Australian Capital Territory Government

Management Discussion and Analysis for the Financial Year Ended 30 June 2016

The 2015-16 Management Discussion and Analysis represents the consolidated ACT Government's Total Territory financial results.

Risk Management

The Territory has largely emerged from the impact of the Commonwealth Government's fiscal restraint, although downsizing continues. The ACT economy will always have a degree of uncertainty as a result of the future policy settings of the Federal Government.

The most prominent risk in the ACT is the effect of the Australian Public Service efficiency dividend which increases from 2017-18 onward. As one-third of the Australian Public Service workforce is based in the ACT, the impact of this policy decision on employment and the wider economy in the Territory is potentially significant.

The Territory has a moderate private employment base in the education, small scale manufacturing sectors, and wholesale trade.

ACT Economy in 2015-16

The ACT economy performed well across a range of key economic measures and is on track to meet the 2016-17 Budget estimate of 2 per cent growth in Gross State Product in 2015-16.

The strength of the ACT economy is also demonstrated by recent outcomes of economic activity, as measured by State Final Demand. The most recent data shows that, for the March quarter this year, the ACT recorded the highest State Final Demand growth of any State or Territory at 1.3 per cent. This was higher than the national average and came at a time when many of the States and Territories actually recorded declines. Over the 12 months to March 2016, State Final Demand grew by 2.9 per cent.

The 2015-16 outcomes were driven by the lifting of the Commonwealth Government’s hiring freeze on 1 July 2015, a pickup in private sector business confidence, a weak Australian dollar, and low interest rates.

In 2015-16, the labour market improved, with employment growth reaching a solid 1.7 per cent, equating to the creation of 3,500 new jobs and exceeding the 2015-16 forecast of 1 per cent growth. The unemployment rate was 3.7 per cent in June 2016.

The ACT’s population also continued to rise, increasing by 5,271 people over the year to December 2015 (1.4 per cent), of which net overseas migration contributed around 40 per cent.

The Economic Outlook

Looking forward, the ACT economy is expected to continue to expand, with economic growth forecast to reach 2¼ per cent in 2016-17.

Administrative Changes

There have been no administrative changes for 2015-16 that affect the Total Territory.

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for the Financial Year Ended 30 June 2016

Highlights

The Uniform Presentation Framework (UPF) Operating Result for the Total Territory is a deficit of $373 million, which is lower than the Budget deficit of $649 million by $276 million and lower than the 2014-15 deficit of $646 million by $273 million.

Total revenue increased by $270 million from the 2014-15 result of $4,843 million. This was mainly due to an increase in taxation and land revenue.

Total expenses was consistent with the 2014-15 outcome of $5,489 million at $5,486 million.

Net Financial Liabilities were higher by $2,583 million compared to the 30 June 2015 result of $8,630 million, predominantly due to the change in the defined benefit superannuation liability valuation.

The Total Territory's Net Debt (excluding superannuation investments) increased by $646 million to $2,849 million, compared to the 30 June 2015 outcome of $2,203 million. This was mainly due to the impact of additional borrowings to meet cash flow requirements, particularly for capital works projects and the loan provided by the Commonwealth Government for the Loose-Fill Asbestos Insulation Eradication Scheme.

Future Trends

In 2016-17 and the forward estimates, the Territory will continue its focus on mitigating financial risks by maintaining expenditure levels within budget in an environment where pressures on the net cost of service delivery are significant.

The ACT Government's commitment to a fiscal strategy that achieves an operating balance over time, offsetting temporary deficits with surpluses in other periods.

The ACT Government decided, for the first time, to foreshadow a variation to the 2016-17 Budget by anticipating the difference between current interest rates and the long-term discount rate used to estimate the value of superannuation liabilities. This is expected to reduce variation within the financial statements at the end of each financial year.

Across the forward estimates period, the UPF Operating Result is estimated to decline from a peak deficit of $371 million in 2016-17 to a deficit of $204 million in 2019-20.

The Territory's Balance Sheet remains relatively strong across the forward estimates. Net Debt is expected to peak at $4,613 million in 2018-19, decreasing to $4,332 million in 2019-20, driven largely by the inclusion of lease liabilities associated with the ACT Law Courts and Canberra Light Rail Public Private Partnership projects.

Net Financial Liabilities are estimated to peak in 2018-19 at $8,601 million and then decline slightly in 2019-20 to $8,293 million.

Total Territory

Financial Performance

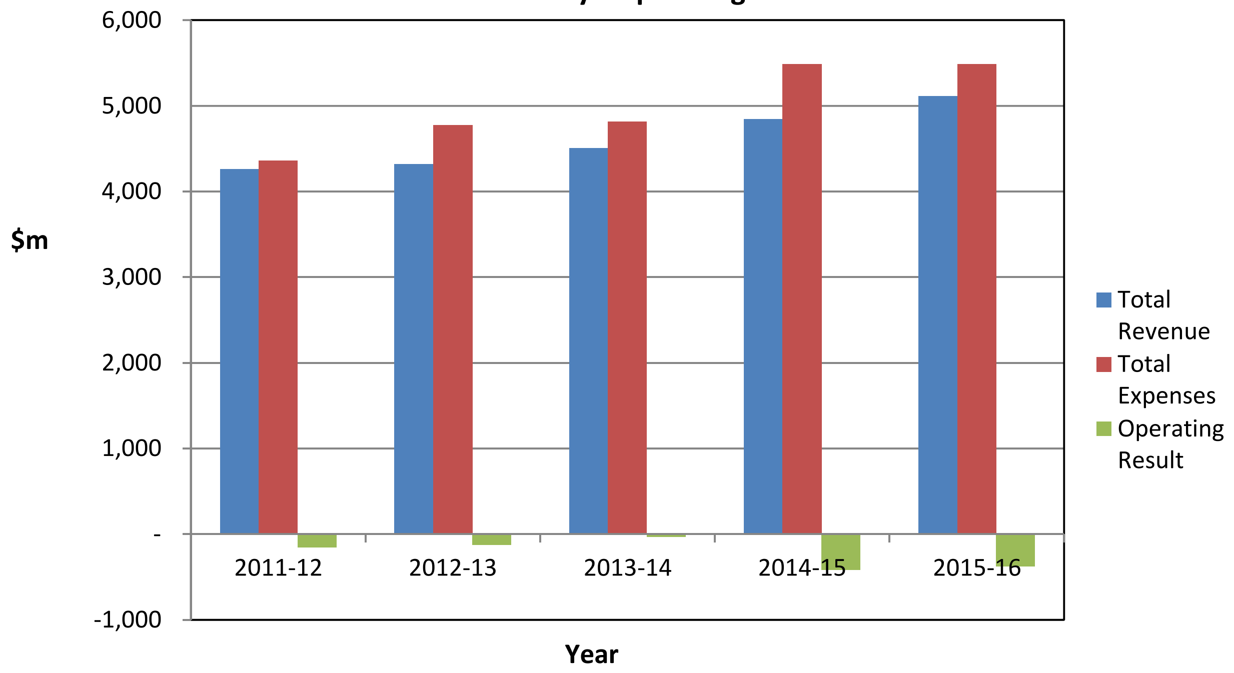
Table 1.1 shows the Territory has a UPF Operating Result deficit of $373 million for 2015-16, which is $276 million lower than the deficit forecast in the 2015-16 Budget of $649 million and $273 million lower than the 2014-15 deficit of $646 million. Major variations in total revenue, expenses and economic inflows/(outflows) are explained on the following page.

Table 1.1
Total Territory - Operating Result

	2015-16 Actual $m	2014-15 Actual $m	2015-16 Annual Budget $m	2016-17 Annual Budget $m	2017-18 Forward Estimate 1 $m	2018-19 Forward Estimate 2 $m	2019-20 Forward Estimate 3 $m
Total Revenue	5,113	4,843	4,871	5,384	5,527	5,750	6,030
Total Expenses	5,486	5,489	5,521	5,755	5,762	5,930	6,234
UPF Net Operating Balance	**-373**	**-646**	**-649**	**-371**	**-235**	**-180**	**-204**
Economic Inflows/(Outflows)	2	231	258	257	203	206	240
Operating Result	**-371**	**-415**	**-391**	**-114**	**-32**	**26**	**36**

As shown below in Chart 1.1, total expenses has exceeded total revenue for the past four financial years.

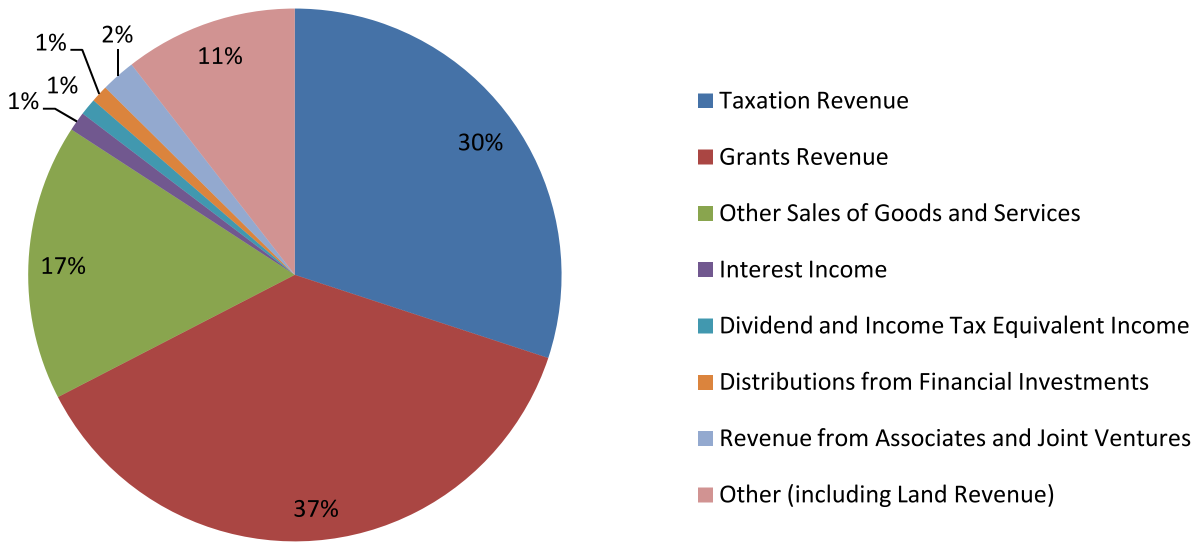
Chart 1.1
Total Territory - Operating Result



Revenue

Total revenue for the 2015-16 financial year was $5,113 million. As demonstrated below in Chart 1.2, the majority of the Territory's revenue is from Commonwealth Government Grants (37 per cent) followed by Taxation (30 per cent).

Chart 1.2
Total Territory - Revenue Sources



Total revenue was $242 million higher than the $4,871 million forecast in the 2015-16 Budget mainly due to higher than anticipated:

• land revenue of $94 million relating to an increase in land sales in Moncrieff, Coombs and Weston Creek;

• taxation revenue of $82 million due to increase in payroll tax in relation to the payroll tax harmonisation scheme[1] and residential and commercial conveyance duties as a result of higher than expected turnover and prices; and

• revenue from associates and joint ventures of $39 million which was mainly due to higher water and sewage use due to higher consumption and an increased customer base for Icon Water and a higher than expected profit from the investment in ACTEW AGL Joint Venture.

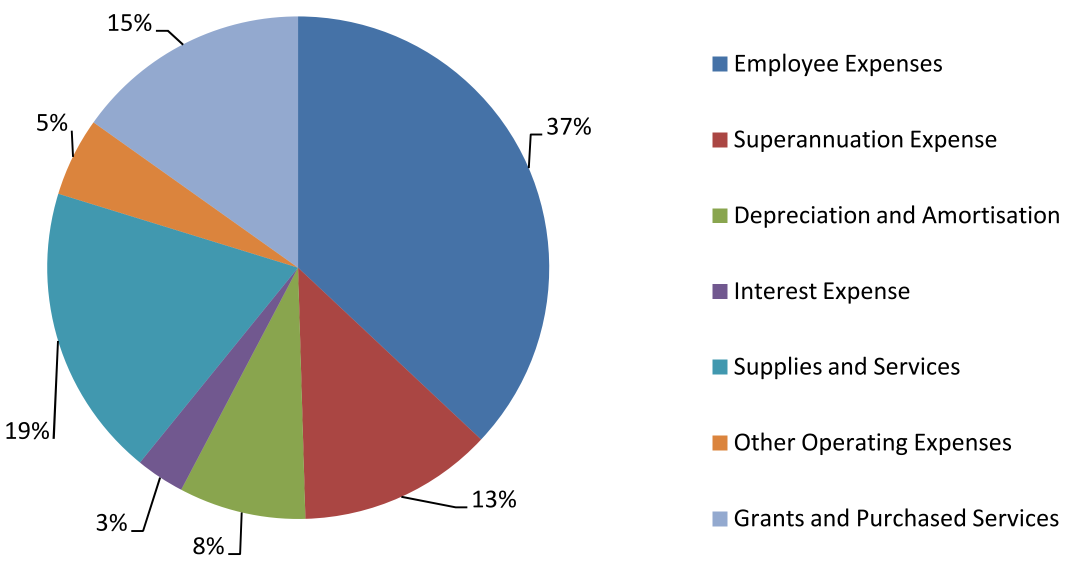
Total revenue increased by $270 million compared to the 2014-15 financial year result of $4,843 million. This was mainly due to higher taxation revenue of $197 million associated with increased payroll tax resulting from growth in employment and wages and the payroll tax harmonisation scheme, increased general rates revenue due to growth in the value of properties and ongoing tax reform and higher conveyance revenue.

Note 1: The Harmonisation Scheme is detailed in the 2016-17 Budget.

Expenses

As shown below in Chart 1.3, the largest portion of the Territory's expenses are Employee Expenses (37 per cent). Total expenses for the 2015-16 financial year were $5,486 million.

Chart 1.3
Total Territory - Areas of Expenditure



Total expenses of $5,486 million were $35 million less than the forecast in the 2015-16 Budget of $5,521 million. This is mainly reflective of the capitalisation of works for the Constitution Avenue project which were forecast to be expensed and delays in repairs and maintenance expenditure due to unfavourable weather conditions.

Total expenses in 2015-16 of $5,486 million were in line with the 2014-15 expenses of $5,489 million.

Economic Inflows/(Outflows)

The total operating result, which includes economic inflows/(outflows) for the 2015-16 financial year was a deficit of $371 million, which is $44 million less than the 2014-15 deficit of $415 million. This is due to the impacts on the UPF Operating Result, as discussed above, in addition to the 2014-15 reported increase in Net Losses on the Sale of Financial Assets. This is mainly as a result of individual asset class investment returns achieved over the financial year for the Superannuation Provision Account, in particular, weak global share market returns. The investment portfolio achieved a return of 2.7 per cent in 2015-16 compared to 10.2 per cent in 2014-15.

Financial Position

Table 2.1
Total Territory - Financial Position

	2015-16 Actual $m	2014-15 Actual $m	2015-16 Annual Budget $m	2016-17 Annual Budget $m	2017-18 Forward Estimate 1 $m	2018-19 Forward Estimate 2 $m	2019-20 Forward Estimate 3 $m
Financial Assets	6,771	6,462	5,758	6,568	6,627	6,853	7,264
Non-Financial Assets	23,144	22,381	23,237	23,916	24,405	25,472	25,364
Total Assets	29,915	28,843	28,995	30,484	31,031	32,325	32,628
Total Liabilities	17,033	14,171	12,506	13,032	13,367	14,464	14,550
Net Assets	**12,882**	**14,672**	**16,489**	**17,451**	**17,665**	**17,861**	**18,078**
Net Financial Liabilities	**11,213**	**8,630**	**7,472**	**7,434**	**7,697**	**8,601**	**8,293**
Net Debt (excluding Superannuation related Investments)	**2,849**	**2,203**	**3,899**	**3,522**	**3,754**	**4,613**	**4,332**

The value of Net Assets at 30 June 2016 was $3,607 million lower than the 2015-16 Budget of $16,489 million, which is primarily due to the increase in superannuation liability. Net Assets was $1,791 million lower than the $14,672 million reported at 30 June 2015, which is mainly as a result of the capital works in progress in 2015-16. The net impact of Assets and Liabilities are discussed in detail over the next two pages.

Net Financial Liabilities at 30 June 2016 were $11,213 million which is $3,741 million and $2,584 million higher than the 2015-16 Budget and 30 June 2015 results respectively. These variances are mainly due to the change in the estimate at the defined benefit superannuation liability at 30 June 2016, based on a discount rate of 2.69 per cent compared to 3.66 per cent at 30 June 2015.

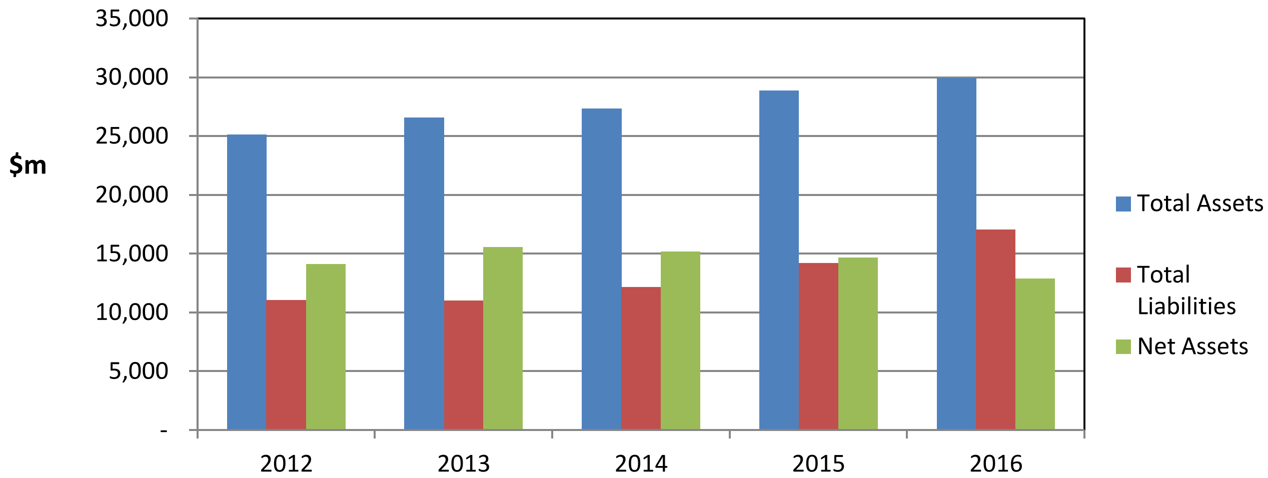
Net Debt, excluding superannuation investments, was $2,849 million at 30 June 2016. This is a $1,050 million decrease from the 2015-16 Budget. The Net Debt decrease is mainly due to an increase in other borrowings as a result of a decrease in cash flow requirements from market financed borrowings and Commonwealth loans.

Net Debt increased by $646 million from the 30 June 2015 result of $2,203 million. This variance is mainly due to additional borrowings to meet cash flow requirements, particularly in relation to capital works projects and an increase in Commonwealth borrowings to fund the Loose-Fill Asbestos Insulation Eradication Scheme.

Financial Position - Continued

Chart 2.1 below demonstrates the Territory's Balance Sheet over time.

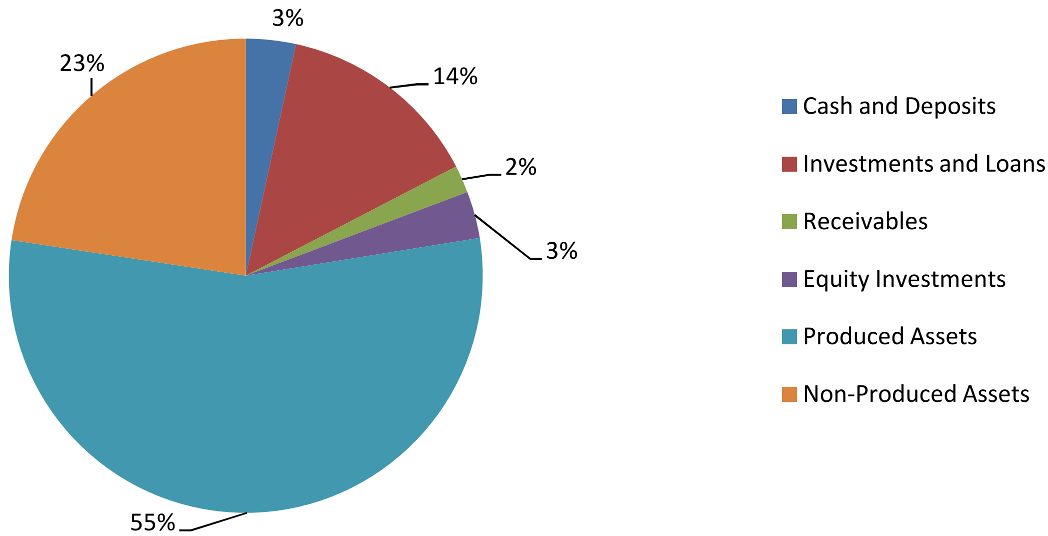
Chart 2.1
Total Territory - Balance Sheet



Assets

Total assets at 30 June 2016 were $29,915 million. As can be seen from Chart 2.2 below, the majority of the Territory's assets are produced assets (55 per cent), specifically property, plant and equipment.

Chart 2.2
Total Territory - Asset Types



Assets - Continued

Total assets were $920 million higher than the 2015-16 annual budget of $28,995 million, mainly due to an increase in cash and deposits to provide flexibility for the management of the Loose-fill Asbestos Insulation Eradication Scheme. This variance is also partially due to the operational and liquidity needs and the timing of end of year cash flow transactions in the Territory Banking Account. This has been partially offset by a lower than anticipated capital works in progress compared to budget due to the deferral of a number projects.

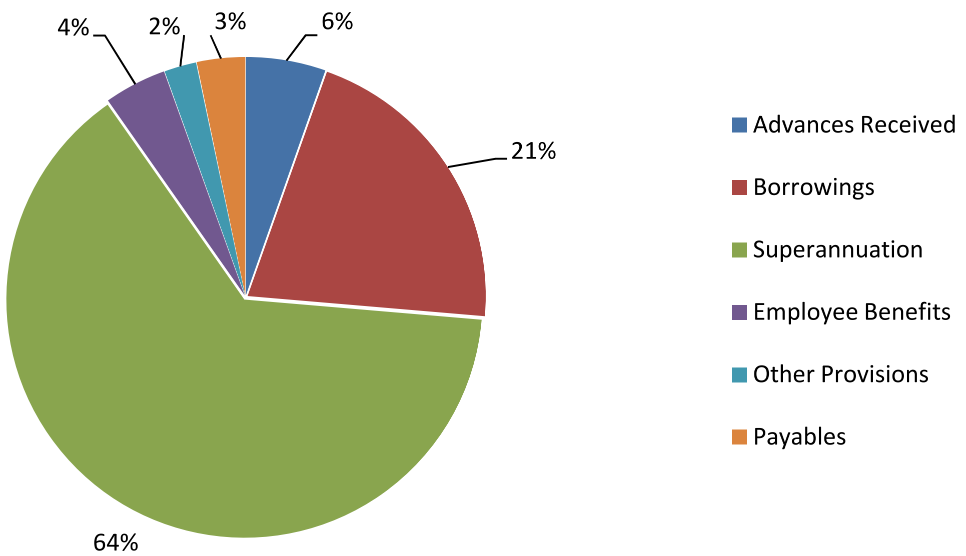
At 30 June 20146, total assets increased by $1,072 million compared to 30 June 2015 from $28,843 million mainly as a result of an increase in capital works in progress and property plant and equipment assets as a result of ongoing capital projects. These include the Secure Mental Health Unit, the University of Canberra Public Hospital, the Ngunnawal Bush Healing Farm, various works throughout the Canberra Hospital campus and other capital upgrade projects.

Liabilities

Total Liabilities at 30 June 2016 were $17,033 million. As can be seen from Chart 2.3 below, the majority of the Territory's liabilities are related to superannuation (64 per cent).

Chart 2.3

Total Territory - Liability Types



Liabilities - Continued

Total Liabilities increased by $4,527 million from the forecast in the 2015-16 Budget of $12,506 million at 30 June 2016. The increase is mainly due to higher than budgeted superannuation liability that reflects a lower discount rate of 2.69 per cent used to estimate the present value of the superannuation liability compared to the current long-term average budget estimate of 6 per cent.

Total liabilities increased by $2,863 million compared to the 30 June 2015 result of $14,171 million. This was mainly due to an increase in the estimated valuation of the superannuation liability at 30 June 2016 related to the discount rate of 2.69 per cent which is lower than the 30 June 2015 rate of 3.66 per cent.

While the unfunded superannuation position is significant, the defined benefit schemes (CSS and PSS) to which the liability relates are closed to new members. All superannuation liabilities incurred for new employees since 1 July 2005 are fully funded through accumulation scheme arrangements.

In relation to the unfunded liability, a key financial objective of the ACT Government is to extinguish these liabilities by accumulating funds in the Superannuation Provision Account which are sourced from both annual budget appropriation and investment earnings.

Cash Flows

Table 3.1
Total Territory - Cash Flow Position

	2015-16 Actual	2014-15 Actual	2015-16 Annual Budget	2016-17 Annual Budget	2017-18 Forward Estimate 1	2018-19 Forward Estimate 2	2019-20 Forward Estimate 3
	$m	$m	$m	$m	$m	$m	$m
Net Cash Flows from Operating Activities	215	128	-30	345	494	437	593
Net Cash Flows from Investments in Non-Financial Assets	-802	-741	-1,022	-724	-597	-513	-239
Cash Surplus (+) / Deficit (-)	**-587**	**-613**	**-1,052**	**-379**	**-104**	**-77**	**355**

Net Cash Flows from Operating Activities were $215 million, which is $245 million more than the 2015-16 Budget outflow of $30 million and $87 million more than 2014-15 outcome of $128 million. This is mainly due to the impacts of taxation revenue as discussed above.

Net Cash Flows from Investments in Non-Financial Assets was $220 million lower than the 2015-16 Budget of $1,022 million and $61 million higher than 2014-15. The less than anticipated outflows is mainly due to the re-profiling of capital works expenditure for projects such as Majura Parkway and Isabella Weir Spillway - Upgrades and delays in current capital works projects due to contract negotiations and construction delays.

Table 4.1
Total Territory - Infrastructure Program

	2015-16 Actual $m	2014-15 Actual $m	2015-16 Annual Budget $m	2016-17 Annual Budget $m	2017-18 Forward Estimate 1 $m	2018-19 Forward Estimate 2 $m	2019-20 Forward Estimate 3 $m
Capital Works Program	573	420	705	644	598	526	205

The 2015-16 Whole-of-Government Capital Works Program Investment for the Territory was $573 million; this was $132 million less than the 2015-16 Budget estimate of $705 million and is $153 million, more than the infrastructure investment of $420 million through the 2014-15 Capital Works Program.

Major infrastructure investment during 2015-16 included (values are whole of life project costs):

- University of Canberra Public Hospital ($200 million)
- Urban Renewal Program – Better Public Housing ($133 million over four years)
- Better Roads for Gungahlin – Enhanced Town Centre road network ($14 million)
- Better Roads for Gungahlin – Gundaroo Drive duplication – Stage 1 ($31 million)
- Better Roads for Gungahlin – Horse Park Drive duplication ($17 million)
- Schools for the Future – North Gungahlin and Molonglo ($28 million)
- Better Roads for Tuggeranong – Ashley Drive Duplication – Stage 2 ($25 million)
- Essential Waste Management Infrastructure ($21 million)
- Schools for the Future – Modernising Belconnen High ($18 million)
- Sterilising Services – Relocation and upgrade ($17 million)
- Urban Renewal Program – City to the Lake – West Basin infrastructure ($10 million)

Major infrastructure physically completed during 2015-16 included (values are whole of life project value):

- Horse Park Drive Extension to Moncrieff Group Centre ($18 million)
- Staging and Decanting – Moving To Our Future ($21 million)
- The Canberra Hospital Redevelopment ($21 million)
- Coombs P-6 School Construction Funding (Charles Weston School ($37 million))
- Mugga Lane – Land Fill Extension – Stage 5 ($20 million)

During 2015-16, the Territory entered into Public Private Partnership (PPP) contracts for the ACT Law Courts Facilities and Canberra Light Rail Project. PPPs are long-term contracts entered into between the Territory and a private sector consortium (the operator) to design, finance, construct and operate/maintain these assets over a concession term. Further details can be found in the consolidated financial statements, particularly notes 2(ak)(xvii), 2(al) and 58.

This completes the analysis of the 2015-16 Management Discussion and Analysis for the consolidated ACT Government's Total Territory financial results.