

## 6. MANAGING THE STATE'S ASSETS AND LIABILITIES

- New South Wales is continuing to use its balance sheet to support the long-term productive capacity of the economy, with a \$112.7 billion infrastructure program funded by a mix of borrowings, operating cash surpluses and financial assets (e.g. Restart NSW).
- Despite the fiscal impact of COVID-19 and floods, new borrowings for 2021-22 are projected to be \$3.0 billion lower than at the 2021-22 Half-Yearly Review, supported in part by the accelerated pace of debt retirement from the NSW Generations Fund (including WestConnex sale proceeds).
- Net debt is projected to stabilise from June 2026 onwards at around 14 per cent of GSP before gradually declining towards the end of the decade. This is consistent with the Government's commitment to a sustainable and diversified infrastructure pipeline that supports a strong and resilient construction sector.
- Net worth is projected to be \$271.8 billion by June 2022 which represents a \$28.6 billion improvement from the June 2022 projection at the 2021-22 Half-Yearly Review. This is supported in part by the State's growing asset base.
- The NSW Government is leading by example in applying environmental, social and governance (ESG) considerations to the balance sheet (e.g., Green and Sustainability Bonds, Social Impact Investment), with a review underway to help ensure the Government can remain at the forefront of ESG investing.
- To help diversify the State's investor base and facilitate capital flows towards ESG objectives, the NSW Government has become one of the largest semi-government issuers of Green and Sustainability Bonds in Australia, with \$7.0 billion issued to date.
- The NSW Office of Social Impact Investment is prioritising the first two investment rounds from the \$30 million Social Impact Outcomes Fund to supporting women facing disadvantage and Indigenous youth.

### 6.1 A sustainable approach to balance sheet management

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The Government is aligning the State's financial activities (e.g., investing, issuing bonds, procuring, and stewarding resources) with more sustainable outcomes through a variety of initiatives, including:

- bringing a longer-term focus on ESG risks and opportunities, which will support the Government's commitment to reduce emissions to 50 per cent below 2005 levels by 2030 and net zero emissions by 2050
- investing in energy and low carbon initiatives such as the Transmission Acceleration Facility (\$1.2 billion net maximum impact after recycling proceeds) to accelerate the delivery of the new transmission projects required for Renewable Energy Zones across regional New South Wales (total gross investment, which is intended to be fully recouped, is \$3.1 billion over the next 10 years)
- committing to build the 700-Megawatt Waratah Super Battery (the largest network standby battery in the Southern Hemisphere) to allow Sydney, Newcastle, and Wollongong consumers to access more energy from existing electricity generation following the early closure of Eraring Power Station in 2025

- integrating ESG principles into TCorp's investment decision-making and active ownership of companies, with an ESG Review underway (see Box 6.1)
- meeting investor demand in Green and Sustainability bonds, by adding over \$4.6 billion to the NSW Sustainability Bond Programme's asset pool in 2021-22 (see Box 6.4).

### **Box 6.1: Managing the State's Investment Funds in line with Environmental, Social and Governance (ESG) principles**

The Government recognises the importance of ESG factors in pursuit of longer-term sustainable financial returns alongside delivering a healthier economy, society and environment. Currently, NSW Treasury Corporation manages around \$105 billion of State funds in accordance with its Investment Stewardship Policy.

#### **ESG Review**

Responsible investment advisor Pru Bennett is currently leading a review into the incorporation of ESG factors into the investment processes of TCorp. The ESG Review will consider the existing stewardship policy and practices of TCorp and recommend potential areas of improvement to ensure the State remains at the forefront of ESG investing. The ESG Review is expected to be completed later in 2022.

#### **Divestment of Russian Holdings**

In March 2022, the Treasurer directed TCorp not to purchase further Russian investments and to divest its existing ones to show support for Ukraine. TCorp has since divested all direct holdings of Russian debt. Some portfolios continue to hold Russian equities as the Russian Central Bank has constrained foreign investors' ability to sell these by imposing market access restrictions and capital controls. Markets continue to be monitored for opportunities to complete the divestment process.

#### **ESG Impact on the State's Credit Rating**

In April 2022, Moody's issued New South Wales with a neutral to low ESG Credit Impact Score, reflecting the neutral to low impact ESG factors have on the State's credit rating. Moody's rated the State's exposure to social and governance risks as positive. However, these were offset by a moderately negative exposure to environmental risks arising from climate-change related natural disasters and the carbon transition.

#### **Sustainable Finance Framework**

The soon to be released New South Wales Sustainable Finance Framework will ensure the NSW Government's financial activities are aligned with its environmental and social priorities. It will also help to establish the conditions and tools to support embedding these considerations across the finance sector and economy more broadly. Implementation of the Framework will assist NSW to more effectively manage ESG related risks and capture economic opportunities over the short and long term.

## 6.2 Key balance sheet changes since the 2021-22 Half-Yearly Review

Key balance sheet movements since the 2021-22 Half-Yearly Review (see Table 6.1) include:

- a projected \$5.7 billion decrease in outstanding borrowings to \$105.6 billion at June 2022, primarily driven by the Government's debt retirement program and a \$3.0 billion decrease in new borrowing requirements in 2021-22. This decrease is driven by an improved revenue outlook and a reprofiling of agency expenditure to future years. This is partially offset by the additional spending on economic support measures for floods and the Omicron outbreak
- a projected \$28.6 billion increase in net worth to \$271.8 billion at June 2022 since the 2021-22 Half-Yearly Review. This increase is primarily driven by an increase in equity investments in other public sector entities and a reduction in the valuation of the Government's defined benefit superannuation liability.

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

	June 2021 Actual	June 2022 Revised	June 2023 Budget	June 2024	June 2025 Forward Estimates	June 2026
Total Assets (\$m)	454,096	495,052	514,439	540,643	560,341	579,575
Financial Assets (\$m)	168,211	186,630	189,143	198,548	205,155	212,443
Non-Financial Assets (\$m)	285,884	308,421	325,296	342,095	355,186	367,132
Total Liabilities (\$m)	219,509	223,239	247,236	267,413	281,274	299,260
Net Worth (\$m)	234,587	271,812	267,203	273,230	279,067	280,316
Net Worth as a per cent of GSP <sup>(a)</sup>	36.5	39.6	35.5	34.7	34.4	33.5
Net Debt (\$m)	37,076	53,538	78,169	93,749	105,519	114,814
Net Debt as a per cent of GSP	5.8	7.8	10.4	11.9	13.0	13.7

(a) Gross State Product (GSP) for NSW from June 2022 to June 2026 is forecast by NSW Treasury.

## 6.3 Maintaining sustainable levels of net debt

The Government is committed to maintaining sustainable debt levels over the medium term. This Budget is projecting net debt to be \$105.5 billion at June 2025 (13 per cent of GSP), which remains in line with projections at the 2021-22 Half-Yearly Review. This reflects an improved revenue outlook offset by an increase in investment in the long-term productive capacity of the economy (see Box 3.3) funded by borrowings.

Net debt is projected to stabilise from June 2026 onwards at around 14 per cent before gradually declining towards the end of the decade. This is consistent with the Government's commitment to a sustainable and diversified infrastructure pipeline that supports a strong and resilient infrastructure sector.

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 \$52.9 billion at June 2022, which is \$1.2 billion lower than projected at the 2021-22 Half-Yearly Review. This is primarily driven by a lower cash balance to support the accelerated pace of debt retirement (see Box 6.2). These assets also include the State's investment funds and other assets.

Fund performance to April 2022 was weaker than the prior 12 months, as financial markets have been affected by rising inflation and uncertainty about monetary policy actions to manage it. Nonetheless, longer-term performance remains broadly in line with expectations.

Financial assets at fair value are projected to grow to \$63.4 billion by June 2026, supported by growth in the State's investment funds over the budget and forward estimates. Key Government investment funds are shown in Table 6.2.

Table 6.2: NSW investment funds returns to April 2022

Fund	Inception Date	Fund Balance (as of April 2022) \$ billion	Investment Objective %	FYTD Returns (as of April 2022) %	Returns Since Inception %
NSW Generations Fund (NGF)	Nov-18	15.2 <sup>(a)</sup>	CPI + 4.5	(0.2)	7.0
NSW Infrastructure Future Fund (NIFF)	Dec-16	9.0	CPI + 2.0	(2.9)	4.2
Social and Affordable Housing Fund (SAHF)	Aug-17	1.6	CPI + 4.0	(1.8)	6.7
Treasury Managed Fund (TMF)	Mar-99	12.7	CPI + 3.5	(0.8)	6.8

(a) This does not include cash set aside for debt retirement.

The Snowy Hydro Legacy Fund (SHLF) was established only in December 2021, seeded by a portion of the Snowy Hydro sale proceeds. As such, there has been insufficient time to establish a robust track record for its returns. As of April 2022, the SHLF's balance was \$1.6 billion, with commitments identified for regional projects.

Other financial assets included in the calculation of net debt include cash and cash equivalents. Since the 2021-22 Half-Yearly Review, cash and cash equivalents are projected to decrease by \$2.0 billion to \$3.1 billion at June 2022. This is driven by the Government accelerating the pace of debt retirement using the NGF in 2021-22 (see Box 6.2).

## Financial liabilities included in net debt

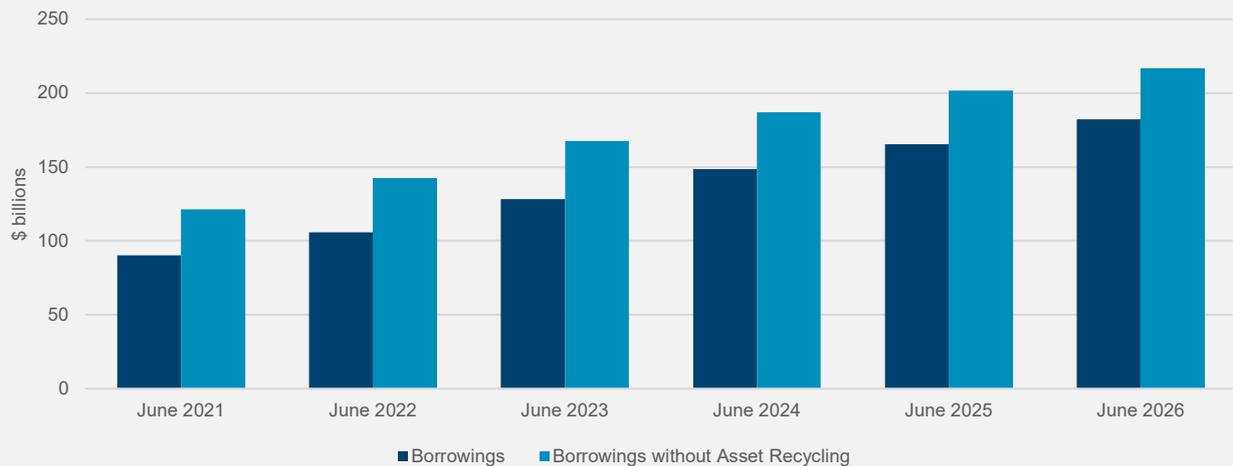
Financial liabilities included in the calculation of net debt are projected to be \$106.5 billion at June 2022. These liabilities include borrowings (including leases), advances received, and deposits held.

Projected borrowings at amortised cost for 2021-22 have decreased by \$5.7 billion since the 2021-22 Half-Yearly Review. This reduction is primarily driven by the Government's debt retirement program (see Box 6.2) and a \$3.0 billion decrease in new borrowing requirements in 2021-22.

### Box 6.2: Managing Debt Sustainably

Since January 2022, \$7.7 billion of State debt has been retired using the NGF, including a \$4.3 billion benchmark bond maturing in March 2022. This is possible because of the sale of WestConnex in 2021. Consequently, projected debt retirement has been brought forward since the 2021-22 Half-Yearly Review, with the remaining \$3.3 billion to be retired in 2022-23. Along with previous asset recycling initiatives, this has reduced the debt burden in future years (see Chart 6.2).

Chart 6.2: Asset recycling has reduced borrowings



For 2022-23, projected borrowing requirements have increased by \$2.0 billion since the 2021-22 Half-Yearly Review. Higher borrowing requirements have been driven by additional support measures for the Government's COVID-19 response (see Box 5.2) and flood relief (see Box 5.3), and an increase in Government investment to support the long-term productive capacity of the economy (see Box 3.3).

To take pressure off the State's cash requirements in 2021-22, the Government suspended contributions to the NGF. That suspension has now been extended to 2022-23. Contributions to the NGF are projected to resume in 2023-24, when the cash operating position is projected to return to a surplus of \$3.8 billion.

Financial liabilities included in the calculation of net debt are forecast to grow to \$182.8 billion by June 2026. The projection for financial liabilities by June 2025 has increased since the 2021-22 Half-Yearly Review, primarily due to a \$4.3 billion increase in borrowings.

Elevated borrowing levels create interest rate and refinancing risks (see Box 6.3). The NSW Government seeks to reduce these risks where possible through various measures including extending the average maturity of liabilities in the portfolio and diversifying the investor base. The bulk of the borrowings portfolio is fixed rate bonds.

**Box 6.3: Interest rate affordability and refinancing risk**

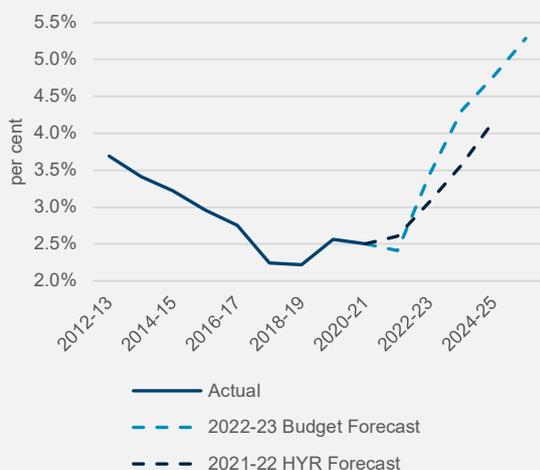
Since 2020, TCorp 10-year bond yields have risen from around 1.0 per cent (a record low reached in November 2020) to over 4.0 per cent in June 2022. This follows a similar trajectory to Australian Government 10-year bonds and is primarily due to investor expectations of a stronger economic recovery, record low unemployment, a sharp rise in inflation and continued global shocks. Consequently, interest expense projections have also risen (see Chart 6.3).

The NSW Government's interest expense as a percentage of revenue is estimated to be an average of 3.7 per cent over the four years from 2021-22 to 2024-25, which is above the 3.4 per cent projected at the 2021-22 Half-Yearly Review (see Chart 6.3). Even with the increase in yields, the cost of Government borrowings remains manageable and below 5 per cent of revenue on average over the forward estimates.

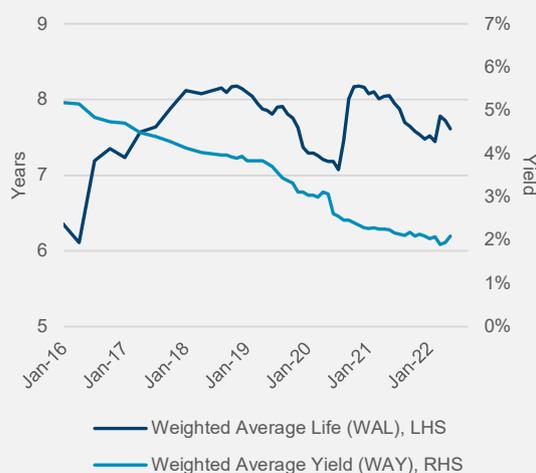
**The Government's borrowing portfolio**

Despite the sharp rise in Australian bond yields, the weighted average yield across the general government borrowing portfolio remains at around 2.1 per cent. Additionally, the weighted average life (the period for which that low weighted average yield is locked in) is approximately 7.6 years (see Chart 6.4). The Government has proactively locked in a lower average interest rate for a longer period, limiting the increase in interest expense even as bond yields rise.

*Chart 6.3: Interest Expense to Revenue - Budget vs Half-Yearly Review*



*Chart 6.4: Average yields have fallen as the average weighted life of debt has increased*



**6.4 Net worth continues to grow**

Relative to 2021-22 Half-Yearly Review, general government sector net worth is projected to increase by \$28.6 billion to \$271.8 billion by June 2022. This is primarily driven by an increase in investments in other public sector entities and a reduction in borrowing requirements.

From June 2023 to June 2026 net worth is forecast to increase by \$13.1 billion to \$280.3 billion (see Chart 6.5). This increase is driven primarily by a stronger cash operating position over the forward estimates, an increase in investments in other public sector entities and the growth of the State's investment funds.

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

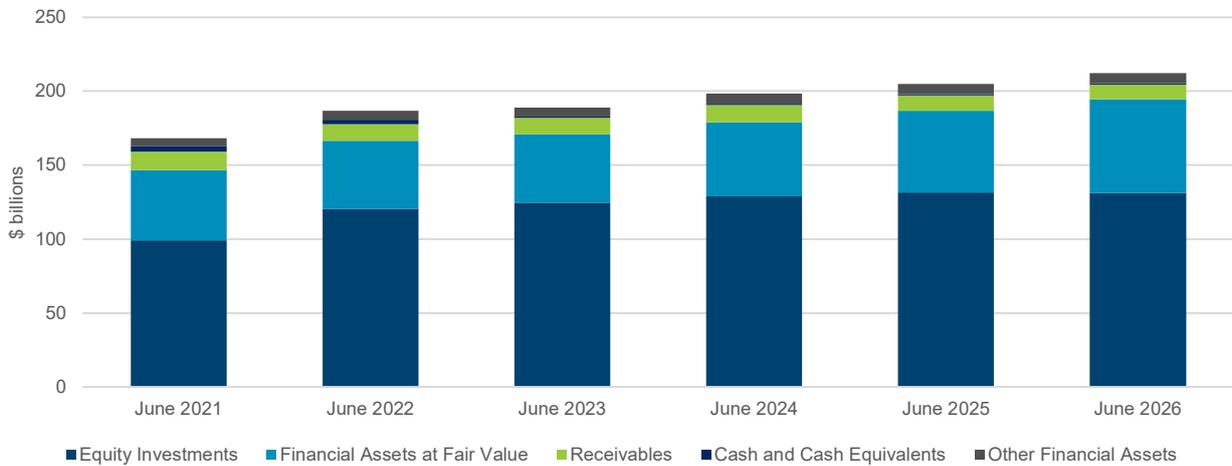


### Financial assets included in net worth

The State's total financial assets are projected to rise to \$186.6 billion at June 2022 (see Chart 6.6). Financial assets are forecast to reach \$212.4 billion by June 2026 driven by the expected returns of and contributions into the State's investment funds.

The Government's projected total financial assets in June 2022 will increase by \$10.0 billion compared to the 2021-22 Half-Yearly Review, primarily driven by a \$10.4 billion valuation increase in equity investments in other public sector entities including NSW Land and Housing Corporation.

Chart 6.6: General government sector financial assets increasing over time

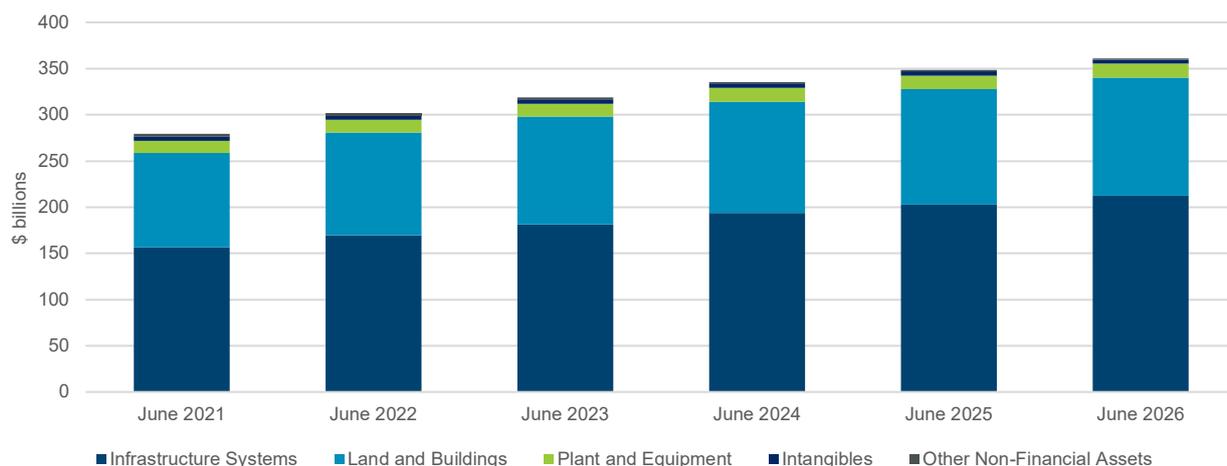


### Non-financial assets included in net worth

The State's non-financial assets are projected to reach \$308.4 billion by June 2022 (a \$4.6 billion increase relative to the 2021-22 Half-Yearly Review) and \$367.1 billion by June 2026 (see Chart 6.7). This expected increase to June 2026 is primarily due to:

- a projected increase in the State's productive infrastructure systems of \$31.1 billion from June 2023 to June 2026 driven by investment in public transport infrastructure
- a projected increase in the value of land and buildings, projected of \$11.7 billion from June 2023 to June 2026 driven by investment in transport, schools, and hospitals.

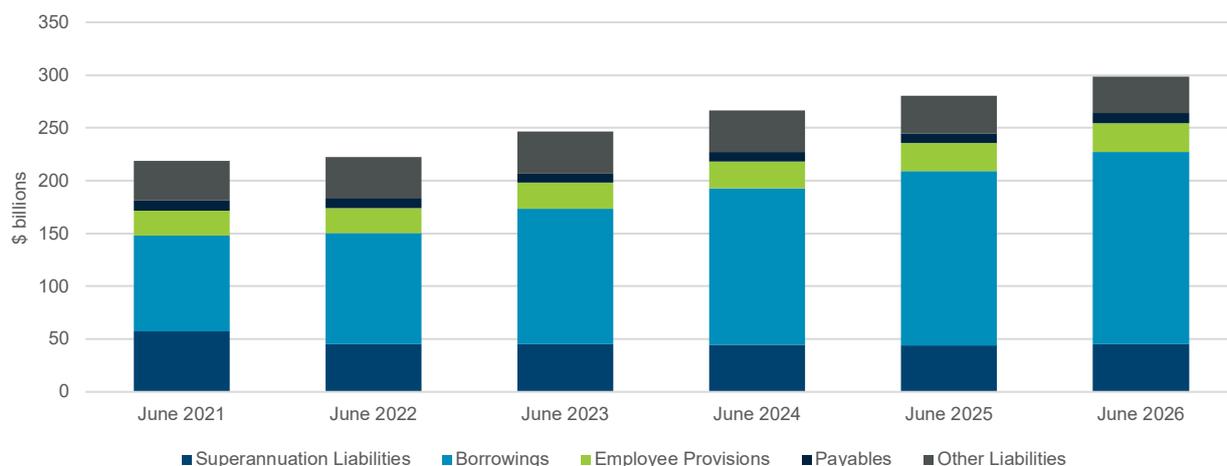
**Chart 6.7:** *General government sector non-financial assets growing over time due to infrastructure investment*



### Liabilities included in net worth

Total liabilities are projected to be \$223.2 billion at June 2022 and increase to \$299.3 billion by June 2026 (see Chart 6.8). This is predominately driven by the State's increased borrowings to deliver the Government's record infrastructure program.

**Chart 6.8:** *Liabilities to increase 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 from \$105.6 billion at June 2022 to \$182.2 billion by June 2026. 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 Programme (see Box 6.4), lengthening the maturity profile and issuing different types of fixed interest instruments to appeal to a broader set of investors.

The second largest category is the defined benefit superannuation liability, the valuation of which is sensitive to long-term Commonwealth Government bond rates. Forecasted movements in the Commonwealth Government bond rate over the forward estimates result in a June 2026 valuation that is similar to the June 2022 valuation. Superannuation liabilities are projected to gradually decline over the medium term as the Government makes progress towards full funding.

As noted in the 2020-21 Budget, the Government suspended contributions into its defined benefit schemes for two years. The Government also re-anchored its target for superannuation liabilities to be fully funded from 2030 to 2040, considering the pressure COVID-19 placed on the State's finances. Contributions into defined benefit schemes will resume in 2022-23.

As of 30 June 2021, PricewaterhouseCoopers confirmed that the Government is on track to meet its commitment towards its 2040 full funding target in the latest triennial review of the Pooled Fund (which represents the vast majority of the Government's defined benefit superannuation liabilities). Once the current period of heightened uncertainty is over, the Government will progress amendments to the *Fiscal Responsibility Act 2012* to reflect the 2040 full funding target.

Employee provisions, including long service leave, are projected to increase marginally over the forward estimates from \$23.7 billion in June 2022 to \$27.3 billion in June 2026.

#### **Box 6.4: NSW Government and Impact Investing**

Investors are increasingly recognising the broader environmental and social profiles of governments and the private sector. The NSW Government is a leader in this space, having the largest sustainability bond program in Australia and launching Australia's first two social impact bonds in 2013.

##### **NSW Sustainability Bond Programme (SBP)**

The SBP enables the NSW Government to diversify the State's investor base and facilitate capital flows towards ESG objectives, with \$7.0 billion in Green and Sustainability bonds issued to date. Proceeds are earmarked to finance or refinance assets and projects with transparent and positive environmental and/or social outcomes.

In 2021-22, the Office of Social Impact Investment, TCorp and the Office of Energy and Climate Change added over \$4.6 billion to the SBP asset pool. Diversification was also achieved by including more social assets and projects, such as the Critical Communications Enhancement Program and Social Housing Maintenance Stimulus Program.

##### **Social Impact Investments Delivered to Market**

Understanding the role of impact investing in driving better services, outcomes and value, New South Wales has delivered another seven investments since 2013 through the Office of Social Impact Investment in partnership with for-purpose and for-profit sectors (see Table 6.3).

A key social impact investment initiative includes Foyer Central, which provides 18 to 22 year old out-of-home care (OOHC) leavers with a stable, affordable home and tailored, strengths-based, 24/7 support to develop skills to lead independent and fulfilling lives. Opened in 2021, this is the first Foyer globally to be financed through a Social Impact Bond, attracting investment from private investors and funding from the Commonwealth.

These investments demonstrate that the principles of social impact investment have potential to help empower the people of New South Wales to live better lives. These principles include a focus on outcomes, innovation, prevention and partnerships. Learnings from these investments form the basis of the State's second Social Impact Investment Policy.

*Table 6.3: Timeline of Key Social Impact Investment Initiatives*

Year	Key Initiatives
2015	Inaugural Social Impact Investment Policy launched
2016	On TRACC (recidivism) social impact investment began
2017	Resolve (mental health) and Silver Chain (palliative care) social impact investments commenced
2018	Resilient Families (family preservation) the first social impact bond to mature in Australia, the program continued under a payment-by-results contract
2019	Sticking Together Project (youth employment) and Home and Healthy (homelessness) social impact investments began
2020	Newpin (family restoration) social impact bond matured, the program continued under a payment-by-results contract
2021	Youth Employment Social Impact Program and Foyer Central (OOHC leavers) social impact investments commenced
2022	Second Social Impact Investment Policy launched

### **New Social Impact Investment Initiatives**

Enabled by the \$30 million Social Impact Outcomes Fund, the Government is piloting innovative cross-sector solutions, including the recently announced market opportunity focusing on advancing women's economic wellbeing through social enterprises.

Recognising the need to invest in capability building, the Government will also allocate \$1.3 million over two years from 2022-23 to establish a Social Enterprise Grant Program for women-focused social enterprises. The Grant Program will support social enterprises that are focused on delivering outcomes for women to receive tailored capability-building support to develop, grow or scale up their business.