6. MANAGING THE STATE'S ASSETS AND LIABILITIES

- By leveraging the State's balance sheet, the Government has delivered temporary and targeted fiscal stimulus.
- The Government is also increasing its 4-year infrastructure program by $9.7 billion to a record $107.1 billion to support jobs and the economy through this downturn, leading to a stronger economic position over the medium term.
- NSW has the largest infrastructure program of any government in Australia, including the Commonwealth Government. This massive investment will see general government sector non-financial assets rise from $250.3 billion at June 2020 to a record $334.6 billion by June 2024.
- Natural disasters and COVID-19 have significantly reduced the amount of operating cash available to fund infrastructure. The Government will meet this shortfall with additional borrowings, which will contribute to net debt rising from 3.1 per cent of GSP at June 2020 to a peak of 14.7 per cent of GSP by June 2024.
- By continuing its successful asset recycling program (e.g. the sale of the Government's 49 per cent residual share of WestConnex) and its innovative balance sheet reform agenda (e.g. NGF), the Government will rebuild balance sheet capacity, bringing net debt back down towards 7 per cent of GSP over the medium term.
- This Budget includes $12.0 billion in balance sheet reform measures, initiating the fiscal repair task and building capacity to respond to any future natural disaster or economic shock.
- Overall, NSW's net worth is projected to grow from $238.7 billion by June 2020 to $258.7 billion by June 2024, with New South Wales having the highest net worth of any State or Territory in Australia.

6.1 A strong balance sheet helping NSW through crisis

With the challenges facing the NSW economy and the community from COVID-19, bushfires and drought, the Government is using its strong balance sheet to support the people of New South Wales and build productive infrastructure for the State's economic future.

Despite the economic uncertainties arising from this crisis, the Government is continuing its successful strategy of balance sheet reform. This will ensure the State's balance sheet remains resilient into the future, the 2020-21 Budget includes:

- diversification of debt funding sources – the Government has been able to broaden its investor base by issuing sustainability bonds, new long-dated bonds, and tapping into floating rate notes. The Government has issued a total of $5.2 billion in green and sustainable bonds to date, including $2.1 billion in a sustainability bond first issued in November 2019 and $3.1 billion in green bonds including a $1.3 billion green bond issued in October 2020. These funds are earmarked to finance projects and assets that deliver positive environmental and social outcomes (see Box 6.2)

- an ongoing program of cash management reforms – this includes cash internalisation which involves centralising as much cash as possible within the Treasury Banking System (TBS) thereby enabling the State to manage its overall cash position more efficiently and effectively. This program has seen another $0.7 billion in cash centralised into the TBS, bringing the total amount to around $4.3 billion to date
- growing the NSW Generations Fund to support the State's triple-A credit rating and sustainable debt position over the medium-term. In line with the *NSW Generations Funds Act 2018*, the Government will invest the proceeds of the planned sale of its 49 per cent residual share in WestConnex into the NGF. Additionally, the Government will direct SOC dividends and mining royalties into the NGF (see Box 3.2 in Chapter 3).

Overview of key changes since the 2019-20 Half-Yearly Review

Key balance sheet movements since the 2019-20 Half-Yearly Review (see Table 6.1) include:

- an increase in net debt to $19.3 billion at June 2020, from the earlier $12.9 billion forecast at the 2019-20 Half-Yearly Review. This is due to a $12.7 billion increase in borrowings in response to the crisis, partially offset by a $4.9 billion increase in cash reserves to help the State maintain adequate liquidity during the early period of the COVID-19 pandemic.
- a reduction in net worth from the $251.1 billion projected in the 2019-20 Half-Yearly Review to $238.7 billion at June 2020. This has been primarily driven by a large increase in additional expenses in response to COVID-19, bushfires and droughts and a large fall in taxation revenue. Additionally, there has been a $0.1 billion increase in the value of unfunded defined benefit superannuation liabilities due to the lower Commonwealth Bond rate (which is merely a valuation impact due to AASB 119 *Employee Benefits* requirements, not a cash funding shortfall).

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

	June 2019	June 2020	June 2021	June 2022	June 2023	June 2024
	Actual	Actual	Budget		Forward Estimates	
Total Assets ($m)	401,181	425,651	459,731	480,748	501,788	529,974
Financial Assets ($m)	169,490	175,326	173,081	176,281	182,136	195,343
Non-Financial Assets ($m)	231,690	250,325	286,649	304,468	319,652	334,631
Total Liabilities ($m)	152,110	186,964	230,731	252,427	265,390	271,277
Net Worth ($m)	249,070	238,688	228,999	228,321	236,398	258,698
Net Worth as a per cent of GSP(a)	39.8	38.4	36.3	34.8	34.8	36.6
Net Debt ($m)	(10,401)	19,261	53,187	75,433	91,771	104,347
Net Debt as a per cent of GSP	(1.7)	3.1	8.4	11.5	13.5	14.7

(a) Gross State Product (GSP) for NSW from 2018-19 to 2023-24 is forecast by NSW Treasury

6.2 Delivering record infrastructure while maintaining sustainable net debt

A significant write-down in Government revenue and higher expenditure as a direct result of COVID-19, bushfires and drought has challenged the State's fiscal position. Even amidst this crisis, the Government has drawn on its balance sheet to borrow at record low interest rates to fund infrastructure.

General government net debt is projected to rise from $19.3 billion from June 2020 to $104.3 billion at June 2024, with a commensurate rise in non-financial assets of $84.3 billion over the same period. The Government aims to bring net debt back down towards 7 per cent of GSP over the medium-term.

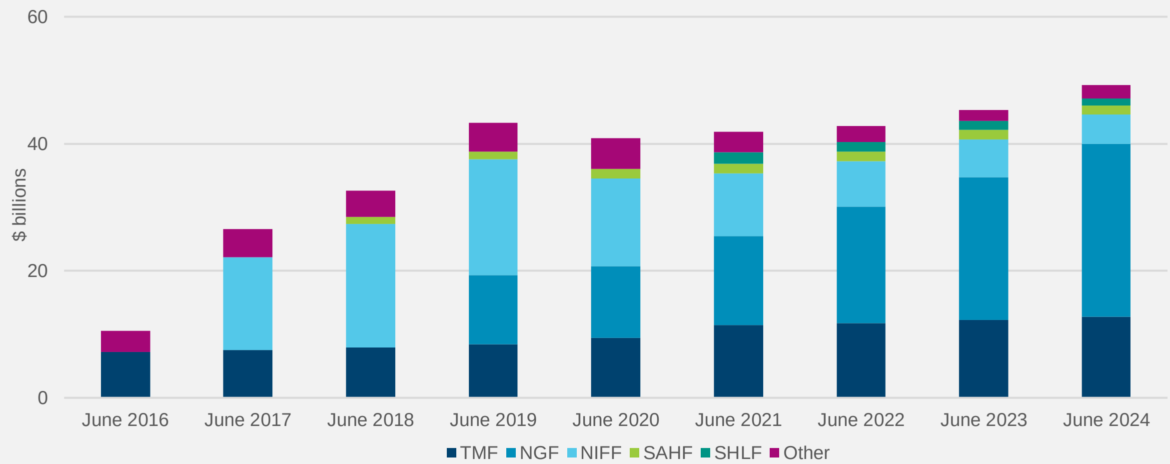
Box 6.1: The strong liquidity position of NSW leads the way in Australia

- The Government was well placed to support the economy as a result of strong fiscal and balance sheet management leading into the crisis.
- The Government's balance sheet reform agenda has ensured that every dollar of taxpayers' funds on the State's balance sheet continues to work for the people of New South Wales. Whilst borrowings will increase due to COVID-19, bushfires and drought, this is manageable due to the State's exceptional liquidity levels, highlighted by the Government's investment funds in conjunction with historically low interest rates.
- From June 2020 to June 2024, the Government's financial assets that contribute to its net debt position are projected to grow by $3.9 billion. With the sale of WestConnex in 2021 and the proceeds deposited into the NGF, this position will grow even further.

The State's financial assets included in the calculation of net debt are estimated to grow to $53.7 billion by June 2024. These financial assets comprise, among others:

- **NSW Generations Fund (NGF)** – a debt retirement fund that is treated as an offset to the State's gross debt by Moody's and S&P Global in their credit rating assessments
- **NSW Infrastructure Future Fund (NIFF)** – an investment vehicle to temporarily hold the net proceeds from the Government's past recycling transactions and supports the Restart NSW/Rebuilding NSW infrastructure programs
- **Social and Affordable Housing Fund (SAHF) –** an investment fund that provides much needed social and affordable housing to the community
- **Treasury Managed Fund (TMF)** – the State's Government self-insurance fund for a liability, injury, loss or damage that may be suffered by individuals who work for and assets owned and run by the NSW Government
- **Snowy Hydro Investment Fund** – announced in this Budget to support the Snowy Hydro Legacy Fund's economic investment in regional NSW.

Chart 6.1: Growth of investments used in the calculation of net debt[(a)(b)]



(a) WestConnex future proceeds have not been included in the projections
(b) The financial assets categorised under 'other' comprises Long Service Corporation (LSC), Worker's Compensation (Dust Diseases) Authority and SiCorp other funds (excluding TMF) among other smaller funds

Mitigating the increase in borrowings are historically low interest rates (see Box 6.3). One of the key factors of debt sustainability is interest servicing costs. Maintaining low interest expenses means the Government is able to allocate more resources to providing essential services and investing in productive infrastructure.

Prior to COVID-19, the State's interest servicing costs represented 2.8 per cent of revenue, on average, over the four years to 2023-24. Even with the increase in borrowings to support the record infrastructure program, the 2020-21 Budget shows a marginal increase in the State's interest expenses, which are expected to average 3.2 per cent of revenue over the four years to 2023-24.

Box 6.2: The State continues its successful Sustainability Bond Program

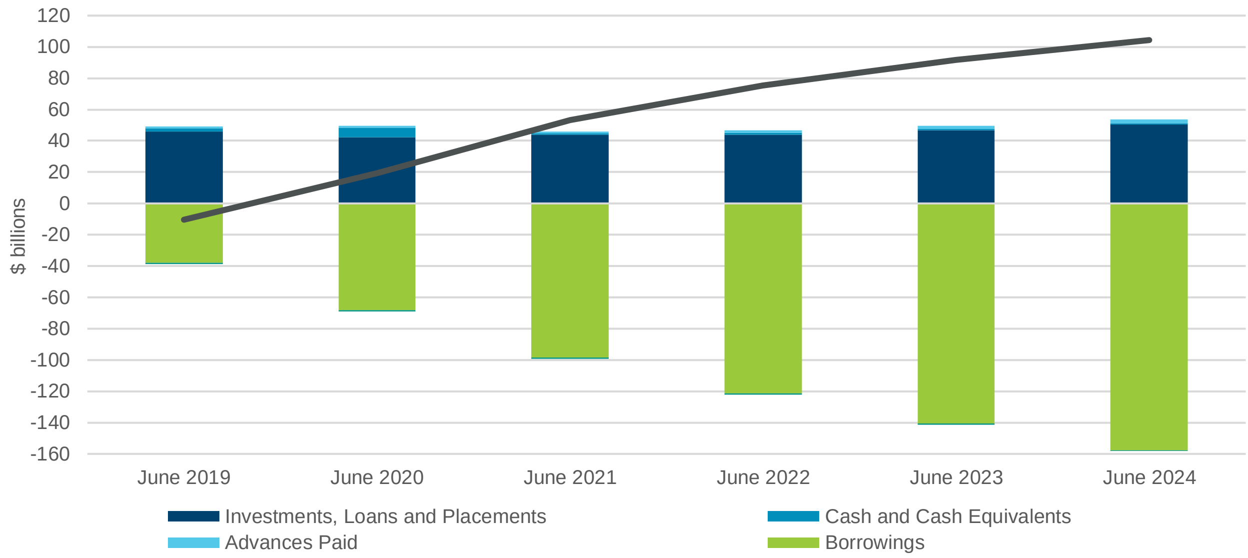
- The NSW Government's Sustainability Bond Program is the only program of its type amongst Commonwealth and semi-government issuers in Australia.
- Launched in 2018 the program is designed to support NSW Government environmental and social policies, strategies and goals, while providing a mechanism for investors to allocate capital to projects and assets that achieve a positive environmental or social outcome. The program draws on and contributes to global best practice in the discipline of outcomes measurement, reporting and transparent disclosure of sustainability outcomes.
- The program supports the UN Sustainable Development Goals, and is aligned with the International Capital Market Association's (ICMA's) Green Bond Principles, Social Bond Principles, and Sustainability Bond Guidelines. External assurance is actively sought and made available publicly with the program independently audited, second party opinions solicited and the green bonds issued so far being certified by the Climate Bonds Initiative.
- The program covers the issuance of 3 types of bonds:
  - **Green Bonds –** proceeds are exclusively applied to finance eligible Green Projects, in alignment with the four core components of the Green Bond Principles (GBP)
  - **Social Bonds –** proceeds are exclusively applied to finance eligible Social Projects, in alignment with the four core components of the Social Bond Principles (SBP)
  - **Sustainability Bonds –** proceeds will be exclusively applied to finance a combination of both Green and Social Projects, in alignment with both GBP and SBP.
- NSW Treasury Corporation (TCorp), on behalf of the Government, has issued a total of $5.2 billion in Green and Sustainability Bonds to date. The most recent bond issued was particularly noteworthy, attracting over $4.1 billion in bids for a $1.3 billion green bond in October 2020 at a yield of 1.11 per cent over 10 years, with offshore investors taking up around 40 per cent of the deal.
- New South Wales is the largest issuer of Green Bonds and Sustainability Bonds in Australia and the program has received multiple awards, including:
  - KangaNews Awards 2018 "Australian Sustainability Deal of the Year"
  - FinanceAsia Achievement Award 2018 "Best Sustainable Finance Deal"
  - Environmental Finance Bond Awards 2020 "Sustainability Bond of the Year"
  - Asset Triple A Infrastructure Awards 2020 "Green Project of the Year".

Financial assets included in the calculation of net debt were $49.8 billion at June 2020. These assets primarily consist of the NIFF, NGF, SAHF and the TMF (see Chart 6.1)[1].

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

Over the four years to June 2024, these funds are projected to increase by $3.9 billion to $53.7 billion. This increase is largely being driven by an increase in the projected balance of the NGF, in line with projected investment returns and additional contributions. This is offset somewhat by reductions in the balance of the NIFF over the forward estimates in line with scheduled drawdowns to support the Restart NSW/Rebuilding NSW programs.

Chart 6.2: General government sector net debt



Liabilities included in the calculation of net debt were $69.0 billion at June 2020. Over the four years to June 2024, these liabilities are projected to increase to $158.1 billion mainly driven by increased borrowing to support the economy as it recovers from the impacts of COVID-19.

The Government is taking advantage of the historically low interest rate environment (see Chart 6.3). This supports the State's primary short-term focus of job creation with the intention of a shift towards fiscal repair in the medium term.

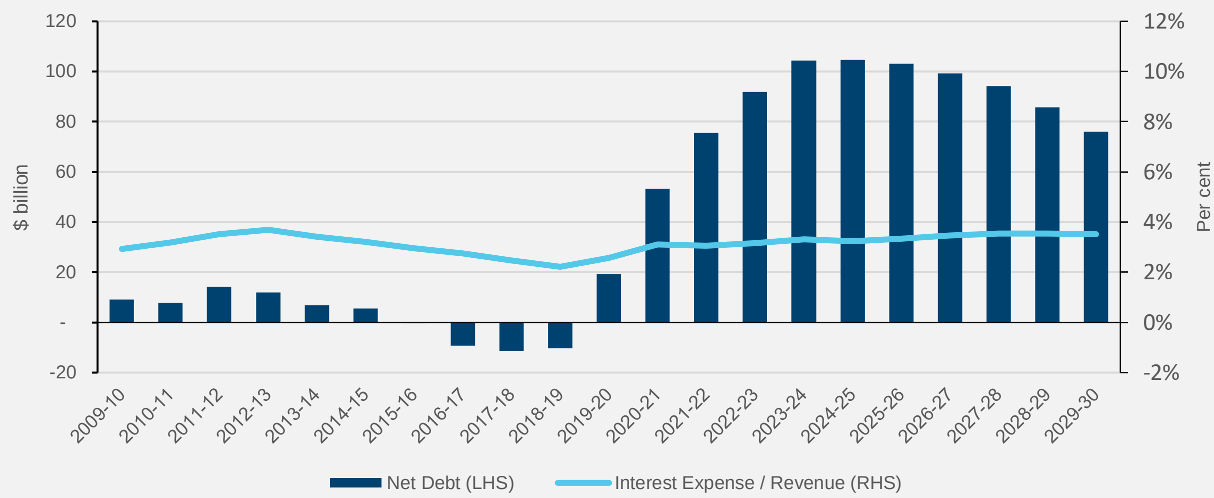
Box 6.3: Supporting the State's economy while taking advantage of historically low interest rates

The Government has monitored financial conditions closely in order to implement its investment task using favourable interest rates and has been able to lower the average interest cost on its borrowings. While there has been significant volatility in bond markets (due to the uncertainty of the pandemic), capital markets have responded well with a strong and sustained demand for NSW Government bonds during the COVID-19 period.

The Government has also been able to broaden its investor base by issuing into new long-dated tenors as well as further tapping into floating rate and sustainability bond lines.

The current borrowing environment supports leveraging the balance sheet to invest in productive infrastructure. The net debt to revenue level is forecast to increase over the four years to June 2024. At the same time the Government is keeping its debt serviceability levels (interest expenses to revenue) relatively constant (see Chart 6.3). NSW will aim to maintain interest expenses to revenue below 5 per cent over the medium term to help support its triple-A credit rating.

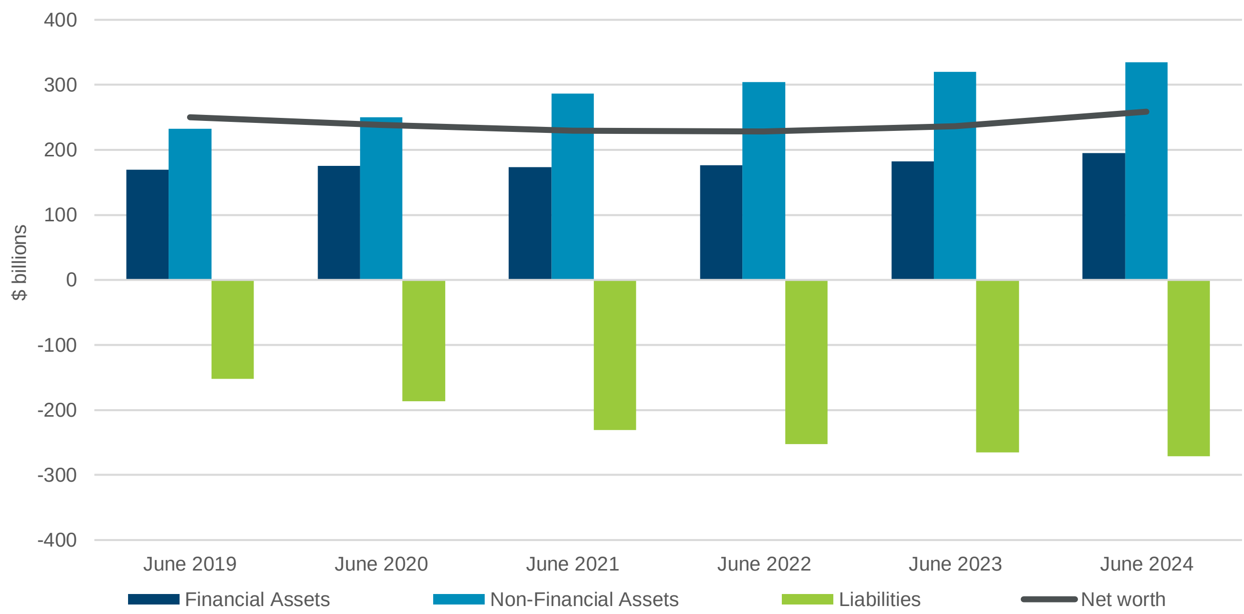
Chart 6.3: General government borrowings vs debt serviceability



6.3 The strongest net worth of all Australian states and territories

General government sector net worth fell to slightly under a quarter of a trillion dollars, sitting at $238.7 billion as at June 2020 (see Chart 6.4). Net worth is projected to recover, reaching $258.7 billion by June 2024.

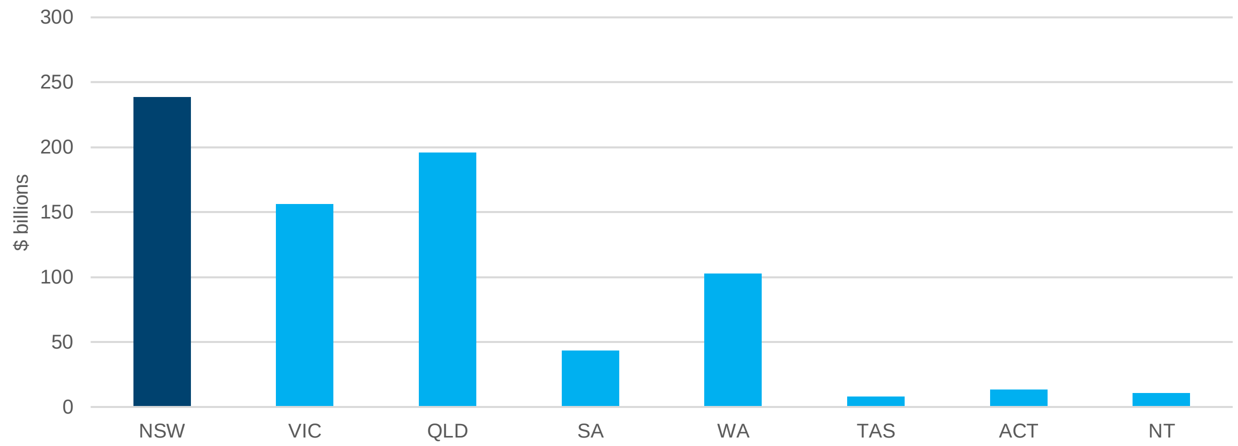
Chart 6.4: NSW general government sector net worth to increase by $20.0 billion over the next four years



The reduction in net worth in the short-term is driven by a significant increase in COVID-19 related stimulus expenses and revenue loss. The key components driving recovery from 2022-23 are:

- the Government's equity investments which are expected to increase from $112.1 billion at June 2020 to $127.6 billion by June 2024, driven by strong growth in the public non-financial corporations sector
- a reduction in the projected superannuation liabilities of the State by $17.6 billion from June 2020 to June 2024.

Chart 6.5: General government sector net worth of Australian States and Territories at June 2020

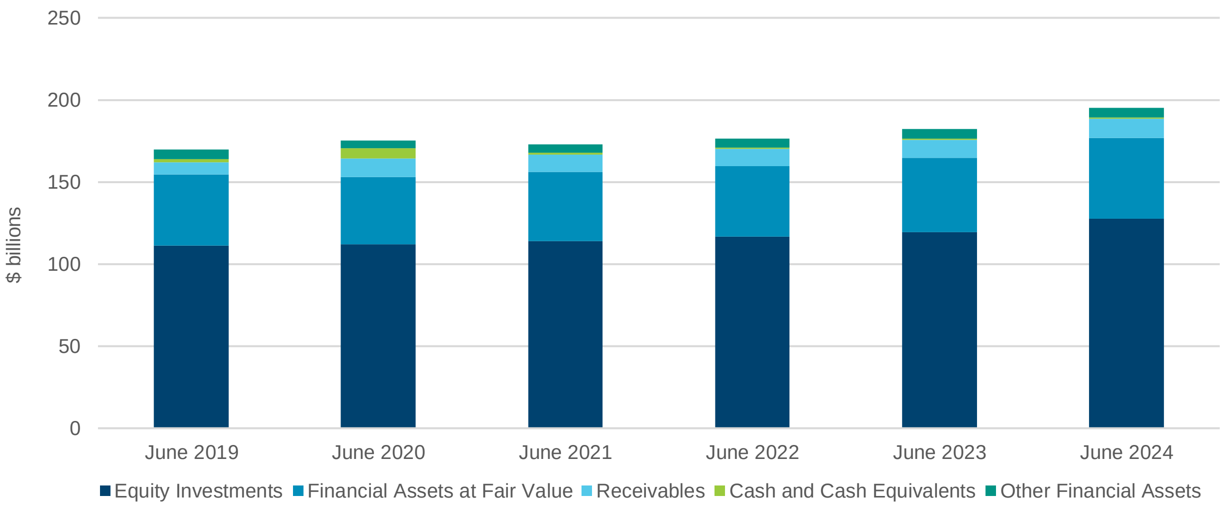


(a) Net worth for VIC, QLD and ACT as per their 2020-21 Pre-Budget update.

Financial assets

The State's total financial assets were $175.3 billion at June 2020, and are projected to increase to $195.3 billion by June 2024 (see Chart 6.6). This is largely represented by the growth in the value of the State's equity holdings in State Owned Corporations in addition to the growth in the State's financial assets at fair value.

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



Total financial assets at June 2020 were $5.6 billion higher compared to 2019-20 Half-Yearly Review estimates. This was driven mainly through a $4.9 billion increase in cash and cash equivalents and a $3.6 billion increase in receivables on the State's balance sheet. The increase in cash holdings is largely represented by maturities of term deposits and other financial assets held for liquidity purposes in response to COVID-19 uncertainties.

The variation in receivables results from the deferral of tax revenues from a cash perspective. The State's equity investments in other public-sector entities[2], which make up the majority of the State's financial assets, decreased by $3.7 billion as assets were transferred between the public non-financial corporation sector and general government sector.

Financial assets are projected to grow over the forward estimates to $195.3 billion by June 2024, primarily driven by growth in the size of the NGF, which remains a core element of the State's fiscal repair plan with proceeds of asset recycling initiatives, State Owned Corporation (SOC) dividends and mining royalties being deposited into it.

The Government's balance sheet strategy is to capitalise on historically low interest costs and leverage investment returns, so it can continue reaping benefits in the current environment. The NGF is projected to grow over the medium term to an expected balance of more than $70.0 billion by June 2030 (see Box 3.1 in Chapter 3).

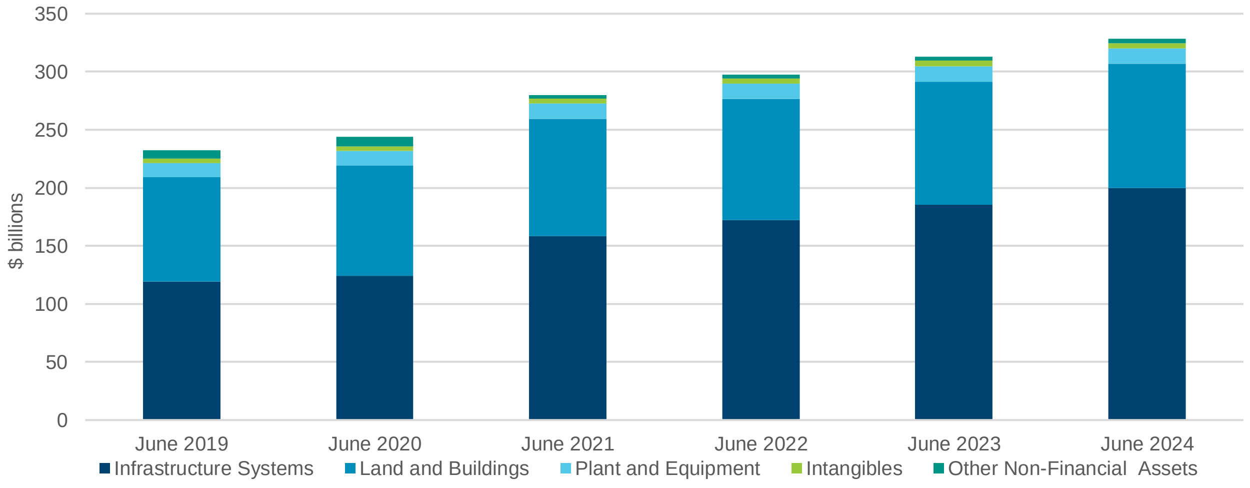
Non-financial assets

The State's non-financial assets were $250.3 billion at June 2020, a $1.8 billion decrease relative to the 2019-20 Half-Yearly Review. This figure is expected to increase to $334.6 billion by June 2024, due to the Government's ongoing infrastructure investment and asset revaluations (see Chart 6.7). This represents the largest non-financial assets profile across all State and Territory Governments in Australia.

Investment in productive infrastructure systems (e.g. public transport infrastructure) is projected to increase over the forward estimates from $124.4 billion at June 2020 to $200.0 billion in June 2024 as the delivery of State's record infrastructure program progresses.

Land and building assets are projected to grow from $94.8 billion at June 2020 to $107.0 billion in June 2024, 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

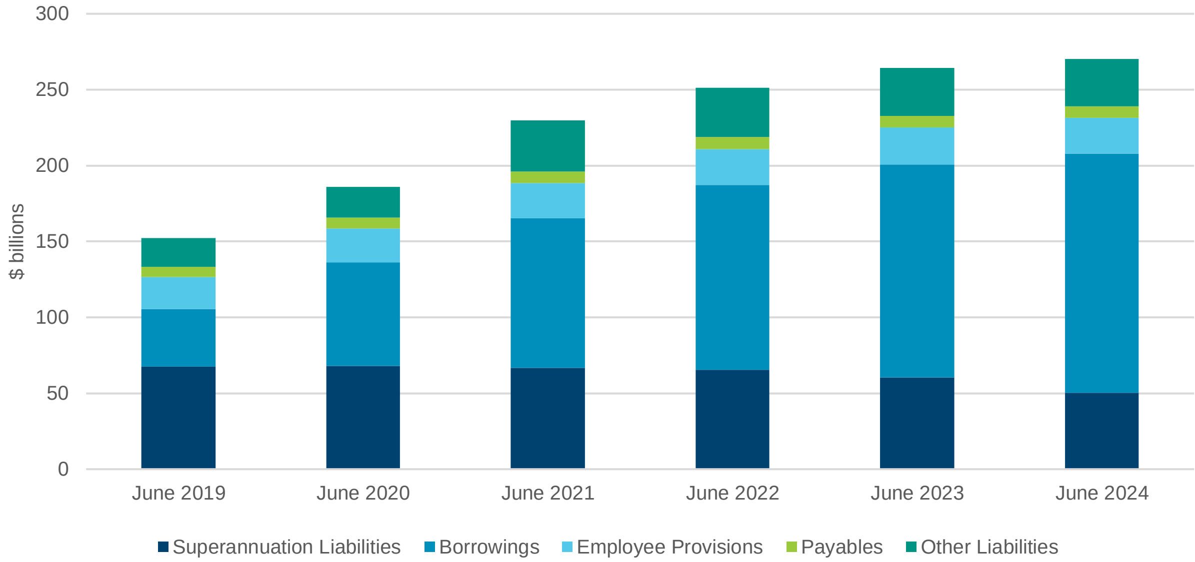


[2] Equity investments in other public-sector entities represents the general government sector's interest in the public non-financial corporation and public financial corporation sectors reflecting, in the absence of fair value, the carrying amount of net assets of those sectors (before consolidation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

Liabilities

Total liabilities are projected to be $187.0 billion at June 2020 and are expected to increase to $271.3 billion by June 2024 (see Chart 6.8). This is mainly driven by increased borrowings as the State funds its economic response and recovery, and record infrastructure program.

Chart 6.8: Liabilities stable over the forward estimates



Due to the pandemic, government borrowings have marginally overtaken unfunded superannuation liabilities as the largest category of liability on the general government sector balance sheet as at June 2020.

As the government capitalises on the historically low interest rate environment to fund the record $107.1 billion infrastructure program and around $29.0 billion in economic support for the Governments COVID-19 package of response, recovery and reform measures, borrowings are projected to increase over the forward estimates to $157.5 billion at June 2024.

Mitigating the increase in borrowings are historically low interest rates (see Box 6.3). One of the key factors of debt sustainability is interest servicing costs. In 2023-24, interest expenses as a per cent of revenue remains low at 3.3 per cent – well below the previous historical peak of 3.7 per cent in 2012-13.

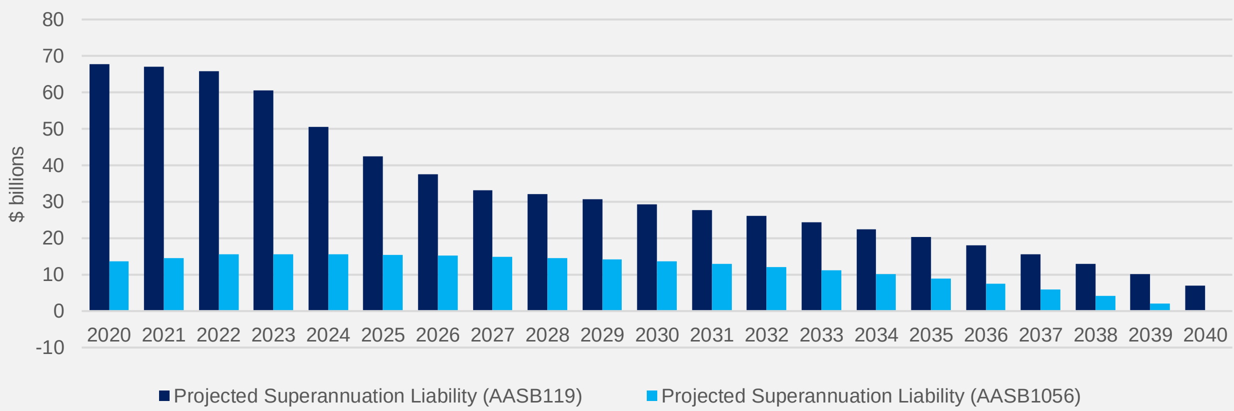
Superannuation liabilities are projected to decrease from $67.9 billion at June 2020 to $50.3 billion at June 2024 primarily driven by rising long-term bond rates (see Box 6.4).

Employee provisions, including long service leave, are projected to increase slightly over the forward estimates from $22.6 billion in June 2020 to $23.8 billion in June 2024.

Box 6.4: Fully funding the State's defined benefit superannuation liabilities

- The Government remains committed to fully funding its superannuation liabilities.
- In light of the pressure COVID-19 has placed on the State's finances, the Government is proposing a revised contribution plan that will allow the Government to fully fund these liabilities, while providing the financial flexibility necessary to navigate the current economic downturn. The revised contribution plan includes a two-year contribution holiday, after which the contributions resume and increase by 5 per cent per annum.
- The Government will also re-anchor its superannuation target to 2040. This will help spread contributions over a longer period of time. This initiative will require an amendment to the *Fiscal Responsibility Act 2012*. However, with some significant uncertainty remaining in the economic and fiscal outlook due to COVID-19, the NSW Government will aim to update the Act as a clearer picture of the broader outlook emerges.
- The superannuation liability reported on the State's balance sheet is the unfunded component of the liability and is governed by AASB 119 *Employee Benefits*. The Accounting Standard creates a larger and more volatile liability[3] due to very conservative valuation requirements. AASB 1056 *Superannuation Entities*[4] allows the target return on superannuation assets to be used to determine funding of the superannuation liability towards the 2040 target, creating a lower and less volatile liability as it reflects a more realistic cash-funding basis. Chart 6.9 below shows the difference between the two accounting standards.

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



[3] AASB 119 requires the reported superannuation liability 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. a 1 per cent decrease in this bond rate would increase the value of the liability by $14.1 billion.

[4] 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 was estimated to be $14.7 billion at June 2020 and is projected to increase to $16.0 billion by June 2024. The target of fully funding the State's superannuation liabilities by 2040 is determined using the AASB 1056 basis.