7. MANAGING THE STATE'S ASSETS AND LIABILITIES

- The Government is implementing an agenda of financial reforms to enable better use of the State's assets and more efficient management of the State's liabilities, creating a more resilient balance sheet.
- As the Government invests asset recycling proceeds into the State's $72.7 billion infrastructure program, general government assets are projected to reach $399.5 billion by June 2021, increasing by $42.0 billion over four years.
- General government liabilities are expected to increase by $6.7 billion over the four years to June 2021, with a $9.7 billion decrease in superannuation liabilities being offset by a $12.7 billion increase in borrowings (including new finance leases) and higher payables.
- For the second consecutive year, general government net debt is expected to be negative. Net debt of -$7.8 billion at June 2017 represents an historic low of -1.4 per cent of GSP.
- As the Government rolls out its infrastructure program, net debt is forecast to increase to 2.7 per cent of GSP by June 2021. However, New South Wales is still forecast to maintain the lowest net debt as a percentage of GSP of the mainland states over the next four years.
- New South Wales is projected to be the first state to have a net worth of more than one quarter of a trillion dollars, with net worth forecast at $273.2 billion by June 2021. This represents an increase by $35.6 billion over four years, with an annual average growth of 8.5 per cent, the highest growth of all the mainland states.
- The strength of the State's balance sheet is reflected in the State's triple-A credit rating.

7.1 Reforming the State's balance sheet

The Government continues to enhance how New South Wales manages its finances, including balance sheet and financial risk management. This work helps protect the State's finances from downside shocks whilst unlocking fiscal capacity that can be used to improve outcomes for the people of New South Wales.

The Government takes a whole-of-government approach to balance sheet and financial risk management. This ensures:

- financial assets and liabilities are effectively and efficiently managed through a robust centralised approach
- the State has access to liquidity to fund the State's operations and ensure a prudent buffer is maintained
- the investment of any surplus cash considers both future requirements and the State's risk profile
- funding costs are minimised, while investment returns are maximised
- government can plan ahead and adjust its management of assets and liabilities to maximise opportunities and mitigate risk
- key balance sheet decisions are managed within the State's legislative framework.

Box 7.1: Asset and Liability Committee informing smarter balance sheet decisions

The International Monetary Fund and World Bank have acknowledged the potential of an Asset and Liability Committee (ALCO) to improve balance sheet management in the government sector. The NSW Government's creation of a whole-of-government ALCO in 2015 was a world-first for government.

ALCO advises the Treasury Secretary and brings commercial best practice, including asset and liability matching, observations of natural hedges, and stress testing. This allows government to make smarter decisions about the State's balance sheet.

Since the establishment of ALCO, the Government has implemented a number of reforms, including:

- the establishment of the New South Wales Infrastructure Future Fund (NIFF) (see Box 7.2), with an expected balance of $14.8 billion at 30 June 2017
- the establishment of the Social and Affordable Housing Fund (SAHF) (see Box 7.2), with available cash of $1.1 billion
- further cash and liquidity management reforms, including cash management reforms which have already centralised approximately $4.0 billion of cash into the Treasury Banking System with up to an additional $1.0 billion planned for 2017-18
- the staged retirement of debt held by the assets divested by the State
- improved debt management and the adoption of a smoother, longer-dated borrowing profile for the State, including the issue of a 2027 benchmark bond by TCorp in March 2017
- tighter management of borrowing requirements which, along with other strategies including asset recycling, has helped New South Wales maintain lower net debt as a percentage of GSP than other mainland states.

The Government is focused on improving the performance of its debt portfolio through the use of active debt management strategies aimed at lowering overall funding costs, mitigating risks and maintaining an appropriate maturity profile for its debt portfolio.

Following the successful partial long-term lease of Ausgrid and Endeavour Energy in 2016-17, net debt is once again projected to be negative, at -$7.8 billion as at 30 June 2017, surpassing the record low outcome for June 2016. The Government will keep net debt at sustainable levels with net debt as a percentage of GSP forecast to be lower than all mainland states at -1.4 per cent to 2.7 per cent from June 2017 to June 2021.

The NSW Government's successful asset recycling strategy is helping deliver a $72.7 billion infrastructure program. Proceeds from other transactions are also being reinvested to fund essential infrastructure that will enhance the State's productive capacity and provide improved services to the people of New South Wales. The Government is using its cash and financial investment holdings to support these commitments rather than relying solely on debt.

7.2 General government sector

The balance sheet includes the forecast value of all assets, liabilities and net worth estimated at the end of each financial year for the budget year and forward estimates. Table 7.1 outlines the key balance sheet aggregates for the GGS across the budget year and forward estimates.

Total assets are projected to be $348.9 billion at June 2017, increasing to $399.5 billion by June 2021. The total asset position includes financial and non-financial assets.

Total liabilities are projected to be $123.9 billion at June 2017, increasing to $126.3 billion by June 2021.

Table 7.1 Key balance sheet aggregates of the general government sector

	June 2016 Actual	June 2017 Revised	June 2018 Budget	June 2019	June 2020 Forward Estimates	June 2021
Total Assets ($m)	316,278	348,855	357,525	372,135	386,509	399,484
Financial Assets ($m)	144,618	166,309	161,289	160,168	163,030	166,684
Non-Financial Assets ($m)	171,660	182,545	196,235	211,968	223,479	232,799
Total Liabilities ($m)	134,478	123,938	119,665	121,157	123,835	126,317
Net Worth ($m)	181,799	224,917	237,859	250,978	262,674	273,166
Net Worth as a per cent of GSP	33.8	39.5	39.8	40.2	40.2	39.9
Net Debt ($m)	(57)	(7,788)	(521)	9,864	15,850	18,583
Net Debt as a per cent of GSP	(0.0)	(1.4)	(0.1)	1.6	2.4	2.7

Financial assets

Financial assets are expected to be $166.3 billion at June 2017, with a minor increase to $166.7 billion by June 2021. They include cash, receivables, financial investments and equity investments and are typically invested by the State to match against future liabilities and manage liquidity needs.

Cash balances have fallen during 2016-17 primarily due to investment in the Government's infrastructure program and investing cash previously held in the Restart NSW cash account into other financial assets managed through the NIFF (see Box 7.2). The NIFF makes better use of Restart NSW resources by better matching investment profiles with the State's infrastructure delivery timetable. Accordingly, higher returns can be earned within acceptable risk parameters while the funds are waiting to be used. Investment strategies used for the NIFF ensure the State maintains an adequate level of liquidity against its obligations.

Overall, non-equity financial asset holdings are forecast to decrease by $14.2 billion from June 2017 to June 2021 driven primarily by a reduction in cash and other financial assets (NIFF) associated with investment in infrastructure (see Chart 7.1).

Box 7.2: More active management of the State's financial assets – NIFF and SAHF

New South Wales Infrastructure Future Fund (NIFF)

In December 2016, the NIFF was established by the NSW Government as part of its active management approach to the State's balance sheet. The net proceeds from the State's asset recycling program are being invested into the NIFF, which is managed by TCorp and is expected to have a balance of $14.8 billion by 30 June 2017.

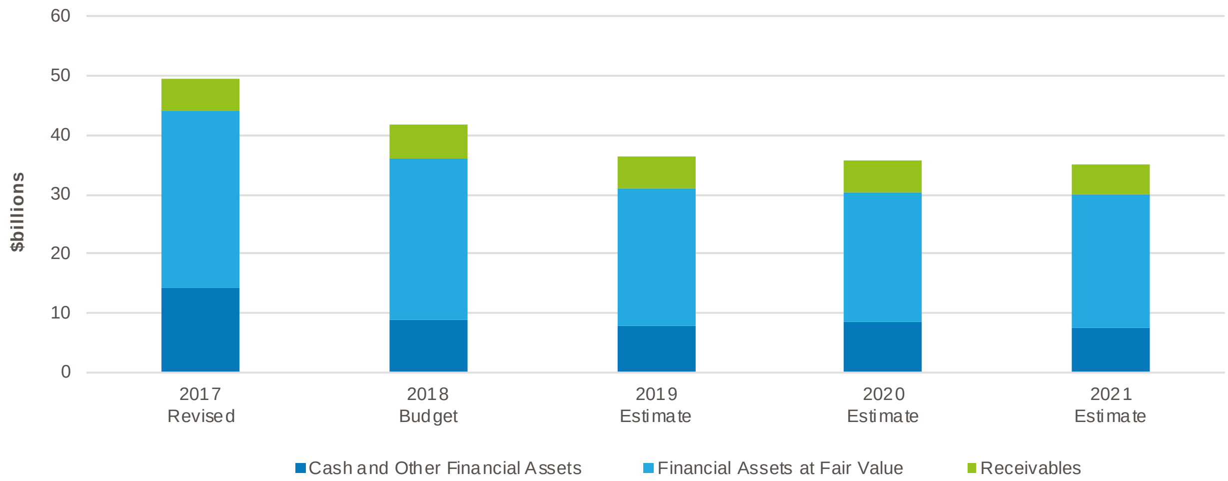
This approach makes the best use of the State's large cash holdings and delivers better returns over time within acceptable risk parameters to the State. Funds raised are invested through the NIFF until the Government requires them for critical infrastructure projects as part of the Restart NSW and Rebuilding NSW program of works.

ALCO and TCorp provide advice on the NIFF's performance and management. The NIFF's long-term investment return targets are expected to result in the fund yielding significantly higher returns than the Government's cash portfolio.

Social and Affordable Housing Fund (SAHF)

The Government has also established the SAHF to provide funding for social and affordable housing. About $1.1 billion has been deposited into the SAHF and these funds will be invested by TCorp through a SAHF Investment Trust. By actively managing these funds, the volume of housing that can ultimately be provided can be increased. ALCO oversees the SAHF to ensure a careful investment approach to the risk/return trade-off, in recognition of the importance of maintaining funding certainty for new social and affordable housing stock.

Chart 7.1 Non-equity financial assets of the general government sector at 30 June



The Government also holds equity investments, predominantly in public non-financial corporations (PNFCs) and public financial corporations (PFCs). These deliver transport, housing, electricity, water and other services on behalf of the State and include the 49.6 per cent shareholdings of both Ausgrid and Endeavour Energy. The general government's equity investments are projected to be worth $116.9 billion at June 2017. For further detail on the performance of PNFCs and PFCs, refer to Chapter 8 of this *Budget Statement*.

Non-financial assets

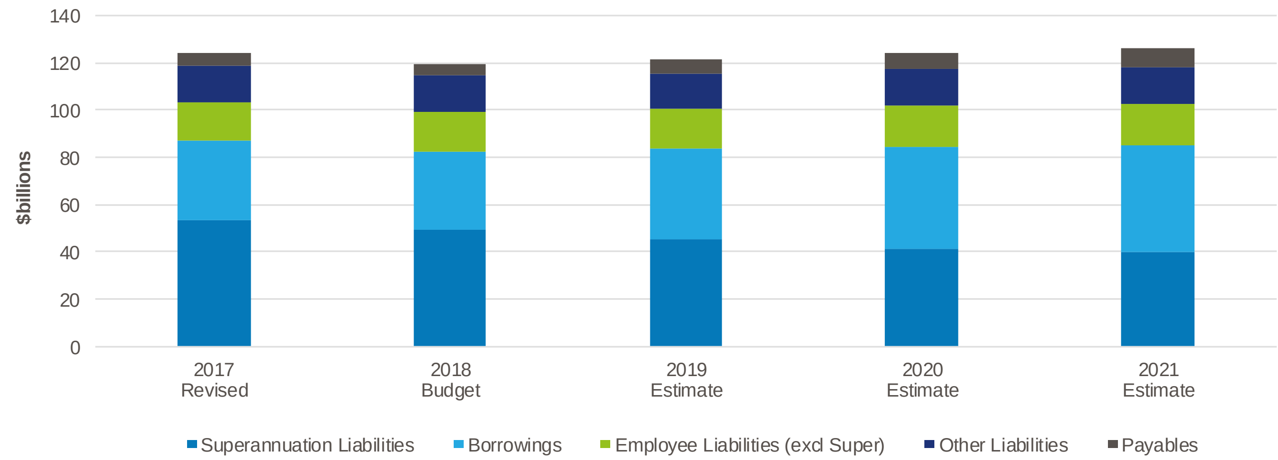
Total non-financial assets are projected to be $182.5 billion at June 2017, increasing to $232.8 billion by June 2021. This increase is driven by record levels of infrastructure investment in transport, health, and education, enabled by strong balance sheet management including the Government's asset recycling strategy. Further information on the Government's infrastructure program is provided in Budget Paper No. 2 *Infrastructure Statement*.

Liabilities

The State's liabilities represent contractual obligations of the government to pay another entity and are usually incurred in the normal course of delivering government services. The Government continues to efficiently manage and service its liabilities as part of its active approach to balance sheet management, which will help reduce balance sheet risk over the coming years. This includes the Government's reforms to Insurance and Care NSW (icare) to deliver better public services through more effective administration of the State's managed fund schemes (see Chapter 8 of this *Budget Statement*).

Total liabilities are projected to be $123.9 billion at June 2017 and $126.3 billion by June 2021. The composition and projection of GGS liabilities are shown in Chart 7.2.

Chart 7.2 Liabilities of the general government sector at 30 June



Superannuation liabilities are the largest category of liabilities that the GGS holds and are expected to total $53.7 billion by 30 June 2017. This liability is forecast to fall to $39.8 billion by June 2021. The lower liability reflects the Government's commitment to eliminate the GGS unfunded superannuation liability by 2030, consistent with the *Fiscal Responsibility Act 2012.*

A comprehensive review of the condition and sufficiency of the defined benefit superannuation schemes is carried out by the schemes' actuary every three years. At the time of the last review in December 2015, the Government's current funding plan was assessed as being reasonable to deliver full funding of the liability by 2030. The next full triennial review is due to be completed in 2018.

There are two methods for valuing unfunded superannuation. The underlying funding of superannuation liabilities should be considered on a funding basis rather than a financial reporting basis, as the funding basis uses more relevant forecasts of superannuation fund earnings to provide a better estimate of unfunded liabilities. For funding purposes, AASB 1056 *Superannuation Entities* is used, which assumes the forecast long-term fund earnings rate as the discount rate for the superannuation liability. The liability for reporting purposes as presented in the balance sheet is calculated in accordance with AASB 119 *Employee Benefits*, and is based on Commonwealth Government 10-year bond yield forecasts. On a funding basis, the estimated superannuation liability at 30 June 2017 is $13.5 billion.

Borrowings, through direct debt raising or leasing arrangements, form the next largest category of liabilities. The GGS is projected to hold $32.0 billion of borrowings at June 2017, with borrowings increasing by $13.3 billion across the forward estimates.

Net debt

Net debt measures the Government's ability to repay its debt. Net debt is calculated as the sum of borrowings, deposits held and advances received, minus the sum of cash and cash equivalents, investments, loans and placements and advances paid.

The proceeds from the successful completion of the Ausgrid, Endeavour Energy and Land and Property Information transactions has resulted in a significant improvement in GGS net debt position, projected to be - $7.8 billion at 30 June 2017.

The government has taken a proactive approach to the retirement of debt from Ausgrid and Endeavour Energy (see Box 7.3). The retirement of Ausgrid and Endeavour Energy debt does not impact general government net debt, but does impact at the total state sector level (see Box 7.3).

Box 7.3: Retirement of debt as a result of the electricity networks transactions

The $9.5 billion Ausgrid debt retirement strategy was implemented before the organisation was partially leased in December 2016, and was successfully completed by April 2017. The purpose of the strategy was to proactively manage the risks associated with the retirement of Ausgrid debt, resulting in a better overall outcome for the State.

This proactive approach enabled around $2.8 billion of Ausgrid term debt to be reallocated to other government agencies with borrowing needs. This lowered the costs associated with debt retirement by reducing the amount of debt to repurchase from the market after the partial leasing of Ausgrid.

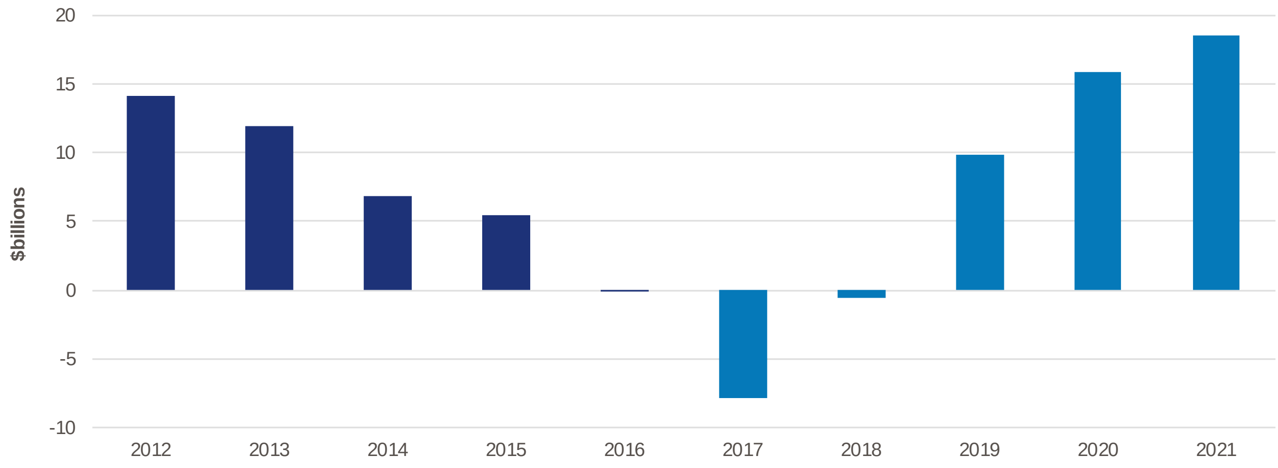
Due to the debt repayment occurring during a period of historically low interest rates, some capital losses were incurred by Ausgrid as part of the transaction. Market and interest rate risks were managed as part of the strategy, which enabled the orderly retirement of debt from the market with minimal disruption.

A similar strategy is underway for Endeavour Energy, with savings already being realised.

In this Budget, the Government is recognising the financial impact of stage 3 of WestConnex (see Box 1.5 of Budget Paper 2 – *Infrastructure Statement*). However, in line with usual budget practice, the planned sale of at least a 51.0 per cent share of Sydney Motorway Corporation will not be recognised in the budget until the transaction is complete.

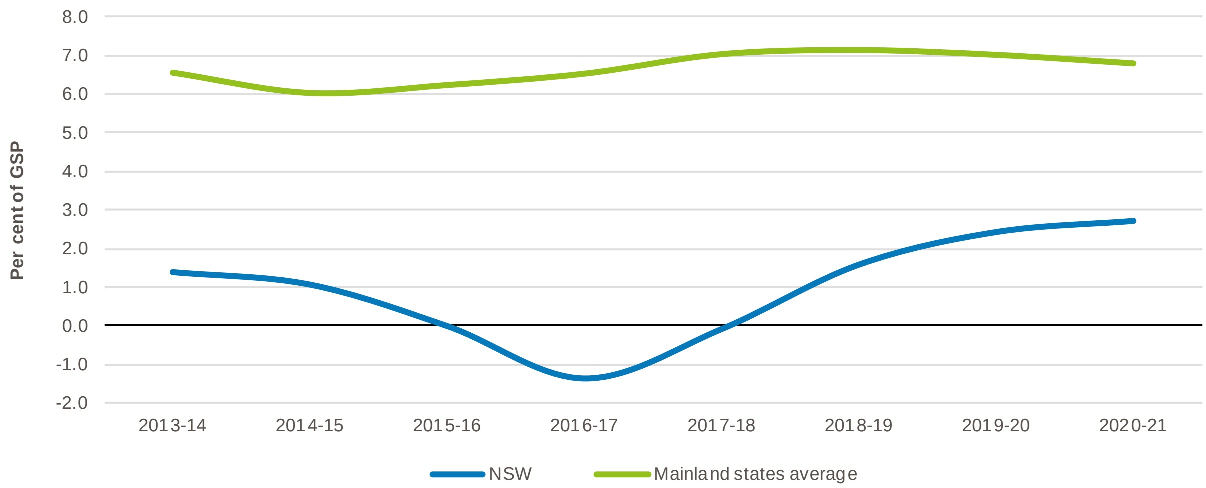
Net debt is projected to increase to $18.6 billion by June 2021 (Chart 7.3), driven by the reinvestment of asset recycling proceeds into the State's infrastructure program.

Chart 7.3 General government net debt at 30 June



At 30 June 2017, GGS net debt is forecast to be the lowest since records began in 1996-97. The current estimate of net debt as at 30 June 2017 is projected to be -1.4 per cent of GSP, lower than the average of all mainland states (see Chart 7.4).

Chart 7.4 General government net debt as a per cent of GSP for mainland states at 30 June



Source: Latest publicly available data for each jurisdiction
Note: Net debt for Queensland has been adjusted for superannuation liabilities that are fully funded
Projections for 2020-21 have been calculated for some jurisdictions based on prior year growth where data is not yet available

Box 7.4: Total state sector net debt

The total state sector (TSS) comprises the general government sector (e.g. Ministry of Health), the public non-financial sector (e.g. Sydney Water Corporation) and the public financial sector (e.g. New South Wales Treasury Corporation).

Total state sector net debt is projected to be $23.5 billion at 30 June 2017, which is lower than estimated at the 2016-17 Budget due to both the retirement of electricity network debt over the forward estimates and the receipt of proceeds from the Land and Property Information, Ausgrid and Endeavour Energy transactions (see Table 7.2).

Total state sector net debt is projected to increase to $57.4 billion by 30 June 2021. This increase is driven by infrastructure spending by both general government agencies and public non-financial corporations.

Table 7.2 Key balance sheet aggregates of the total state sector

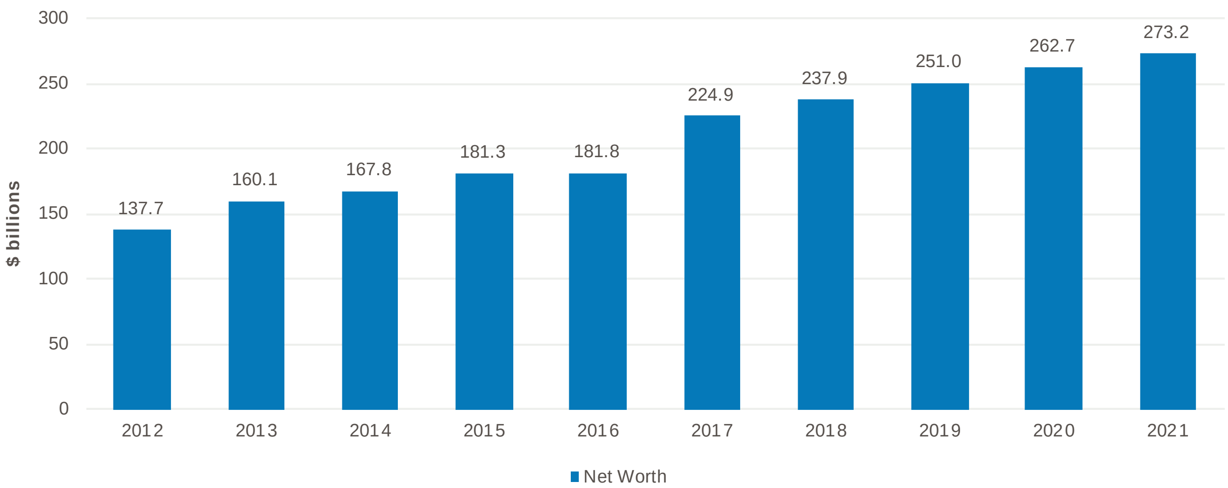
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
	Actual	Revised	Budget		Forward Estimates	
Total Assets ($m)	376,944	399,691	410,055	426,722	440,208	452,666
Total Liabilities ($m)	195,145	174,772	172,219	175,765	177,551	179,515
Net Debt ($m)	38,053	23,459	36,945	48,383	54,047	57,446
Net Debt as a per cent of GSP	7.1	4.1	6.2	7.7	8.3	8.4

7.3 Net worth

Net worth reflects the financial value of the State to the people of New South Wales and comprises total assets less total liabilities.

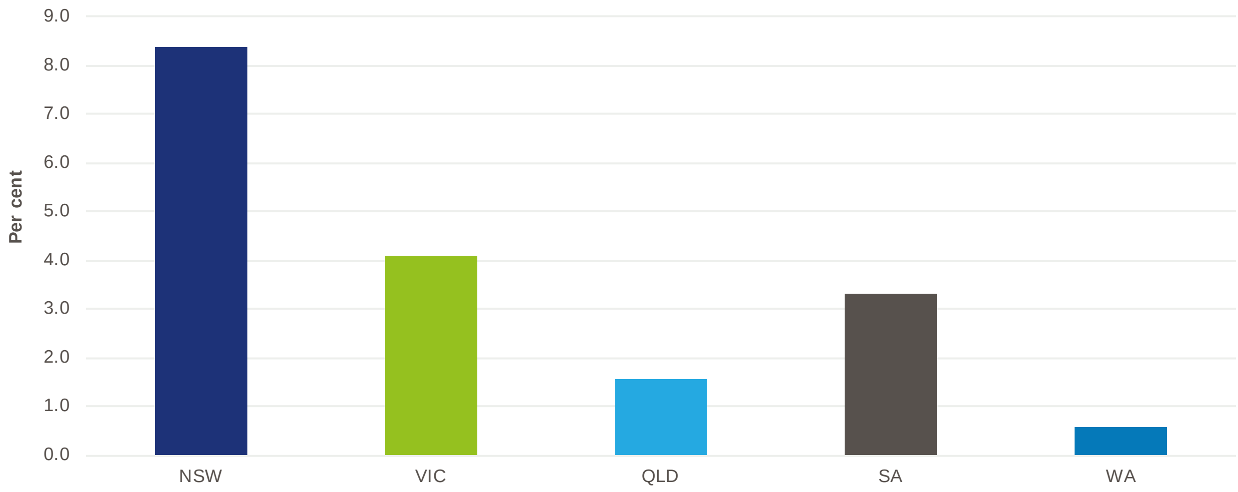
Net worth is expected to grow annually over the budget year and forward estimates by an average of 8.5 per cent, reaching $273.2 billion dollars by June 2021 (see Chart 7.5).

Chart 7.5 Net worth at 30 June



Over the five years to June 2021, New South Wales' net worth is growing faster than any other mainland state (see Chart 7.6). This significant growth is being driven by the Government's infrastructure program with a large increase in non-financial assets over the four years to June 2021. A significant decrease in superannuation liabilities following positive forecast bond rate movements over the four years to June 2021 is also contributing to the growth in net worth. However, this is being offset to some extent by an increase in borrowings over the four years to June 2021.

Chart 7.6 Annual average growth in general government sector net worth for mainland states from 2016 to 2021



Source: Latest publicly available data for each jurisdiction
Note: Projections for 2020-21 have been calculated for some jurisdictions based on prior year growth where data is not yet available