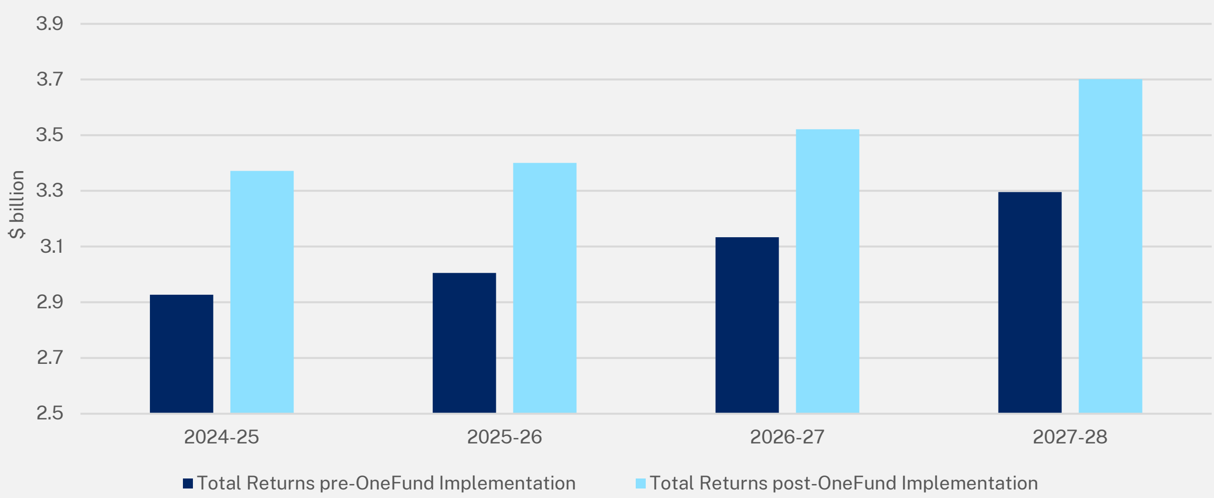
Over time, the State has set up various investment funds, each with its own specific legislated purpose. This includes funds such as the Treasury Managed Fund (the State's self-insurance fund), the DRF, and the NSW Infrastructure Future Fund (NIFF) among others.

The OneFund initiative will see these funds and several other funds (including the Social and Affordable Housing Fund, Long Service Corporation funds and Snowy Hydro Legacy Fund) which TCorp currently manages individually, be managed instead *as if* they are a single fund. These funds, amounting to approximately $46.7 billion, will invest through the same master fund structure, adopting the same risk and return settings. The master fund structure will then invest in the underlying assets (e.g., equities, bonds).

The various investment funds will keep operating to support their legislated purposes (e.g., the DRF will remain ring-fenced for debt retirement). However, pooling their resources through a master fund structure can help enable a broader range of investment opportunities and the possibility to invest more efficiently. OneFund will be complemented by a new framework, which will enable a more efficient way of keeping the investment funds in OneFund appropriately funded to meet their policy requirements.

OneFund is expected to earn around CPI + 4.5 per cent per year, on average, over rolling 10-year periods. As some investment risk needs to be taken in pursuing this rate of return, performance and fund balances will fluctuate periodically. The risk parameters have been set from a whole of State perspective, taking into account the various investment funds' needs.

Chart 6.2: Total annual OneFund investment returns



5 The DRF is hypothecated solely towards debt retirement.

Financial assets included in the calculation of net debt are financial assets at fair value (e.g., DRF, TMF, NIFF), other financial assets, and cash and cash equivalents.

Financial assets at fair value are projected to grow to $52.4 billion by June 2027, which is $15.9 billion lower than projected at the 2023-24 Half-Yearly Review. This projected reduction in financial assets is due to the suspension of DRF contributions, offset somewhat by the expected higher returns from the OneFund initiative.

The funding ratio for IfNSW funds was 101 per cent based on 31 December 2023 valuations. This is below the 105 per cent threshold set in the Net Asset Holding Level Policy. The decline is driven by:

- worsening physical and psychological injury claims performance
- liability discount rate changes
- initial recognition of costs relating to the Christmas/New Year storms.

In its last determination under the NAHLP, the Government will contribute $925 million in 2023-24 to bring funding levels back up. A new contribution and transfers framework based on OneFund, which will replace the NAHLP, will now apply to most of the IfNSW funds. Key principles of the framework include:

- where possible, reallocating money between investment funds in OneFund to meet short-term funding adequacy needs
- contributing if the ratio of OneFund assets to liabilities backed by these assets falls below a certain threshold
- the DRF remaining ring-fenced, to be used for debt retirement only.

In line with the Government's decision to cease contributions to the DRF, this fund is now projected to grow at a more sustainable rate (see Box 6.2).

Cash and cash equivalents are projected to be $5.3 billion at June 2024, $5.0 billion higher than projected in the 2023-24 Half-Yearly Review. This is primarily driven by pre-funding for 2024-25 cash requirements. Cash and cash equivalents are expected to decrease to $1.2 billion by June 2025 and remain around $1 billion across the forward estimates.

Box 6.2: NSW Debt Retirement Fund management framework

Following reviews into the DRF by both EY-Port Jackson Partners and the Legislative Council's State Development Committee, the NSW Government has decided to suspend previously budgeted contributions to the DRF. It has also developed a framework for determining when money should be contributed to the DRF or redeemed from it to retire debt.

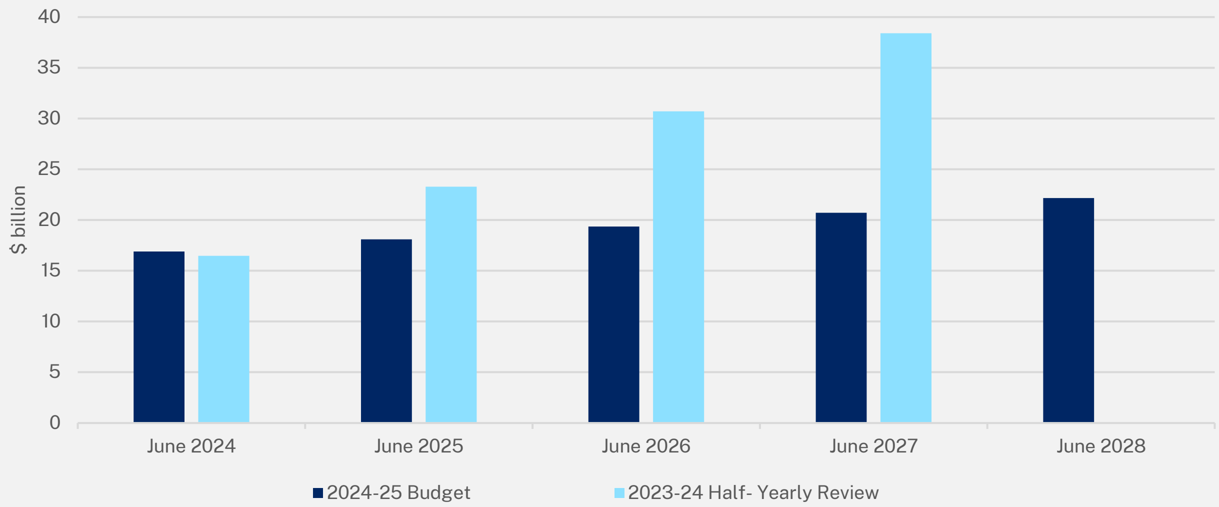
This framework has been developed to manage the DRF more sustainably (see Chart 6.3), taking into account the potential budget result, balance sheet impacts and economic conditions.

Key contribution principles include:

- contributing only when the Budget is in surplus, net of DRF impacts (an 'underlying' surplus)
- limiting contributions to the value of the underlying surplus.

Significant redemption considerations include the State's interest expenses and how much a severe fall in the DRF's value could affect the State's balance sheet.

Chart 6.3: NSW Generations Fund balance projections[6]



Gross Debt (the financial liabilities included in net debt)

Gross debt is the sum of borrowings (including leases), advances received[7], and deposits held[8], with borrowings making up 99.4 per cent of gross debt.

Since the 2023-24 Half-Yearly Review, gross debt at June 2024 is projected to increase by $7.9 billion to $155.5 billion. This increase is primarily the result of pre-funding and changes in the cash operating position.

Gross debt is projected to increase from $166.9 billion by June 2025 to $199.9 billion by June 2028, primarily driven by the Government's infrastructure program.

All key balance sheet measures, including gross debt and net debt, are shown in Table 6.1.

[6] Projections for the 2027-28 financial year are not included in the 2023-24 Budget and 2023-24 Half-Yearly Review.

[7] Advances Received are advances and loans made from the Australian Government in funding various approved projects. Advances are loans motivated by government policy rather than liquidity management purposes.

[8] Deposits Held are cash and deposits held at banks and other financial institutions on behalf of entities and individuals external to the State.

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

	June 2023 Actual	June 2024 Est. Actual	June 2025 Budget	June 2026	June 2027 Forward Estimates	June 2028
Total Assets ($m)	571,674	636,543	650,333	660,470	670,340	686,374
Financial Assets ($m)	207,255	246,989	246,338	245,193	244,381	250,324
Non-Financial Assets ($m)	364,419	389,554	403,995	415,277	425,959	436,050
Total Liabilities ($m)	249,717	270,699	281,510	296,618	308,379	319,119
Net Worth ($m)	321,957	365,844	368,823	363,852	361,961	367,255
Net Worth as a per cent of GSP[(a)]	41.4	44.8	42.7	40.2	38.3	37.3
Net Debt ($m)	74,873	96,833	110,523	121,935	130,965	139,497
Net Debt as a per cent of GSP	9.6	11.9	12.8	13.5	13.9	14.2
Gross Debt ($m)	132,914	155,516	166,885	178,889	188,505	199,883
Gross Debt as a per cent of GSP	17.1	19.0	19.3	19.8	20.0	20.3

(a) Nominal gross state product (GSP) for New South Wales for 2023-24 to 2027-28 is forecast by NSW Treasury.

Box 6.3: Interest expense affordability and refinancing risk

The Government continues to place a strong emphasis on managing the affordability of the State's interest expenses and its refinancing risk.

Since January 2020, TCorp 10-year bond yields have ranged from a low of around 1.0 per cent (in November 2020) to approximately 5.2 per cent on 31 May 2024. This is primarily due to the rapid change in monetary policy with the Reserve Bank of Australia raising its cash rate 12 times since May 2022. The cash rate is currently at 4.35 per cent in June 2024.

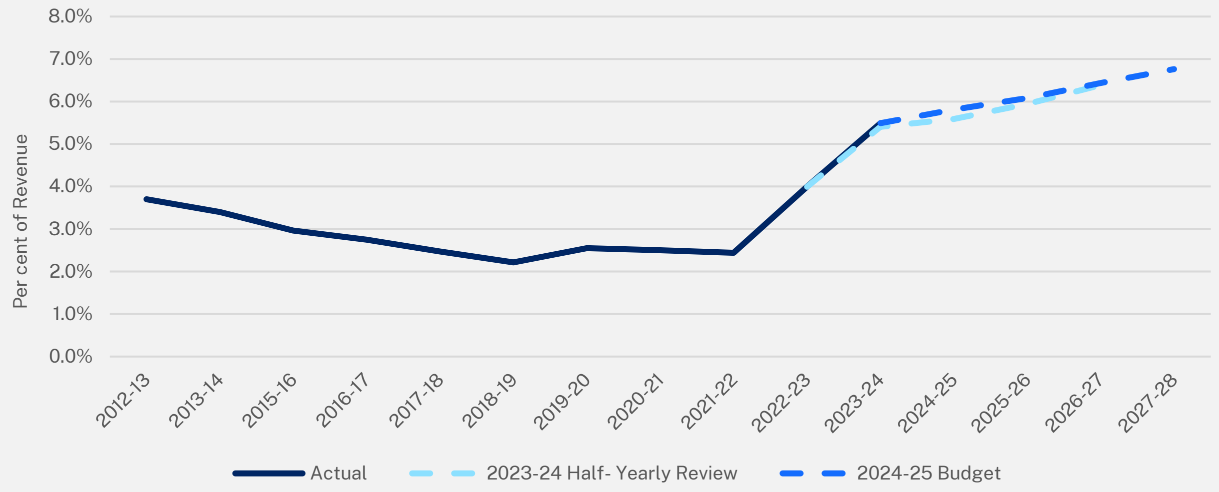
The average interest rate payable on new Crown borrowings was around 5.0 per cent during 2023-24 and is expected to remain around the same level during 2024-25. The average interest rate on new borrowings is forecast to decline over the forward estimates as rates across the economy normalise and the interest rate difference between Australian Government bond yields and NSW Government bond yields are also expected to revert to historic levels.

Interest expenses continue to place significant pressure on the Government's operating position. Increased debt is driving greater interest rate and refinancing risk. As debt grows, the State's fiscal position is more vulnerable to small movements in bond yields and adverse impacts of higher interest rates.

The Government's interest expenses as a percentage of revenue is estimated to be 6.4 per cent in 2026-27. This is in line with the projection at the 2023-24 Half-Yearly Review (see Chart 6.4).

See Appendix B Fiscal Risks and Budget Sensitivities for more information on interest rate risk.

Chart 6.4: Interest expenses to revenue

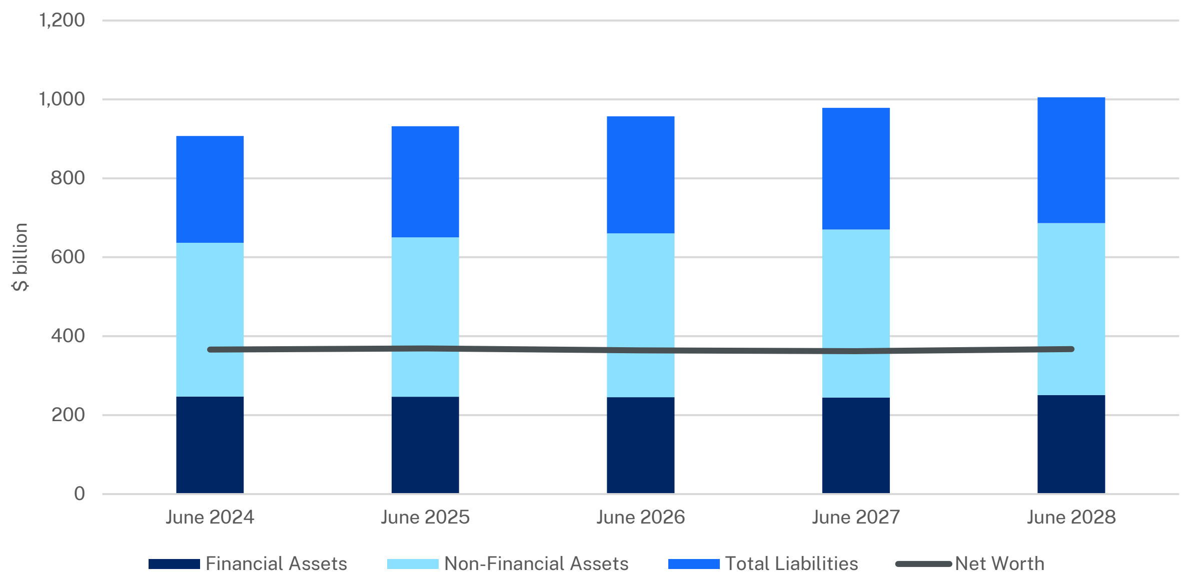


Net worth projections remain steady

General government sector net worth is projected to reach $365.8 billion at June 2024, $10.1 billion higher than the projection in the 2023-24 Half-Yearly Review, primarily driven by higher equity investments in other public sector entities and revaluations of plant, property and equipment. This has been offset somewhat by an increase in borrowings. Further detail is provided below.

By June 2028, net worth is projected to be $367.3 billion, broadly in line with the June 2024 projections.

Chart 6.5: General government sector net worth to remain steady over the next four years

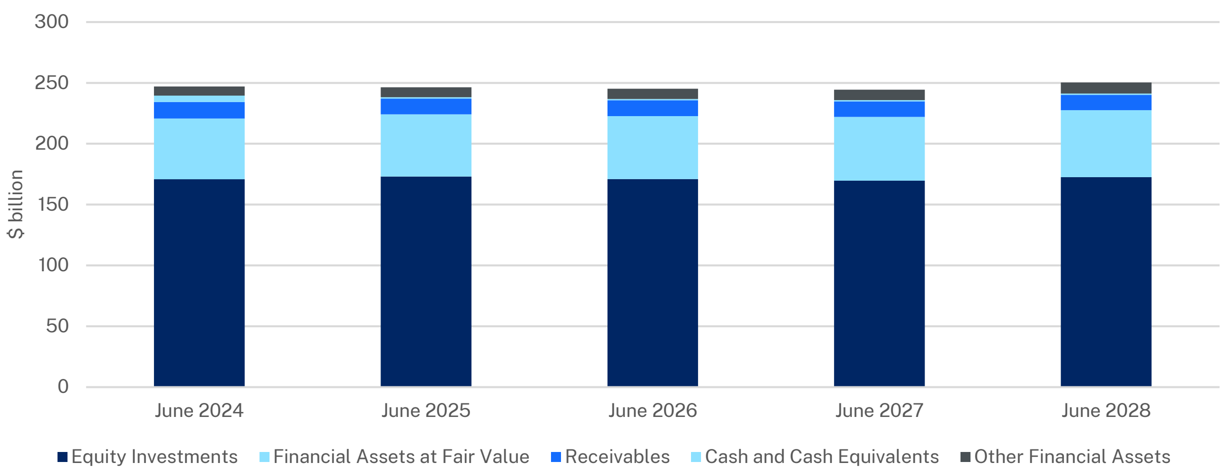


Financial assets included in net worth

The State's total financial assets are projected to be $247.0 billion at June 2024, $13.0 billion higher than the projection in the 2023-24 Half-Yearly Review. This is mainly driven by a temporarily higher cash balance and increases in equity investments in other public sector entities (driven by TAHE revaluations, additional investments in housing through the NSW Land and Housing Corporation, and changes in the net assets of the Public Financial Corporation Sector entities).

Across the budget and forward estimates, financial assets are forecast to remain broadly unchanged, with a projection of $250.3 billion by June 2028 (see Chart 6.6).

Chart 6.6: General government sector financial assets

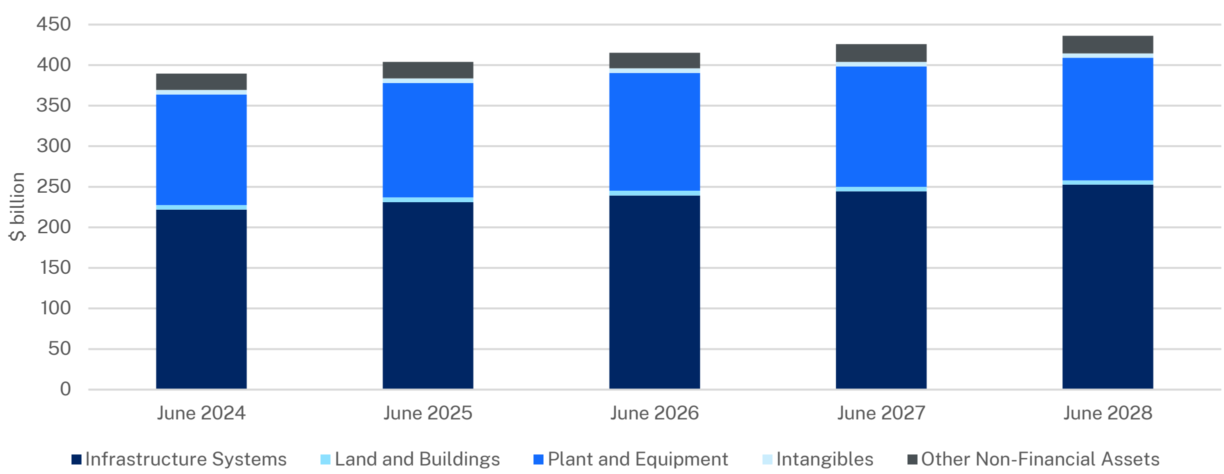


Non-financial assets included in net worth

The State's non-financial assets are projected to be $389.6 billion at June 2024, this is $8.1 billion higher than projected at the 2023-24 Half-Yearly Review due to revaluations of plant, property and equipment based on the latest estimates of the current cost to replace those assets (as required by accounting standards). Recent relatively high levels of inflation have led to higher-than-usual revaluation increases in this and the prior year.

Non-financial assets are estimated to grow to $436.1 billion by June 2028, primarily driven by the State's infrastructure program (see Chart 6.7).

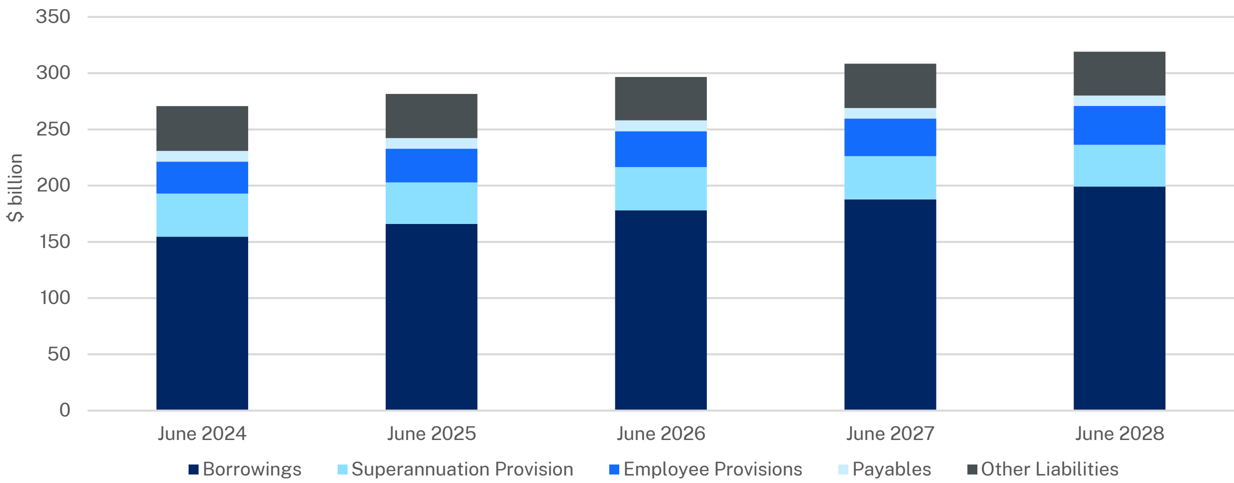
Chart 6.7: General government sector non-financial assets



Liabilities included in net worth

Total liabilities are projected to be $270.7 billion at June 2024, increasing to $319.1 billion by June 2028 (see Chart 6.8). This is predominately due to an increase in borrowings to fund the State's infrastructure program.

Chart 6.8: State liabilities projected to increase across the forward estimates



Borrowings represent the largest liability category on the general government sector balance sheet. They are projected to increase over the forward estimates from $154.6 billion at June 2024 to $199.1 billion by June 2028.

TCorp is the State's central borrowing authority and seeks to mitigate financing risk through diversification of funding sources and funding types. This includes the issuance of Green and Sustainability bonds through the NSW Sustainability Bond Program, lengthening the maturity profile and issuing different types of debt instruments to appeal to a broader set of investors.

The second largest liability of the Government is its defined benefit superannuation liability[9]. The liability is projected to be $38.2 billion at June 2024 and is expected to remain broadly stable over the forward estimates.

6.2 Managing the State's cash flows

The cash flow statement reports two fiscal measures, which are the net increase in cash held and cash surplus/(deficit). The net increase in cash held is the sum of net cash flows from all operating, investing, and financing activities. Cash surplus/(deficit) comprises net cash from operating activities, plus sales and less purchases of non-financial assets.

Since the 2023-24 Half-Yearly Review, the net cash operating position deficit has deteriorated by $1.1 billion to $1.6 billion in 2023-24, primarily driven by lower-than-expected underspends.

A return to a net operating cash surplus is now projected in 2024-25, estimated to be $4.9 billion. The net cash operating surplus is projected to increase to $7.1 billion in 2027-28.

[9] The superannuation liability can be measured using two Australian Accounting Standards Board (AASB): *AASB119 Employee Benefits* and *AASB1056 Superannuation Entities*. The superannuation liability reported on the State's balance sheet is the unfunded component of the liability and is governed by AASB119. It should be noted that this Accounting Standard creates a larger and more volatile liability than under AASB1056 due to the use of a conservative valuation discount rate. AASB1056 is the basis used when assessing the Government's funding position. The defined benefit superannuation liability has remained unchanged since last year at a net projected liability of $19.8 billion as of 30 June 2024 under AASB1056 basis.

Over the four years to 2026-27, net cash requirements from investing in non-financial assets is $4.2 billion higher than the projection in the 2023-24 Half-Yearly Review as the Government increases its investment in essential infrastructure such as housing and preschools.

There is a technical correction of approximately $387.9 million in sales of non-financial assets over the four years to 2027-28 associated with Sydney Metro. This correction will result in higher borrowings over the same period.

Net cash flows from investments in financial assets for policy purposes represents net cash flows from disposal or return of equity (this includes net equity injections into other public sector entities). The Government is providing an equity investment into Landcom which will flow through these net cash flows (see Chapter 7 Commercial Performance in the Broader Public Sector for more information).

Net cash flows from investments in financial assets for liquidity purposes include the contributions into and withdrawal from the State's investment funds, such as the DRF and NIFF. Over the four years to 2026-27, payment for purchases of investments is projected to be $13.5 billion lower than projected in the 2023-24 Half-Yearly Review. This is primarily driven by the Government's suspension of NGF contributions offset by the $925 million contribution for IfNSW schemes.

Since the 2023-24 Half-Yearly Review, the general government sector cash deficit has worsened by $14.2 billion over the four years to 2026-27 as the Government increases its investment in essential services and infrastructure (e.g., housing, health). However, this increase has been offset by the suspension of NGF contributions, resulting in gross debt projections by June 2027 remaining broadly in line with the 2023-24 Half-Yearly Review.

Chart 6.9: General government sector cash surplus/(deficits)