

6. MANAGING THE STATE'S ASSETS AND LIABILITIES

- New South Wales is the only Australian state to retain a triple-A credit rating with Moody's, a position that is supported by the Government's strong balance sheet management. New South Wales is rated double-A-plus by S&P Global, which is the equal highest of all Australian states.
- New South Wales is using its balance sheet to support the State's record \$108.5 billion infrastructure program and deliver targeted short-term stimulus. Active management of interest rate risk is ensuring that the State's cost of borrowings is kept sustainable.
- The State's investment funds have generated exceptionally strong investment returns in the year to April 2021, with the largest funds returning 15.5 per cent (NSW Generations Fund) and 17.0 per cent (Treasury Managed Fund).
- The NSW Generations Fund (NGF) is forecast to grow to more than \$90.0 billion by June 2031. This will help maintain the State's net debt at sustainable levels.
- The NSW Government is taking further steps to strengthen the NGF through the introduction of amendments to the *NSW Generations Fund Act 2018*. These amendments are designed to further protect intergenerational equity and improve the accountability of the Fund (see Box 3.1 in Chapter 3).
- Net debt is projected to be \$103.9 billion by June 2025 (13.7 per cent of GSP). The projection for net debt at June 2024 has improved by \$2.3 billion since the 2020-21 Half-Yearly Review, due to the State's improved revenue outlook and better-than-expected investment funds performance (including the NGF).
- The NSW Government is leading by example in applying Environmental, Social and Governance (ESG) considerations to managing the State's balance sheet. At \$5.2 billion, the NSW Government is the largest semi-government issuer of Green and Sustainability Bonds in Australia.

6.1 A strong balance sheet and further reform

After the recent economic and fiscal challenges (including drought, bushfires, a pandemic and floods) the Government is improving the resilience of the balance sheet and managing financial risk.

The 2021-22 Budget includes a comprehensive suite of balance sheet measures:

- strengthening the NGF by locking in future inflows and improving reporting transparency (see Box 3.1 in Chapter 3)
- diversifying the State's investor base through the issuance of new longer-dated bonds, floating rate notes, offshore notes and green and sustainability bonds
- establishing the Snowy Hydro Legacy Fund, which will generate additional returns to fund Snowy Hydro Legacy Fund projects
- ensuring the sustainable future of coal mining communities through the \$300.0 million Royalties for Rejuvenation Fund.

Incorporating ESG factors into the State's balance sheet

The Government is moving to align the State's financial activities – investing, issuing bonds, procuring, and stewarding resources – with more sustainable outcomes. Existing and new actions include:

- committing to achieving net zero emissions by 2050 through a range of initiatives, including targeting electricity transition and energy efficiency, hydrogen and coal innovation technologies, and sustainable financing
- strengthening identification and management of climate-related risks to NSW Government assets and services with the launch of the Climate Risk Ready NSW Program and associated nationally accredited training delivered through Western Sydney University
- supporting the development of social and environmental impact investing markets through
 - the State's seven existing social impact investments
 - two social impact investments in development
 - \$30.0 million in new funding to pilot new social impact investments
 - the Sustainability Bond Program
- integration of ESG issues into TCorp's investment decision-making and active ownership of companies to which TCorp's clients have exposure.

Overview of key balance sheet changes since the 2020-21 Half-Yearly Review

Key balance sheet movements since the 2020-21 Half-Yearly Review (see Table 6.1) include:

- a decrease in net debt to \$40.6 billion at June 2021, which is below the \$45.4 billion forecast at the time of the 2020-21 Half-Yearly Review. This reduction is driven by an improved revenue outlook and strong returns from the State's investment funds
- a decrease in net worth to \$231.4 billion at June 2021, which is below the \$236.3 billion projected at the time of the 2020-21 Half-Yearly Review. This decrease is driven by a reduction in investments in other public sector entities, due to a change in an asset valuation in the Public Non-Financial Corporations (PNFC) sector, consistent with accounting standards.

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

	June 2020 Actual	June 2021 Revised	June 2022 Budget	June 2023	June 2024 Forward Estimates	June 2025
Total Assets (\$m)	425,651	440,474	469,720	494,979	525,404	549,982
Financial Assets (\$m)	175,326	154,741	165,769	173,496	187,739	202,756
Non-Financial Assets (\$m)	250,325	285,733	303,952	321,483	337,666	347,226
Total Liabilities (\$m)	186,964	209,069	235,208	250,996	263,577	274,083
Net Worth (\$m)	238,688	231,405	234,513	243,983	261,827	275,899
Net Worth as a per cent of GSP ^(a)	37.9	35.9	34.5	35.0	36.1	36.4
Net Debt (\$m)	19,261	40,622	63,258	80,609	94,340	103,863
Net Debt as a per cent of GSP	3.1	6.3	9.3	11.6	13.0	13.7

(a) Gross State Product (GSP) for NSW from 2019-20 to 2024-25 is forecast by NSW Treasury

6.2 As the economy recovers the net debt outlook has improved

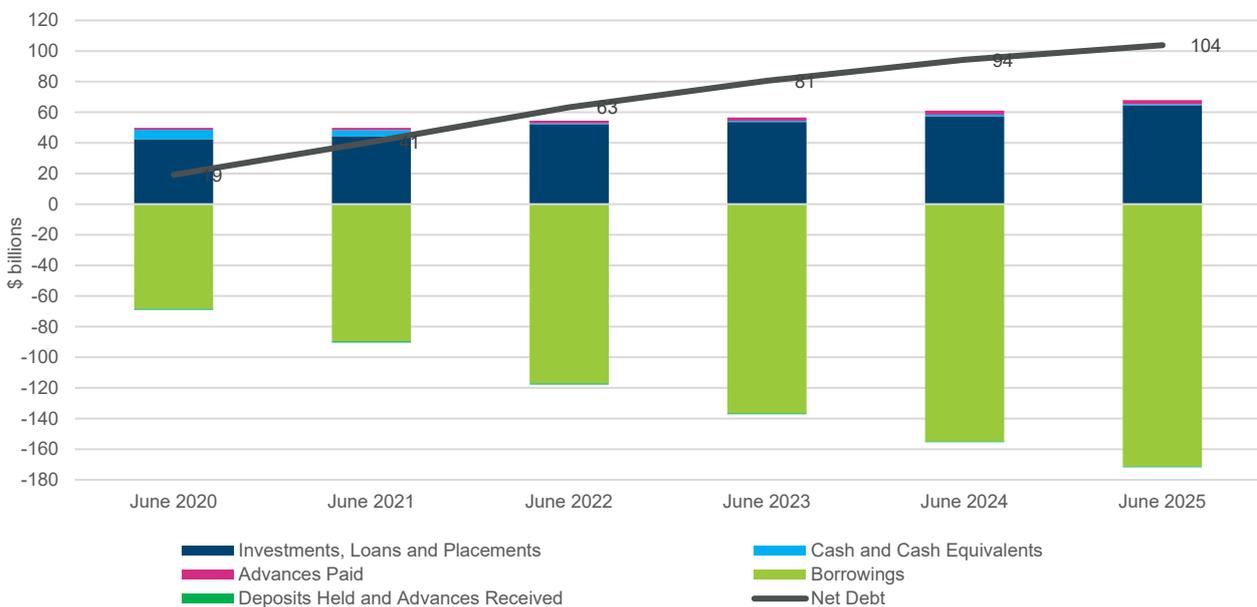
The Government is maintaining sustainable debt levels over the medium term.

The level of net debt in June 2021 is projected to be \$40.6 billion, an improvement of \$4.8 billion since the 2020-21 Half-Yearly Review. This is being driven by an improved revenue outlook (reducing the State's borrowing requirements) and higher-than-expected performance of the State's investment funds, particularly the NGF.

At June 2025 net debt is projected to be \$103.9 billion. This increase over the four years reflects the Government's targeted and temporary stimulus in the short-term, together with the continuation of the record infrastructure program across the forward estimates.

Net debt is forecast to trend back down towards 7 per cent of GSP by June 2030, supported by further balance sheet reforms including asset recycling.

Chart 6.1: General government sector net debt



Financial assets included in net debt

Financial assets included in the calculation of net debt are projected to be \$49.8 billion at June 2021. These assets include the State's cash, investment funds and other assets.

Financial assets included in the calculation of net debt are forecast to grow to \$68.0 billion at June 2025. This increase is driven by the growth of the State's investment funds, due to the expected investment returns and additional contributions into these funds (see Box 6.1).

Box 6.1: Strong management of State's investment funds supporting the fiscal position

The investment funds on the State's balance sheet generate returns that can either be spent or reinvested to support long-term policy aims. The investment funds support the State's fiscal position and, as financial assets, reduce the State's net debt. The major investment funds include:

- **NSW Generations Fund (NGF)** – NSW's own sovereign wealth fund, that invests asset recycling proceeds and other revenues to achieve a competitive return for taxpayers, while supporting a sustainable debt position over the medium term
- **NSW Infrastructure Future Fund (NIFF)** – an investment vehicle that temporarily invests proceeds from the State's past asset recycling transactions, allowing the Government to generate additional returns for taxpayers. It supports investment into key infrastructure projects under the Restart NSW/Rebuilding NSW programs
- **Social and Affordable Housing Fund (SAHF)** – an investment fund that uses its returns to provide funding for social and affordable housing to the community
- **Treasury Managed Fund (TMF)** – the State Government's self-insurance fund for a liability, injury, loss or damage that may be suffered by individuals who work for the NSW Government and for assets owned and run by Government
- **Snowy Hydro Legacy Fund (SHLF)** – this is due to be established in mid-2021 with seed funding of \$2.0 billion. It will support the Snowy Hydro Legacy Fund's project investments in regional New South Wales.

Table 6.2 demonstrates the strong returns of the State's investment funds, despite the largest recession in 80 years.

Table 6.2: NSW investment funds and their returns to April 2021

Fund	Inception date	Fund Balance (as at April 2021) \$ billion	Investment Objective %	Returns (12 months to April 2021) %	Returns since inception %
NSW Generations Fund (NGF)	November 2018	14.7	CPI + 4.5	15.5	8.6
NSW Infrastructure Future Fund (NIFF)	December 2016	12.1	CPI + 2.0	7.6	5.4
Social and Affordable Housing Fund (SAHF)	August 2017	1.6	CPI + 4.0	13.8	8.2
Treasury Managed Fund (TMF)	March 1999	12.3	CPI + 3.5	17.0	7.0

Over the next four years, the State's investment funds are projected to grow by \$18.9 billion, to \$58.9 billion. This is a result of expected returns and additional contributions.

Box 6.2: Supporting Local Governments to deliver local infrastructure

The NSW Government is supporting Local Governments to deliver essential infrastructure through a variety of initiatives.

Investing for the Future

In March 2021, the Government established the \$300.0 million Royalties for Rejuvenation Fund. These funds will be available to help our regional coal mining communities' transition as the global economy moves away from carbon-based energy options.

An expert panel will consider business cases for investments that will benefit coal mining communities.

NSW Treasury Corporation (TCorp) Local Government Lending Facility

Since 2015, the TCorp Local Government Lending program has helped councils invest in local infrastructure. The program ensures that councils can borrow at low interest rates for longer duration.

By the end of 2020-21, the program will have supported a total of \$1.0 billion of loans. Around 80 per cent of lending has been to non-metro areas, enhancing regional councils' ability to invest in local projects.

Examples of recent projects that the program has supported include:

- redevelopment of the Broken Hill CBD and upgrades to recreation facilities
- Shoalhaven City Council's Water Recycling Scheme
- a supported independent living house in Temora Shire Council.

Low-Cost Loans Initiative

The Low-Cost Loans Initiative assists councils with the cost of new infrastructure by funding 50 per cent of the interest paid on infrastructure-related borrowings. This helps bring forward the delivery of infrastructure that enables new housing supply.

Since the initiative was launched, the NSW Government has invested around \$21 million to support over 30 council projects across the State, worth around \$571 million.

Long-Term Investment Opportunities through TCorp

As with State Government, Local Governments across New South Wales are also facing long-term pressures arising from changes in demographics and maintaining sustainable budgets. The NSW Government is enabling Local Governments to better deal with the future challenges and opportunities arising by making available long-term investment options through the State's financial management arm, TCorp. TCorp's core investment products can suit a variety of investment horizons and risk appetites, thus helping Local Governments make the most of their available resources over the longer term.

Box 6.3: Interest rate affordability and refinancing risk

In the first quarter of 2021 global and Australian bond yields have risen from near historic lows. TCorp 10-year bond yields have followed this broader trend, rising from around 1.0 per cent in November 2020 (a record low) to above 1.8 per cent at June 2021. The movement in bond yields has been primarily due to investor expectations of a stronger economic recovery, lower unemployment and a rise in inflation.

The NSW Government's interest expense as a percentage of revenue is estimated to be an average of 3.2 per cent over the four years to 2023-24, which is slightly above the 3.1 per cent projected at the 2020-21 Half-Yearly Review (see Chart 6.2). Even with the increase in yields, the Government's cost of borrowing remains manageable.

Chart 6.2: Net debt and interest expense as a percentage of revenues

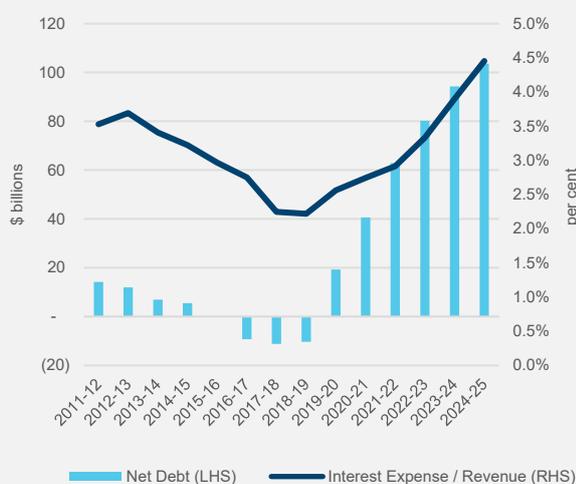
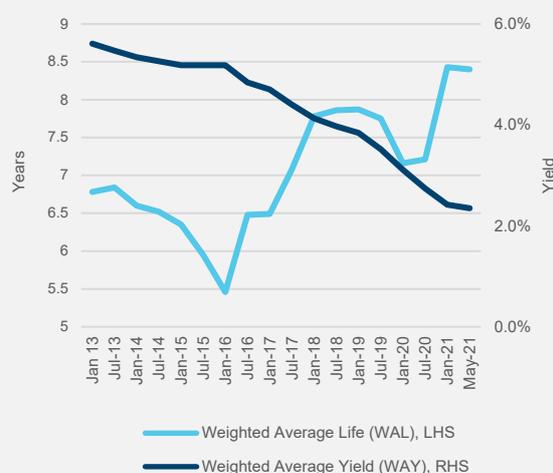


Chart 6.3: Average yields have fallen as the average weighted life of debt has increased



Debt issued since 1 January 2020

The NSW Government is managing both interest rate risk and refinancing risk by issuing longer tenor debt that locks in low rates for an extended period. Since 1 January 2020 the NSW Government has borrowed \$33.0 billion at an average rate of 1.48 per cent. The weighted average life of these new borrowings is 11.3 years. A component of that debt has been issued with a maturity of 30 years.

The Government's borrowing portfolio

The average yield across the entire \$72.9 billion general government borrowing portfolio is 2.4 per cent, a record low. The weighted average life (the period for which that record low weighted average yield is locked in) has also been extended over the past decade to nearly 8.4 years (see Chart 6.3). This means the Government has locked in a lower average interest rate for a longer period, ensuring interest costs are kept as low as possible.

Financial liabilities included in net debt

The liabilities included in the calculation of net debt are projected to be \$90.4 billion at June 2021 and \$171.8 billion at June 2025¹. This position reflects the Government's approach of borrowing during the low interest rate environment to support the economy and invest in infrastructure.

¹ These liabilities include advances received, borrowings and deposits held.

Elevated borrowing levels can create interest rate and refinancing risks (see Box 6.3). The NSW Government's Asset & Liability Committee is chaired by NSW Treasury and comprises of experts from across government. It is monitoring the State's debt position and overseeing active measures to ensure interest costs are minimised.

Net worth remains the strongest of all Australian states

Relative to 2020-21 Half-Yearly Review, general government sector net worth is projected to fall by \$4.9 billion to \$231.4 billion by June 2021 (see Chart 6.4). Net worth is projected to increase to \$234.5 billion by June 2022; the highest of all States and Territories (see Chart 6.5).

Over four years to 2024-25 net worth is forecast to increase by \$44.5 billion to \$275.9 billion. The increase is driven primarily by:

- an increase in the State's non-financial assets of \$43.3 billion from June 2022 to June 2025 for the record infrastructure program
- the growth of the State's investment funds – most notably the NGF, which is expected to increase to around \$40 billion by June 2025
- a reduction in the State's projected superannuation liabilities of \$13.1 billion from June 2022 to June 2025, as the Government progresses its commitment to fully fund its superannuation liabilities by 2040 (see Box 6.4).

Chart 6.4: NSW general government sector net worth to increase by \$44.5 billion over the next four years

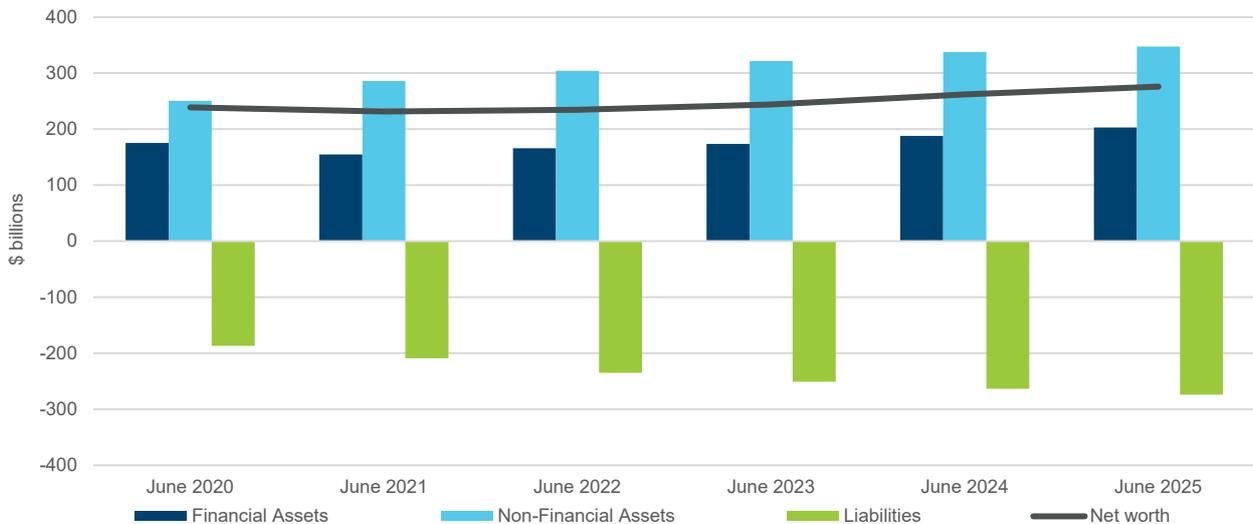
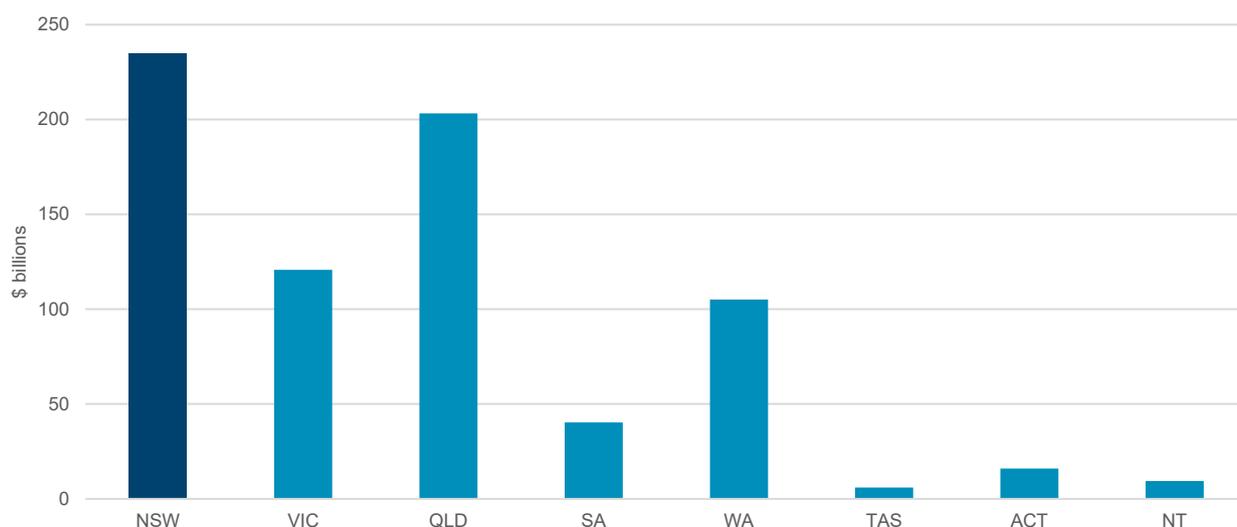


Chart 6.5: General government sector net worth of Australian States and Territories at June 2022^(a)



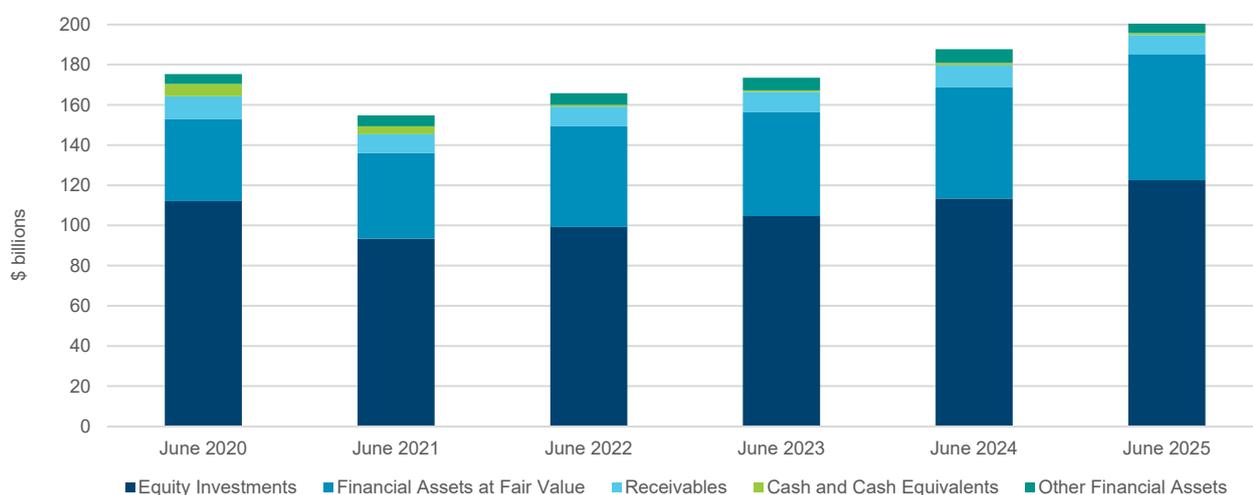
(a) Net worth for SA, TAS and ACT as per their 2020-21 Budget. WA as per their 2020-21 Half-Yearly Review.

Financial assets included in net worth

The State's total financial assets are projected to decline to \$154.7 billion at June 2021 driven by a decrease in investments in other public sector entities, due to a change in an asset valuation in the PNFC sector, consistent with accounting standards.

Financial assets are forecast to reach \$202.8 billion by June 2025 due to the growth in the NGF, the forecast performance of the State's other investment funds, and the increase in the PNFC sector assets (see Chart 6.6).

Chart 6.6: General government sector financial assets increasing over time



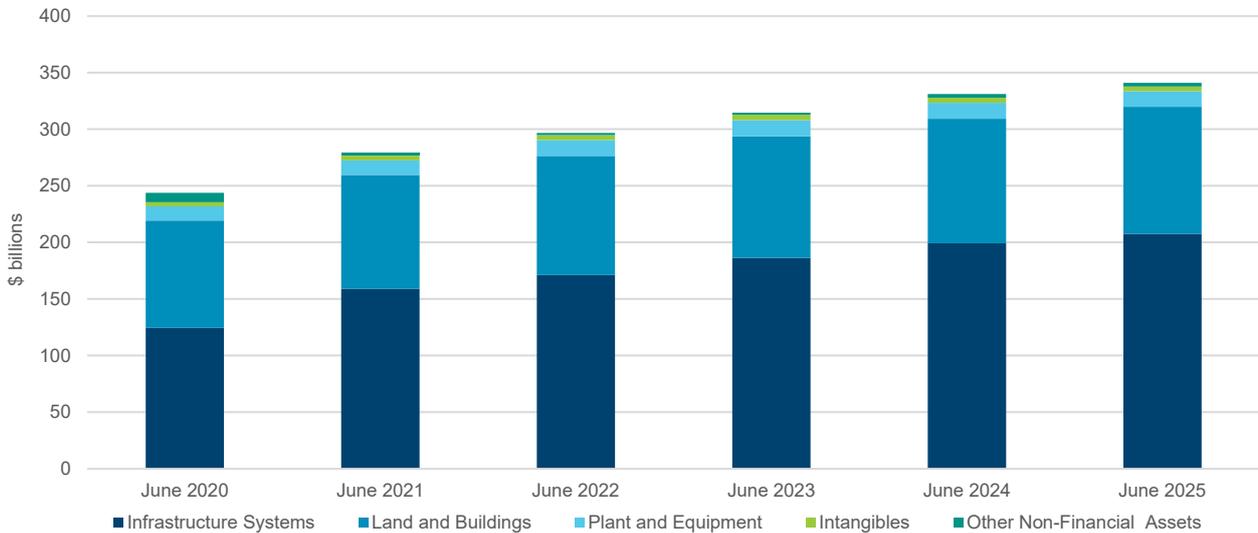
Non-financial assets included in net worth

The State's non-financial assets are projected to reach \$285.7 billion by June 2021 (a \$0.2 billion increase relative to the 2020-21 Half-Yearly Review) and \$347.2 billion by June 2025 (see Chart 6.7). This expected increase to June 2025 is primarily due to:

- the Government's investment in productive infrastructure systems (e.g. public transport infrastructure) – projected to increase from \$158.9 billion at June 2021 to \$207.6 billion by June 2025

- an increase in the value of land and buildings, projected to grow from \$100.6 billion at June 2021 to \$112.2 billion by June 2025. This is primarily due to the Government's record investment in transport, schools and hospitals.

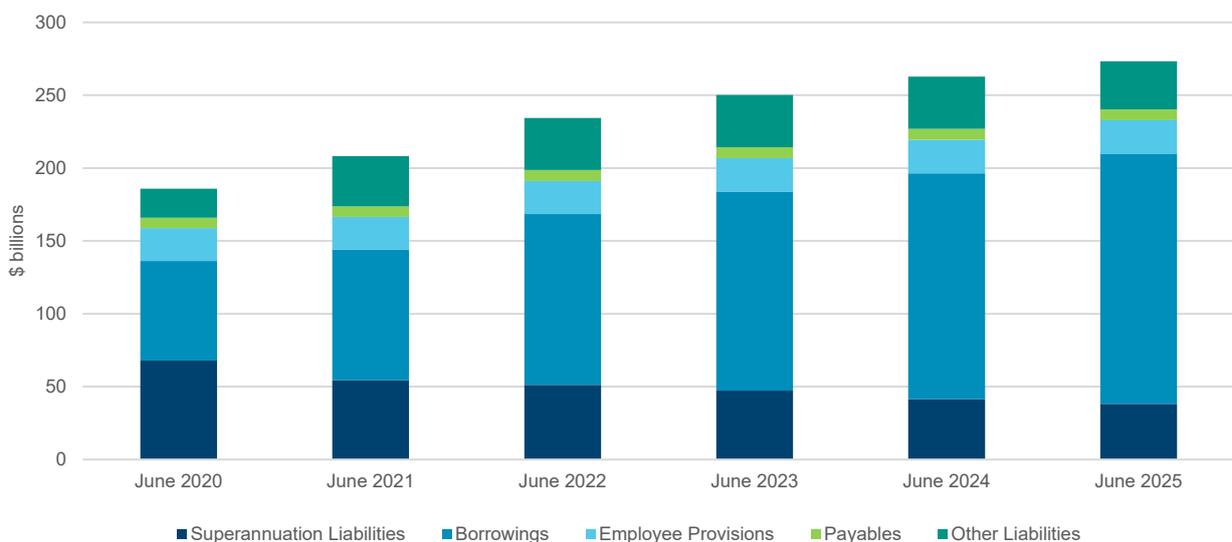
Chart 6.7: General government sector non-financial assets growing over time due to infrastructure investment



Liabilities included in net worth

Total liabilities are projected to be \$209.1 billion at June 2021 and increase to \$274.1 billion by June 2025 (see Chart 6.8). This is predominately driven by the State's increased borrowings to support NSW's economy in the short-term with targeted stimulus, and to continue to deliver the Government's record infrastructure program.

Chart 6.8: Liabilities to stabilise over the forward estimates



Borrowings represent the largest liability category on the general government sector balance sheet and are projected to increase over the forward estimates to \$171.3 billion by June 2025.

The State's second largest liability is its defined benefit superannuation liability which is projected to decrease from \$54.5 billion at June 2021 to \$38.2 billion at June 2025. This is primarily driven by rising long-term bond rates (see Box 6.4).

Employee provisions, including long service leave, are projected to increase marginally over the forward estimates from \$22.3 billion in June 2021 to \$23.2 billion in June 2025.

Box 6.4: Superannuation liability forecast

The NSW Government continues to make progress on its objective to fully fund its defined benefit superannuation liabilities. It is being assisted through the strong investment returns from State Super's financial assets during the year.

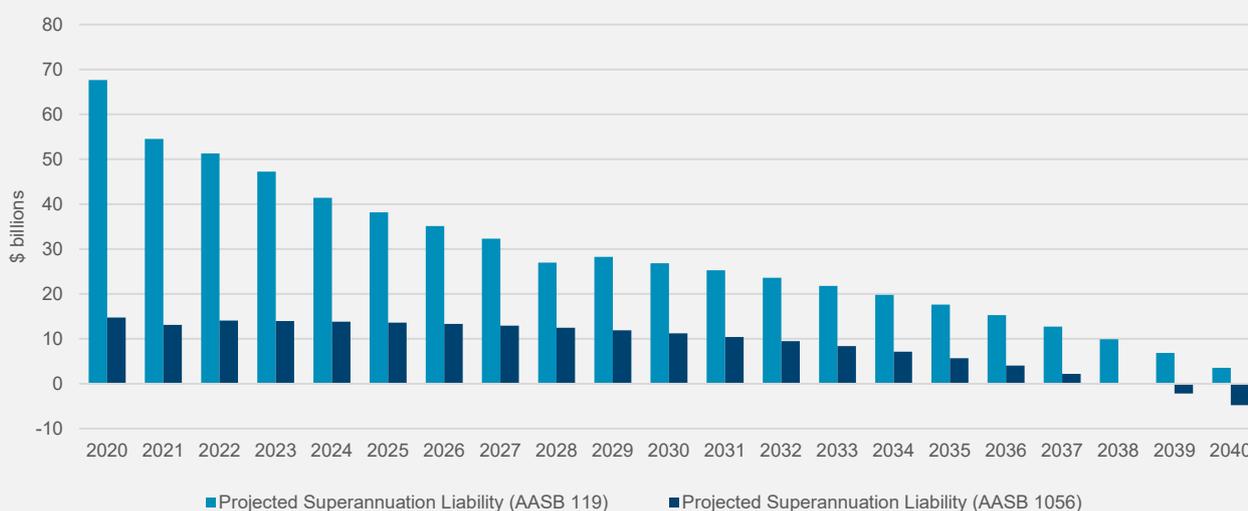
As noted in the 2020-21 Budget, the economic shock caused by COVID-19 put the State's finances under significant pressure. In order to ease some pressure on the State's borrowing requirements, a revised contribution plan was adopted which included a two-year contribution holiday and a re-anchoring of the superannuation target to 2040. Once the current period of heightened uncertainty is over, the NSW Government will table amendments to the *Fiscal Responsibility Act 2012*.

NSW Treasury's actuaries project that the Government is on track to fully fund its defined benefit superannuation liabilities by 2040 under the basis of the Australian Accounting Standards Board (AASB) standard on Superannuation Entities (AASB 1056).

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*. That Accounting Standard creates a larger and more volatile liability² due to very conservative valuation requirements.

AASB 1056 *Superannuation Entities*³ 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 shows the difference between the two accounting standards.

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



² 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 \$10.5 billion.

³ 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 \$13.1 billion at June 2021 and is projected to increase to \$13.6 billion by June 2025. The target of fully funding the State's superannuation liabilities by 2040 is determined using the AASB 1056 basis.