7. MANAGING THE STATE'S ASSETS AND LIABILITIES

- New South Wales' net worth has surpassed a quarter of a trillion dollars, a year earlier than expected. Net worth is expected to be $261.1 billion at June 2018, rising to $305.9 billion by June 2022, the highest of all Australian states.
- Growth in the State's net worth has been supported by the Government investing operating surpluses and asset recycling proceeds into new infrastructure, including rail, roads, hospitals and schools across the NSW community.
- Reflecting the Government's succesful asset recycling program, funds invested in the New South Wales Infrastructure Future Fund (NIFF) have reached a new high of $19.3 billion, delivering returns of 6.3 per cent per annum since its inception. Non-financial assets are projected to grow to $269.1 billion by June 2022 as the NIFF is reinvested along with operating surpluses, and modest borrowings into infrastructure.
- Net debt in the general government sector (GGS) is expected to be negative for the third consecutive year and is projected to reach negative $9.8 billion at June 2018.
- New South Wales' net debt is at a historic low of negative 1.6 per cent of GSP at June 2018 – lower than all other mainland states.
- The 2018-19 Budget continues the implementation of the Government's balance sheet reform agenda. This agenda will support the State's triple-A credit rating and optimise the use of the State's assets and liabilities.

7.1 Reforming the State's balance sheet

The Government continues to implement its financial reform agenda to promote greater balance sheet resilience and enhance the State's management of financial risk. Progress on key reforms include:

- establishing the NSW Generations Fund to help maintain debt at sustainable levels to support the principles of the *Fiscal Responsibility Act 2012* (FRA)
- continuing to seek best practice advice from the Asset and Liability Committee (ALCO) on balance sheet management (see Box 7.1)
- improvements in financial risk management, including a new whole-of-government Foreign Exchange (FX) risk policy to manage currency exposure when government agencies and businesses buy or sell goods and services to or from overseas. This policy has been developed and implemented in partnership with NSW Treasury Corporation (TCorp)
- further cash management reforms, including internalisation of up to an additional $2.0 billion in cash balances over the four years to June 2022, building upon $3.0 billion in cash centralised to date.

NSW Generations Fund

The NSW Generations Fund (NGF) will be established in 2018 to support intergenerational equity and promote New South Wales as a leader in participatory budgeting and community engagement. The NGF supports the FRA and will help maintain the State's triple-A credit rating.

The NGF is a long-term fund that will grow over time to support debt retirement and provide capacity to fund community-focused initiatives.

The Government will seed the NGF with an initial $3.0 billion from balance sheet reserves. The future minority interest in WestConnex will be deposited in the NGF, once the transaction is complete.

This reflects a continuation of the Government's approach to sustainable balance sheet management, by utilising the strength of the State's fiscal position to deliver greater benefit to NSW communities now and into the future.

Overview of key changes in 2017-18 since the 2017-18 Half-Yearly Review (HYR)

Since the 2017-18 HYR (see Table 7.1), key balance sheet movements include:

- a decrease in estimated net debt at June 2018 from negative $2.9 billion at the 2017-18 Half-Yearly Review to an estimated negative $9.8 billion in this Budget. The movement in net debt has been driven by the sale of the State's interests in Snowy Hydro, higher than anticipated cash balances from cash management reforms and strong investment returns in the NIFF
- an increase in estimated net worth at June 2018 from $247.6 billion at the 2017-18 Half-Yearly Review to an estimated $261.1 billion in this Budget, driven primarily by growth in the State's assets while liabilities have remained broadly constant.

Table 7.1: Key balance sheet aggregates of the GGS

	June 2017	June 2018	June 2018	June 2019	June 2020	June 2021	June 2022
	Actual	HYR	Revised	Budget	Forward Estimates		
Total Assets ($m)	354,358	368,783	382,900	389,648	403,757	419,402	431,576
Financial Assets ($m)	169,315	166,575	171,320	162,920	160,600	161,958	162,440
Non-Financial Assets ($m)	185,043	202,209	211,580	226,728	243,157	257,443	269,136
Total Liabilities ($m)	127,887	121,192	121,825	119,521	122,461	125,419	125,700
Net Worth ($m)	226,471	247,591	261,075	270,127	281,296	293,983	305,876
Net Worth as a per cent of GSP	39.3	40.9	43.1	42.9	42.8	42.6	42.2
Net Debt ($m)	(9,344)	(2,935)	(9,797)	2,559	14,133	22,207	28,660
Net Debt as a per cent of GSP	(1.6)	(0.5)	(1.6)	0.4	2.1	3.2	4.0

Box 7.1: Asset and Liability Committee drives balance sheet reform

The NSW Government's creation of a whole-of-government Asset and Liability Committee (ALCO) in 2015 was a world first for government. ALCO provides best-practice advice to the Treasury Secretary on managing the State's balance sheet.

ALCO uses a whole-of-government view to form its advice, with the goals of maintaining New South Wales' triple-A credit rating, monitoring the State's Significant Financial Risks, and ensuring the integrity of the State's reputation.

During 2017-18, ALCO recommended a number of policy actions and frameworks to help manage the State's financial risks and opportunities. These include:

- expanding the scope of ongoing cash management reforms to provide the State with a whole-of-government view on the use of surplus funds. Approximately $3.0 billion has been brought under centralised management to date
- endorsing a new whole-of-government Foreign Exchange (FX) Risk Policy (to take effect on 1 July 2018) to provide a cost-efficient arrangement for managing the State's FX risk, with significant estimated savings
- expanding the strategic management of the State's debt portfolio to guard against potential interest rate rises and to reduce interest costs where possible, including extending the average weighted life of the GGS debt portfolio towards eight years
- endorsing the establishment of a 'sustainability bond' program to further diversify and expand the State's bond investor base and to raise awareness of the Government's social and environmental initiatives.

ALCO will continue exploring opportunities to improve the management of the State's assets and liabilities to ensure balance sheet and fiscal risks are managed in a strong and disciplined manner.

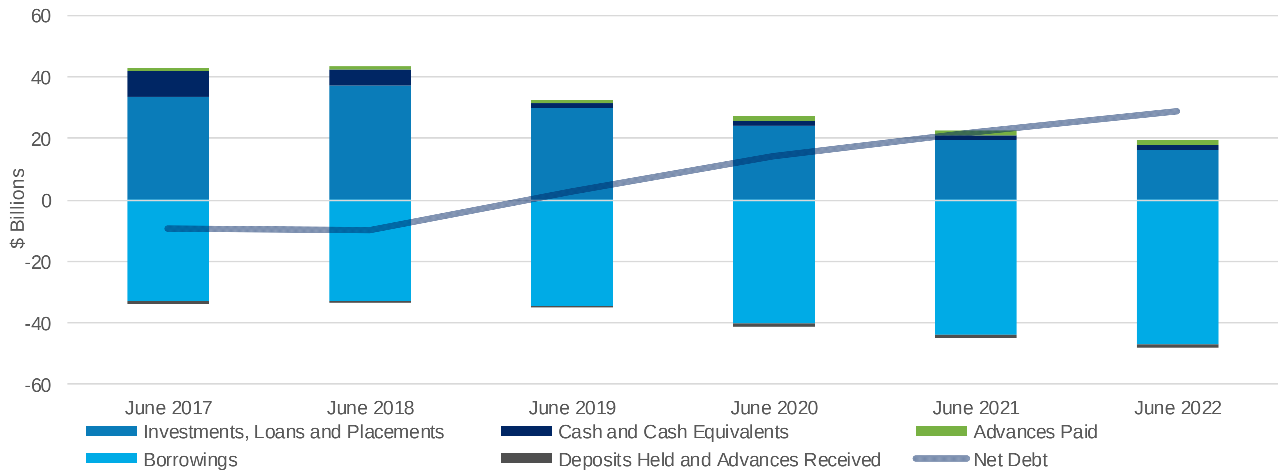
7.2 Net debt

New South Wales' net debt remains at record low levels, driven primarily by the Government's successful asset recycling transactions.

The projection for net debt at June 2018 is negative $9.8 billion. The State is to receive $4.2 billion from the divestment of its share of Snowy Hydro to the Commonwealth Government, which has largely offset increased infrastructure spending in 2017-18 and kept GGS net debt at broadly the same level as at June 2017.

Net debt is projected to reach $28.7 billion by June 2022 as the State implements its record infrastructure program by using its strong budget surpluses, drawing down on asset recycling proceeds and modestly increasing its borrowings (see Chart 7.1).

Chart 7.1: Net debt increases as the record infrastructure program is delivered



In line with usual NSW budget practice, the planned sale of 51 per cent of WestConnex will not be recognised in the Budget until the transaction is complete. When complete, the sale will further improve the State's net debt position.

Financial assets included in the calculation of net debt[1] are projected to be $43.3 billion at June 2018 (see Chart 7.1). They are expected to decrease to $19.5 billion by June 2022 as the Government draws down on the NIFF to fund its infrastructure program with asset recycling proceeds. The NIFF, along with the Social and Affordable Housing Fund (SAHF), other funds, and now the NGF, form a key component of the Government's financial assets (see Box 7.2).

Relative to the 2017-18 HYR, the financial assets that drive net debt have increased by $6.9 billion, primarily due to higher cash balances from cash management reforms, strong NIFF returns and the proceeds from the sale of Snowy Hydro.

[1] The Government is assessing the impact of new accounting standards for *AASB 16 Leases* and *AASB1059 Service Concession Arrangements*: Grantors (which come into effect on 1 January 2019) on the Uniform Presentation Framework (which is used to present the financial information in Appendix A). This may affect the level of net debt reported in the State's financial statements. Net debt consists of the sum of deposits held, advances received, loans and other borrowings less the sum of cash and deposits, advances paid and investments, loans and placements.

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

New South Wales Infrastructure Future Fund (NIFF)

The NIFF was established by the NSW Government in December 2016 as a vehicle to invest the net proceeds from the State's asset recycling program, making it the single largest holding of the State's financial investments. The NIFF is managed by TCorp, to deliver superior returns to the Government's cash portfolio and match investment maturities with expected infrastructure expenditure profiles.

The NIFF had a balance of approximately $19.3 billion as at 31 May 2018, having made a return of 6.3 per cent per annum since its inception. Returns from the NIFF help support the budget result, but are also a source of volatility across the forward estimates.

Investments within the NIFF are managed to align with the required spending profiles of critical infrastructure projects that form part of the Restart NSW and Rebuilding NSW programs. To date, $9.8 billion of Restart projects have been funded, while an additional $5.1 billion has been forecast for funding in 2018-19 (see Chapter 3 of the *Infrastructure Statement*).

Social and Affordable Housing Fund (SAHF)

The Government also established the SAHF in August 2017 to provide more housing for vulnerable people across the State, with coordinated access to tailored support. The SAHF had a balance of approximately $1.2 billion as at 31 May 2018, having made a return of 6.9 per cent per annum since its inception.

TCorp actively manages the SAHF through an investment trust, with the aim of maximising the volume of housing that can be provided. ALCO's oversight of the investments of the SAHF ensures it invests carefully, in recognition of the importance of maintaining funding certainty for new social and affordable housing stock.

Liabilities included in the calculation of net debt (see Table 7.2) are projected to be $33.5 billion at June 2018, broadly in line with 2017-18 HYR estimates. Over the four years to June 2022, these liabilities are projected to increase to $48.2 billion, driven by increased borrowings and the inclusion of finance leases for Sydney CBD Light Rail and Sydney Metro Northwest on the balance sheet.

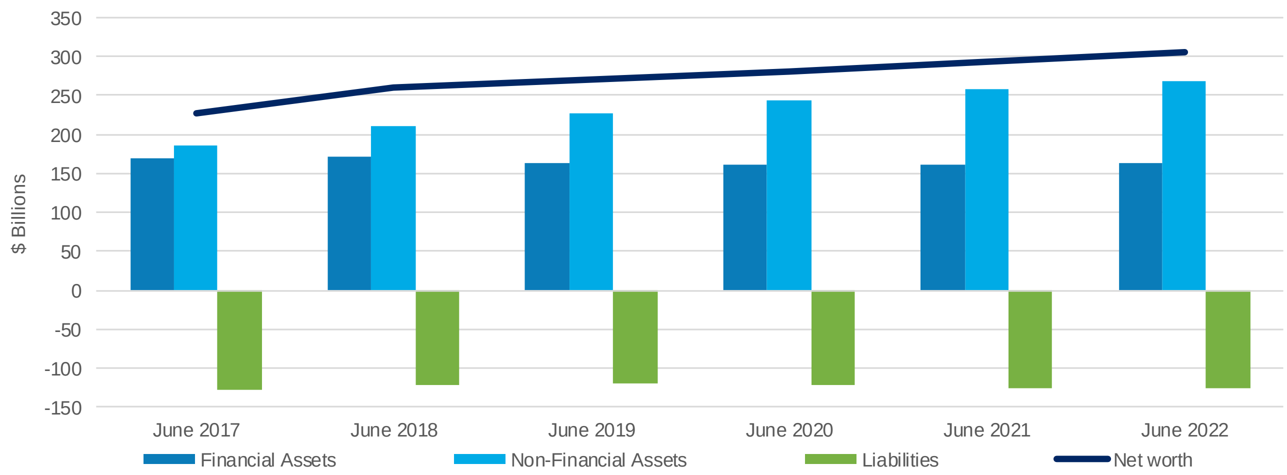
The Government has lengthened the average weighted maturity profile of its debt portfolio to eight years, which reduces liquidity and refinancing risk by better matching liabilities with the infrastructure assets they are funding. This also enables the Government to leverage its triple-A credit rating to secure relatively low-cost debt in the current low-interest rate environment.

7.3 Net worth

GGS net worth is expected to be $261.1 billion at June 2018 (see Chart 7.2), and is projected to be $305.9 billion by June 2022; the highest of all States and Territories (see Chart 7.3)[2]. Net worth at June 2018 is estimated to have increased by $13.5 billion relative to the estimate contained in the 2017-18 HYR, due primarily to the reinvestment of net operating cash in the Government's record infrastructure program, asset recycling and asset revaluations.

[2] Net worth measures the overall wealth of the State and is calculated by taking the difference between total assets and total liabilities.

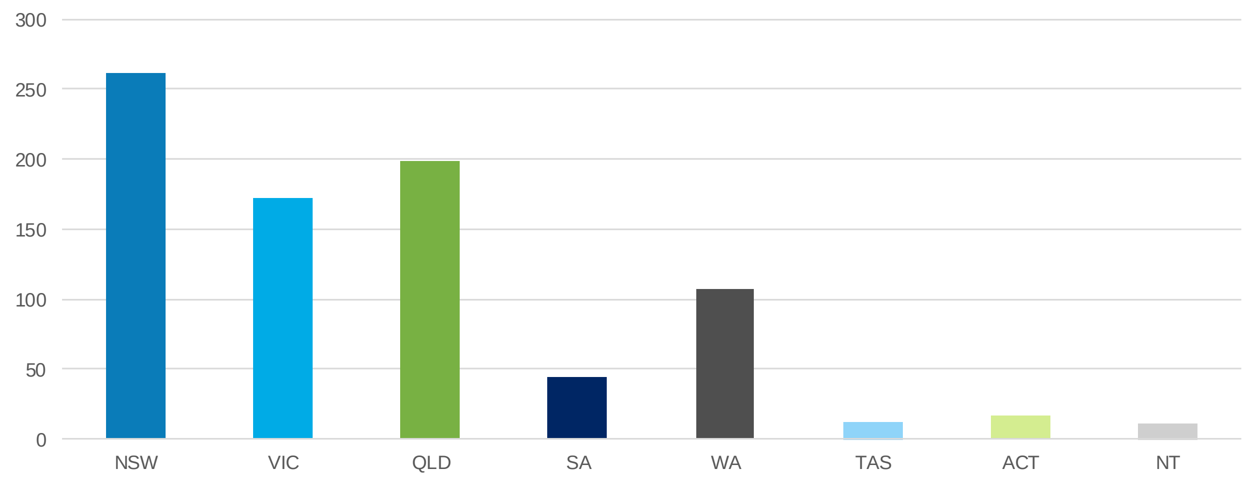
Chart 7.2: NSW GGS net worth to increase by $44.8 billion over the next four years



The expected increase in net worth over the next four years is being driven by strong growth in the State's non-financial assets, which more than offset the projected decrease in financial assets, while liabilities remain generally stable. Most notably:

- the value of property, plant and equipment is expected to grow from $200.1 billion at June 2018 to $254.6 at June 2022, due to a combination of the Government investing net operating cash into infrastructure, asset recycling and asset revaluations
- the Government's equity investments are expected to increase from $119.0 billion at June 2018 to $132.8 billion by June 2022, driven by strong growth in the public non-financial corporations sector (see Chapter 8 of this *Budget Statement*)
- the expected $14.4 billion increase in borrowings over the four years to June 2022 is largely offset by a $12.9 billion decrease in superannuation liabilities, as the State progresses on its commitment to fully fund its superannuation liabilities by 2030 (see Box 7.4 for more detail).

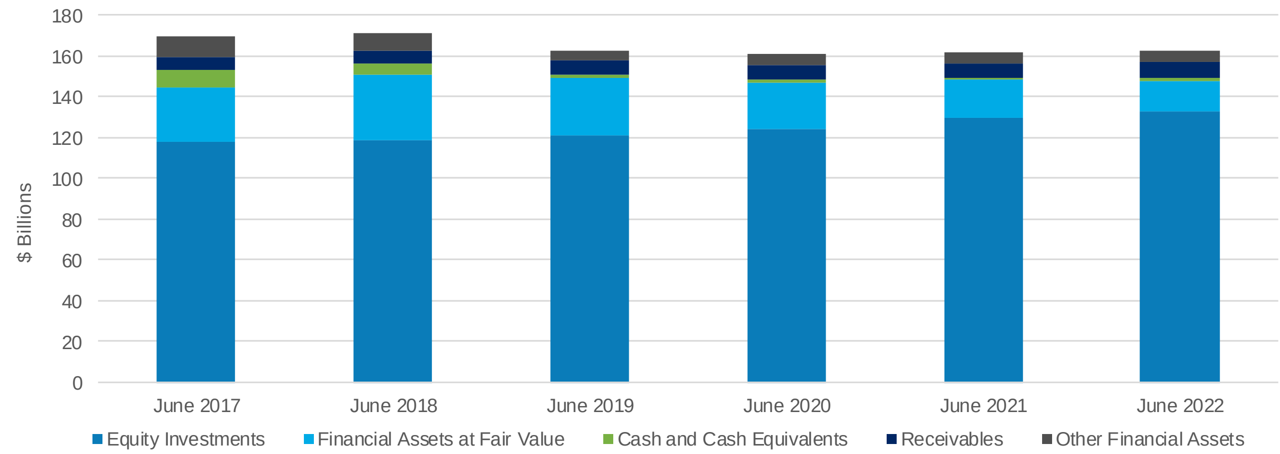
Chart 7.3: GGS net worth for all Australian states and territories in 2017-18



Financial assets

The State's total financial assets are projected to be $171.3 billion at June 2018, decreasing to $162.4 billion by June 2022 (see Chart 7.4). Growth in the value of the State's equity investments partially offset expected falls in financial assets at fair value as funds invested in the NIFF are drawn down to deliver the State's infrastructure program.

Chart 7.4: GGS financial assets reflect asset divestments and cash management reforms



The State's equity investments in other public-sector entities increased by $1.9 billion relative to the 2017-18 HYR estimate, and combined with cash management reforms and strong NIFF returns, has resulted in financial assets at June 2018 increasing by $4.7 billion over this same period.

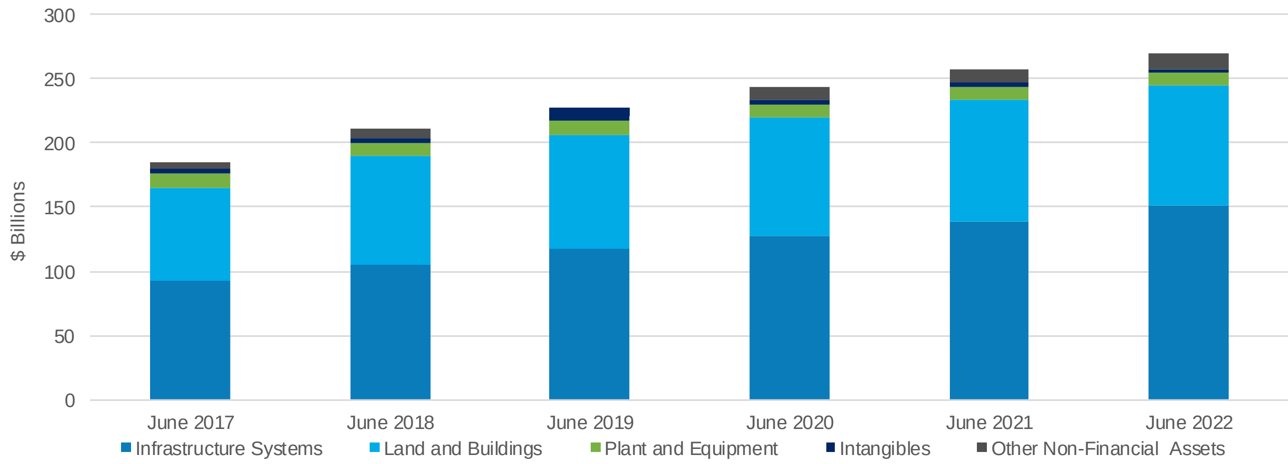
Non-financial assets

The State's non-financial assets are projected to be $211.6 billion at June 2018, a $9.4 billion increase relative to the 2017-18 HYR estimate. This figure is expected to increase to $269.1 billion by June 2022, driven primarily by asset revaluations and the Government's large infrastructure program (see Chart 7.5).

Over the next four years, the largest movement in property, plant and equipment is in infrastructure systems, which are forecast to rise from $105.1 billion at June 2018 to $150.7 billion in June 2022, as the Government invests heavily in public transport infrastructure.

Land and buildings are projected to grow from an expected $84.8 billion at June 2018 to $94.6 billion in June 2022, driven by investment in schools and hospitals, and asset revaluations in the education sector. This growth in land and buildings is happening concurrently to the implementation of the State's Property Infrastructure Policy (see Box 7.3).

Chart 7.5: Infrastructure systems drive the increase in GGS non-financial assets



Box 7.3: A new property infrastructure policy to improve utilisation

In December 2017, the Government approved the Property Infrastructure Policy to encourage a whole-of-government approach to the allocation of the State's real property capital and ensure better use of the State's asset base.

Property NSW will review the government property portfolio to ensure that property assets are only held when required, and in the form necessary to support the provision of core government services.

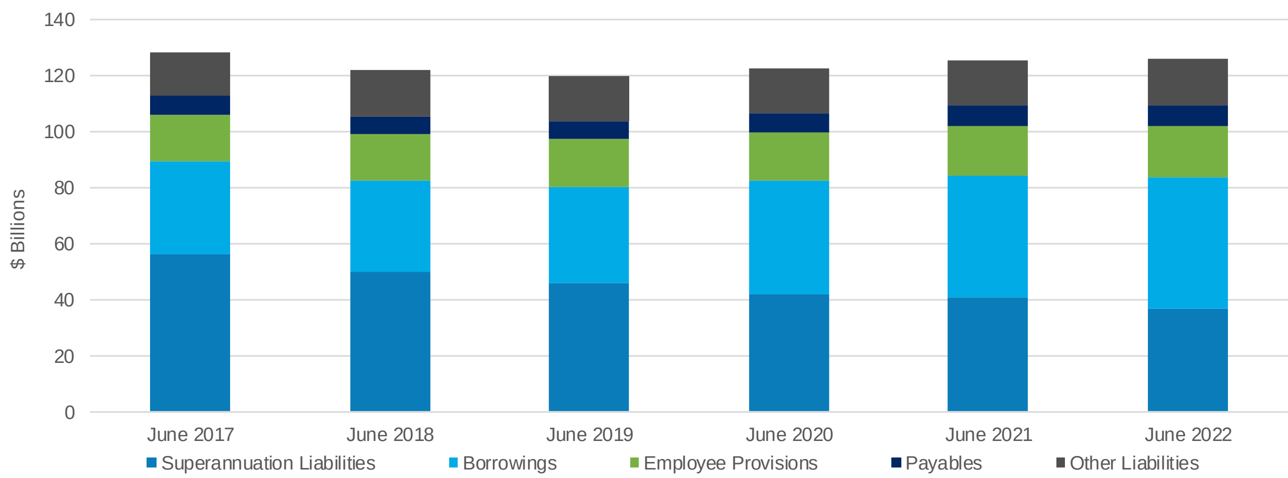
The reviews will identify surplus and underutilised property held by government departments and government businesses, which may be suitable for transfer to other government agencies or sold to deliver housing, social infrastructure or for other purposes.

Consistent with this policy, and to reflect the implementation of these portfolio reviews, the Government has set a target for land and property sales to bring divestments back up to the long-term average. This represents average additional sales of $750.0 million per annum over the next four years, and will help optimise the use of the State's balance sheet and fund its ongoing capital program.

Liabilities

Total liabilities are projected to be $121.8 billion at June 2018, and are expected to increase to $125.7 billion by June 2022 (see Chart 7.6). This increase is driven primarily by higher borrowings as the State progresses its record infrastructure program. The increase in borrowings is largely offset by a decrease in unfunded superannuation liabilities.

Chart 7.6: Increasing borrowings offset by decreasing superannuation liabilities



Unfunded superannuation liabilities remain the largest category of liability on the GGS balance sheet. They are projected to decrease from $49.5 billion at June 2018 to $36.6 billion at

June 2022 as the Government works to eliminate GGS unfunded superannuation liabilities by 2030 (see Box 7.4)[3].

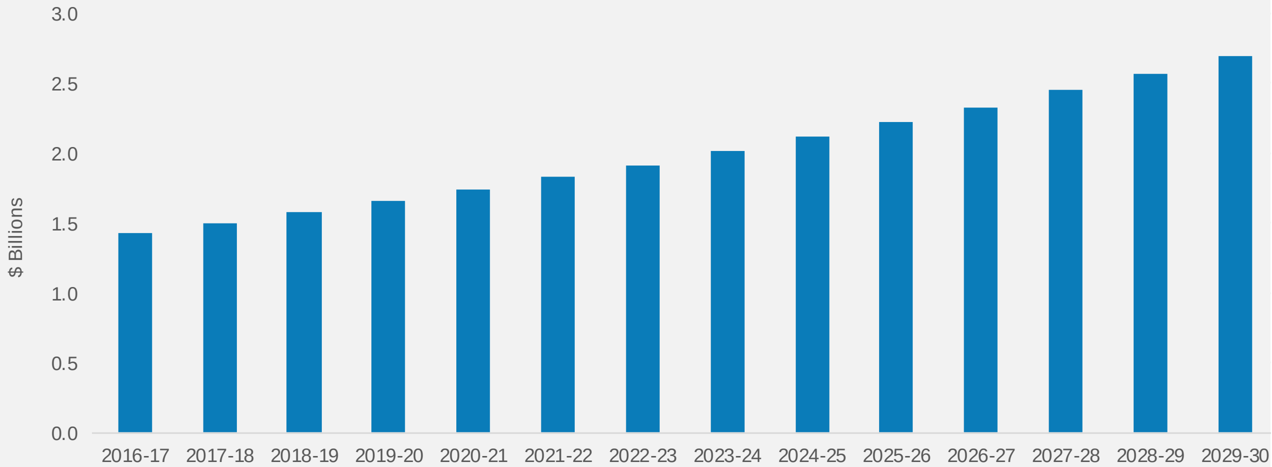
Employee provisions, which include long service leave, are the next largest category of liabilities. The GGS is projected to hold $16.8 billion of employee provisions at June 2018, increasing to $18.0 billion by June 2022.

Box 7.4: Funding the State's superannuation liabilities

The Government remains committed to fully funding its superannuation liabilities by June 2030, consistent with the *Fiscal Responsibility Act 2012*.

To achieve this, the Government's long-term funding program involves contributing $1.6 billion in the 2018-19 financial year towards funding the liabilities, with this amount to increase at a rate of five per cent per annum until 2030 (see Chart 7.7).

Chart 7.7: Government superannuation contributions until 2030



Management of the State's superannuation liability undergoes a triennial review to ensure it is appropriate to meet the 2030 funding target, taking into account demographic changes and economic drivers, such as inflation and investment returns. The 2015 Triennial Review of the State Super schemes stated that the current funding plan appears reasonable to meet this target.

The 2018 Triennial Review into the State's superannuation liabilities is currently underway. Depending on the outcome of the review, the funding plan may be modified to ensure that the Government remains on track to meet its target.

[3] There are two methods for valuing unfunded superannuation liabilities. For reporting purposes, as noted above and presented in the balance sheet, liabilities are calculated in accordance with AASB 119 Employee Benefits, which requires future payments to be discounted at the Commonwealth Government Securities rate.

For funding purposes, AASB 1056 Superannuation Entities is used, which discounts future payments by the expected long-term return on a fund's assets, resulting in a more realistic measure of the present value of the liabilities. On this basis, the unfunded liability is expected to be $15.4 billion at June 2018, and is forecast to decrease to $13.8 billion by June 2022.