Australian Capital Territory Government

Management Discussion and Analysis
For the Financial Year Ended 30 June 2015

The 2014-15 Management Discussion and Analysis represents the consolidated ACT Government's Total Territory financial results.

Risk Management

The Commonwealth Government's fiscal restraint and downsizing continues to present the highest risk for the Territory. The full extent of this restraint and downsizing on the ACT economy and public finances is still yet to be realised.

Although the risk of further job cuts appears to have fallen, the ACT economy still faces the prospect of lower than expected Commonwealth Government spending and continued Commonwealth Government wage restraint, which will affect income and associated household spending growth in the Territory. Other potential risks to the ACT economic outlook are slower than anticipated population, employment and price growth in 2015-16.

The Territory has a moderate private employment base in the education and small scale manufacturing sectors, and wholesale trade. Employment in agricultural and mining industries, important contributors to the diversity and growth in other jurisdictions' payroll tax bases, is small in the Territory.

The ACT Government established the Asbestos Eradication Taskforce in December 2014 to deliver the Loose-fill Asbestos Insulation Eradication Scheme. Under this Scheme, the ACT Government will acquire, demolish and safely dispose of all affected homes, remediate affected blocks and the resell them to defray overall Scheme costs. The estimated net cash cost of the Scheme is $370 million, excluding contingency, but as the Scheme progresses and further information becomes available, it is expected that the financial and cash estimates will be further refined.

ACT Economy in 2014-15

Economic activity in the ACT, as measured by State Final Demand, increased by 2.94 per cent in year-average terms in 2014-15. This is below the long-term trend rate of around 4 per cent per annum.

Employment in the ACT fell by 0.7 per cent in 2014-15 in year-average terms while the participation rate fell by 0.6 percentage points during 2014-15. These outcomes were affected by the Commonwealth Government's job cuts, which totalled around 3,500 in the ACT in 2014-15.

The ACT's population increased by 1.1 per cent or 4,251 persons over the course of 2014. This is below the long-term trend rate of around 1.5 per cent per annum. The 2014 result reflects a natural increase (births less deaths) of 3,739 persons and a net gain of overseas migration of 2,060 persons, partially offset by a net loss of interstate migration of 1,548.

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The Economic Outlook

The ACT's economic growth in 2015-16 is expected to improve moderately, supported by a low interest rate environment and the ending of the Commonwealth Government's hiring freeze on 1 July 2015. Growth will also be supported by an ongoing expansionary fiscal stance by the ACT Government, including in relation to the Asbestos Eradication Scheme.

The key risk to the ACT's economic outlook is higher-than-anticipated spending cuts by the Commonwealth Government, placing downward pressure on economic activity.

Administrative Changes

Administrative changes for 2014-15 include:

• The Lifetime Care and Support Fund (LTCS Fund) which was established under the *Lifetime Care and Support (Catastrophic Injuries) Act 2014* and commenced operation on 1 July 2014. The LTCS Fund is a General Government Sector agency for the Territory's reporting purposes.

• From 1 July 2014, members of the Electoral Commission became independent officers of the ACT Legislative Assembly, following amendments made to the Electoral Act by the *Officers of the Assembly Legislation Amendment Act 2013.* The Electoral Commissioner is a General Government Sector agency for the Territory's reporting purposes.

• In December 2014, the Appropriation (Loose‑fill Asbestos Insulation Eradication) Act 2014‑2015 authorised additional appropriation to enable the establishment of the Asbestos Response Taskforce to manage delivery of the Scheme.

Highlights

The Uniform Presentation Framework (UPF) Net Operating Balance for the Total Territory is a deficit of $646 million, which is higher than the Budget deficit of $537 million and the 2013-14 deficit of $309 million.

The increase in the UPF Net Operating Balance largely arose from management and delivery of the Asbestos Eradication Scheme. These costs will be partially offset by the sale of the surrendered blocks of remediated land across and beyond the forward estimates.

Total expenditure increased by $673 million compared to 2013-14. This was largely the result of the Asbestos Eradication Scheme and an increase in employee expenses expenditure driven largely by changes to Enterprise Bargaining Agreements.

Net Worth declined by $521 million compared to the 30 June 2014 outcome, principally due to an increase in the valuation of superannuation liability, although this was partially offset by higher investments.

The Total Territory's Net Debt increased by $586 million compared to the 30 June 2014 outcome of $1,617 million. This was mainly due to the impact of the loan provided by the Commonwealth Government to help implement the Asbestos Eradication Scheme.

Net Financial Liabilities were also higher by $1,549 million compared to the 30 June 2014 result of $7,081 million, predominantly due to an increase in the superannuation liability.

Future Trends

In 2015-16 and through to 2018-19 (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. Both expenditure and own source revenue are expected to increase gradually across the forward estimates largely in line with forecast indexation.

In 2015-16 and through the forward estimates, expenses are forecast to grow by 3.5 per cent per annum. This growth largely reflects an increase in spending to deliver services in health, education and other purposes, offset by a reduction in housing and community amenities expense as the Asbestos Eradication Scheme winds down in 2019-20.

Across the forward estimates period, the UPF Net Operating Balance is forecast to improve from a peak deficit of $649 million in 2015-16 to a deficit of $216 million in 2018-19.

The Territory's Balance Sheet remains relatively strong across the Budget and forward estimates. Net Debt is forecast to peak at $4,774 million in 2017-18, decreasing to $4,550 million in 2018-19, driven largely by the impact of borrowings to support the Territory's Infrastructure Program.

Net Financial Liabilities are estimated to peak in 2017-18 at $8,494 million and then decline slightly in 2018-19 to $8,283 million.

Total Territory

Financial Performance

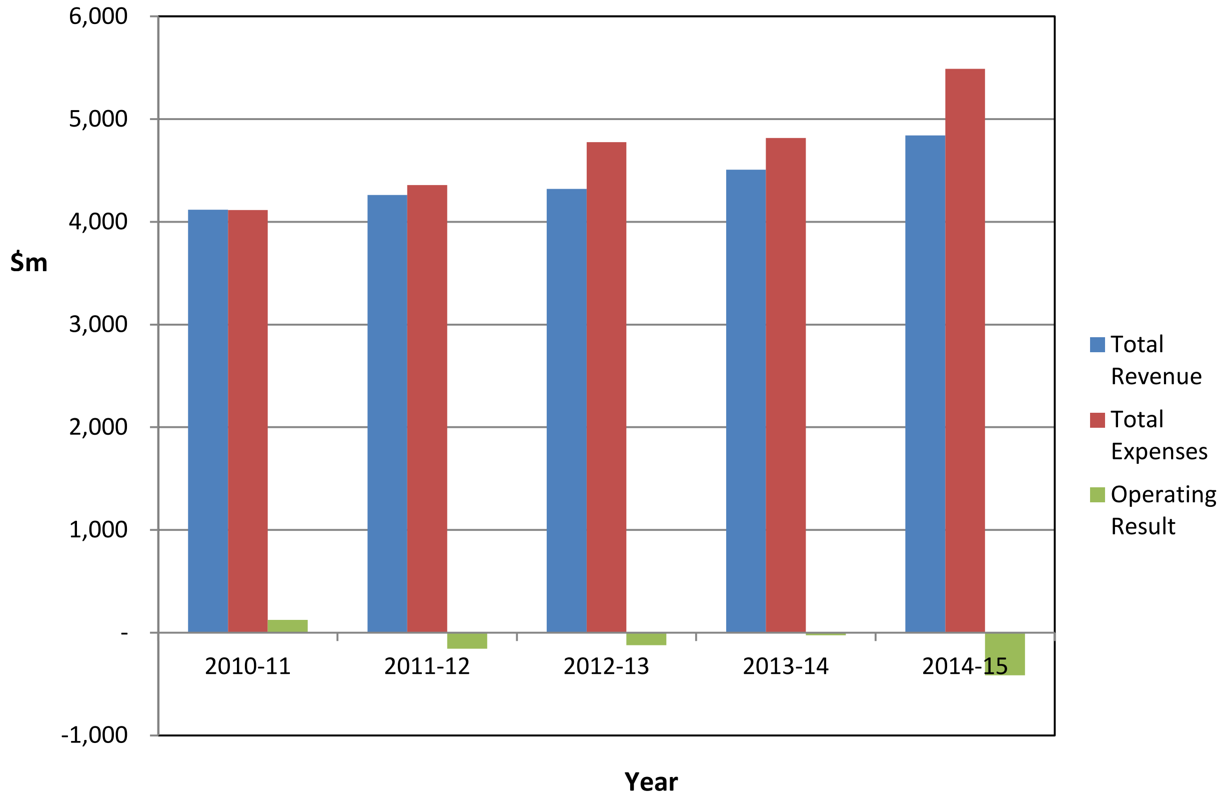
Table 1.1 shows the Territory has a UPF Operating Result deficit of $415 million for 2014-15, which is an increase of $56 million from the budget deficit forecast at the time of the 2014-15 Budget of $359 million. It is also $389 million higher than the 2013-14 financial year deficit of $26 million. Major variations in total revenue, expenses and economic inflows/(outflows) are explained on the following page.

Table 1.1
Total Territory - Operating Result

	2014-15 Actual $m	2013-14 Actual $m	2014-15 Annual Budget $m	2015-16 Annual Budget $m	2016-17 Forward Estimate 1 $m	2017-18 Forward Estimate 2 $m	2018-19 Forward Estimate 3 $m
Total Revenue	4,843	4,507	4,661	4,871	5,163	5,423	5,582
Total Expenses	5,489	4,816	5,198	5,521	5,432	5,661	5,799
UPF Net Operating Balance	**-646**	**-309**	**-537**	**-649**	**-269**	**-238**	**-216**
Economic Inflows/(Outflows)	231	283	178	258	286	214	404
Operating Result	**-415**	**-26**	**-359**	**-391**	**17**	**-24**	**188**

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

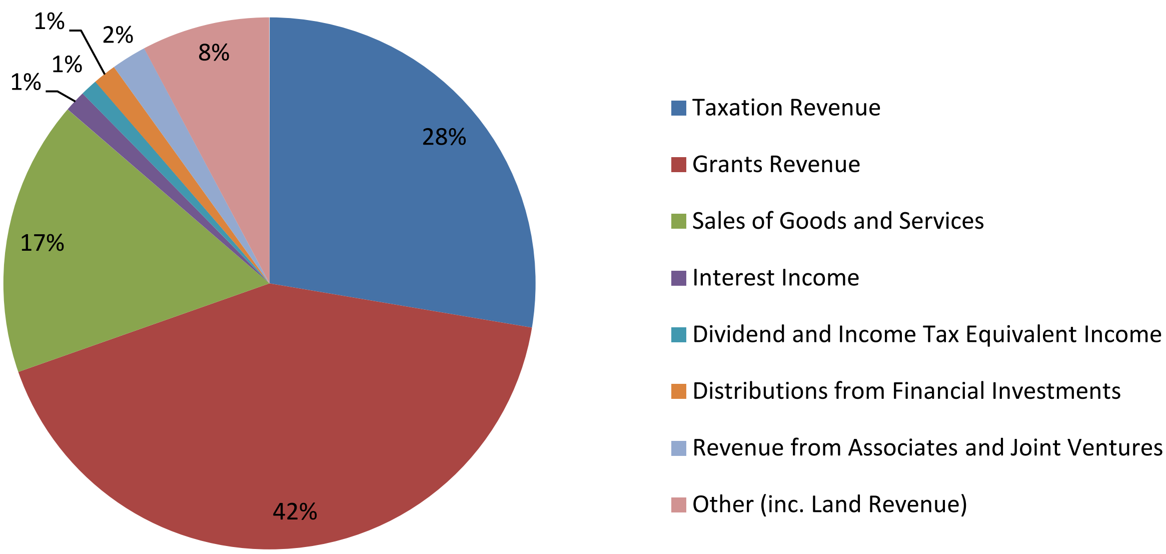
Chart 1.1
Total Territory - Operating Result



Revenue

Total revenue for the 2014-15 financial year was $4,843 million. As demonstrated below in Chart 1.2, the majority of the Territory's revenue is from Commonwealth Government grants (42 per cent) followed by taxation (28 per cent).

Chart 1.2
Total Territory - Revenue Sources



Total revenue was $182 million higher than the $4,661 million forecast at the time of the 2014-15 Budget mainly due to:

- higher Land Revenue (Value Add Component) of $102 million due to higher land settlements, particularly in Coombs, Lawson, Wright, the Flemington Road Corridor and Campbell 5; and

- higher Commonwealth Grants of $101 million largely due to the early payment of Financial Assistance Grants received in 2014-15 and additional payments for the Roads to Recovery National Partnership funding.

Total revenue increased by $336 million compared to the 2013-14 financial year result of $4,507 million. The main drivers for this were:

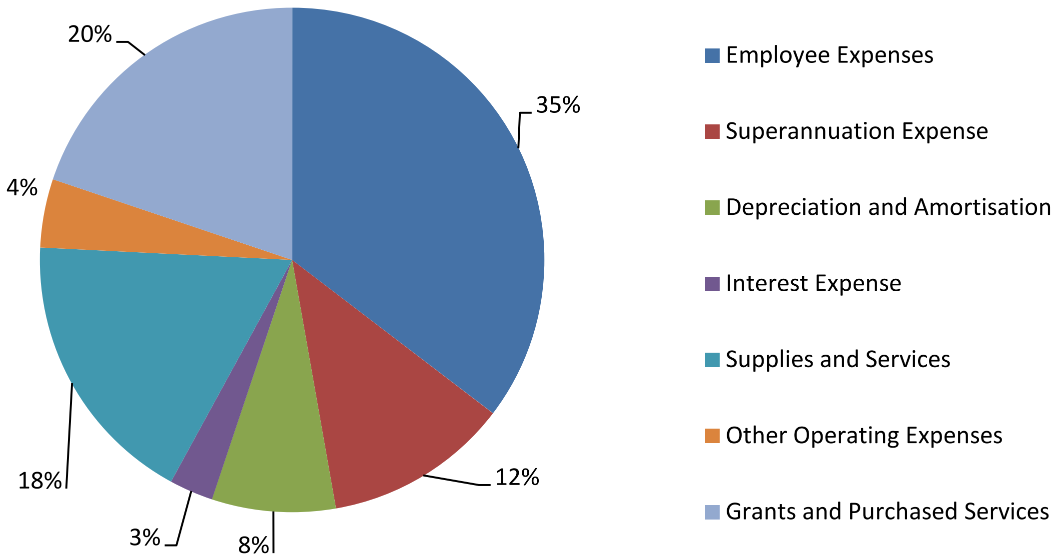
- increased Land Revenue (Value add component) of $161 million related to higher land sales as mentioned above; and

- increased Commonwealth Grants of $153 million largely due to growth in GST receipts and the early payment of Financial Assistance Grants mentioned above.

Expenses

As shown below in Chart 1.3, the largest portion of the Territory's expenses are employee expenses (35 per cent). Total expenses for the 2014-15 financial year were $5,489 million.

Chart 1.3
Total Territory - Areas of Expenditure



Total expenses of $5,489 million were $291 million higher than the forecast of $5,198 million in the 2014-15 Budget. This was mainly due to higher than expected Grants and Purchased Services (by $347 million in total) to support the Scheme as discussed below and higher than anticipated employee expenses[1].

The increase in expenses was partially offset by a decrease in Supplies and Services of $189 million. This was attributed to reprofiling of projects undertaken in the 2015-16 Budget; the capitalisation of works for the Constitution Avenue project which were forecast to be expensed and the timing of project payments as procurement processes progress.

Note 1: Estimates for the cost of the Loose-Fill Asbestos Insulation Eradication Scheme Land were first included in the 2014-15 Budget Review.

Total expenses increased compared to the 2013-14 financial year by $673 million from $4,816 million mainly as a result of:

• higher Grants and Purchased Services of $381 million reflecting impacts of the Asbestos Eradication Scheme;

• increased Employee Expenses of $113 million attributed to the impact of Enterprise Bargaining Agreements and an increase in redundancy payments for Disability ACT and Therapy ACT due to the transition to the National Disability Insurance Scheme; and

• higher other expenses of $72 million attributed to the higher cost of goods sold for the Land Development Agency as a result of increased land sales as discussed above.

Economic Inflows/(Outflows)

The total operating result, which includes economic inflows/(outflows) for the 2014-15 financial year was a deficit of $415 million, which is $389 million higher than the 2013-14 deficit of $26 million. This is due to the impacts on the UPF Net Operating Balance, as discussed above, in addition to an increase of $73 million in Net Losses on the Sale of Financial Assets mainly as a result of volatility of global investment markets on the Territory's superannuation investments.

Financial Position

Table 2.1
Total Territory - Financial Position

	2014-15 Actual	2013-14 Actual	2014-15 Annual Budget	2015-16 Annual Budget	2016-17 Forward Estimate 1	2017-18 Forward Estimate 2	2018-19 Forward Estimate 3
	$m	$m	$m	$m	$m	$m	$m
Financial Assets	6,462	5,680	5,536	5,758	5,991	6,381	6,741
Non-Financial Assets	22,381	21,640	22,423	23,237	24,030	24,466	24,543
Total Assets	28,843	27,320	27,959	28,995	30,020	30,846	31,285
Total Liabilities	14,171	12,127	10,897	12,506	13,392	14,118	14,259
Net Assets	**14,672**	**15,193**	**17,062**	**16,489**	**16,628**	**16,729**	**17,025**
Net Financial Liabilities	**8,630**	**7,081**	**6,027**	**7,472**	**8,144**	**8,494**	**8,283**
Net Debt (excluding Superannuation related Investments)	**2,203**	**1,617**	**2,661**	**3,899**	**4,502**	**4,774**	**4,550**

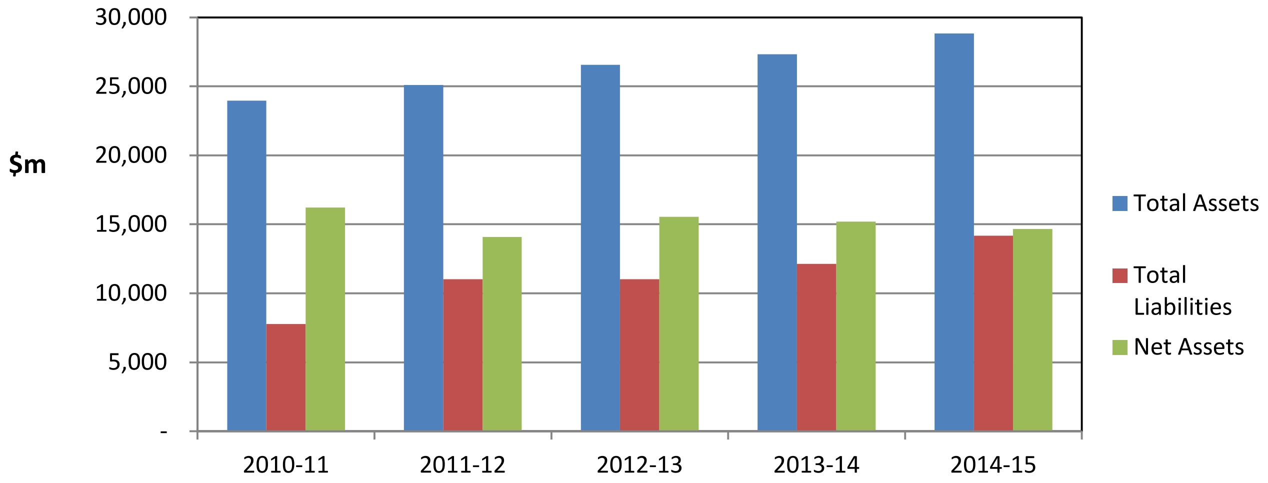
The value of Net Assets at 30 June 2015 was $2,390 million lower than the 2014-15 Budget estimate of $17,062 million and was $521 million lower than the $15,193 million reported at 30 June 2014. Major variances in total assets and liabilities are explained below.

Net Financial Liabilities as at 30 June 2015 were $8,630 million, $1,549 million higher than the 30 June 2014 result of $7,081 million. This variance is mainly due to an increase in the superannuation liability, driven by a change in the valuation rate from 4.08 per cent at 30 June 2014 to 3.66 per cent at 30 June 2015.

Net Debt, excluding superannuation investments, was $2,203 million at 30 June 2015, an increase of $586 million from the 30 June 2014 result of $1,617 million. This variance is mainly due to an increase in Commonwealth borrowings to fund the Asbestos Eradication Scheme.

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

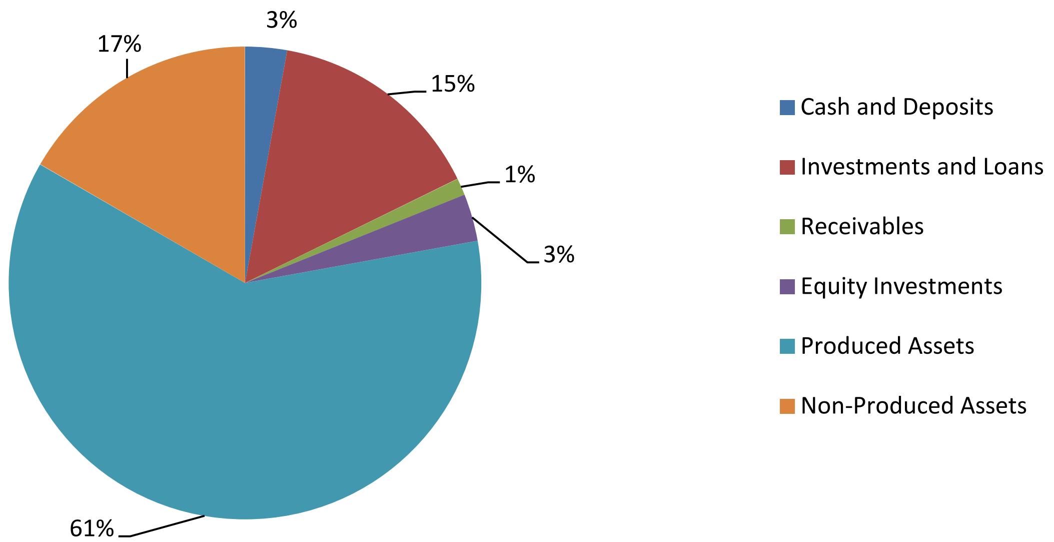
Chart 2.1
Total Territory - Balance Sheet



Assets

Total assets as at 30 June 2015 were $28,843 million. As can be seen from Chart 2.2 below, the majority of the Territory's assets are produced assets, specifically property, plant and equipment (61 per cent).

Chart 2.2
Total Territory - Asset Types



Total assets were $884 million higher than the 2014-15 annual budget[1] of $27,959 million, mainly due to an increase in cash and deposits and the value of land held for the Loose-Fill Asbestos Insulation Eradication Scheme following the planned building demolition and land remediation works on asbestos affected properties.

Total assets increased compared to the 2013-14 financial year by $1,523 million from $27,320 million mainly as a result of higher interest earnings achieved by the Territory's Investment Managers as a result of strong returns on global share markets. The strong return of the global listed share investments increased the investment portfolio return of the Superannuation Provision Account, resulted in higher Cash and Deposits, as well as higher value of Property, Plant and Equipment.

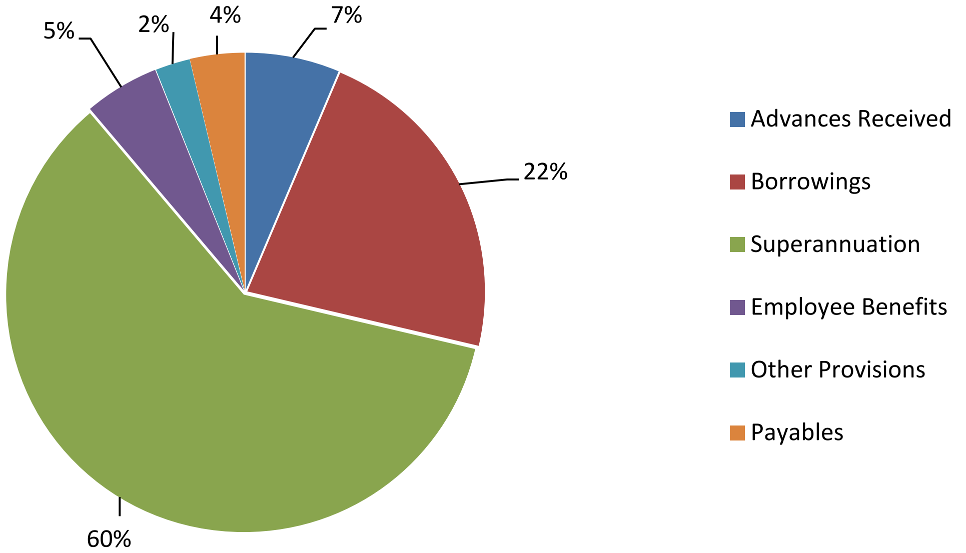
Liabilities

Total Liabilities for the 2014-15 financial year were $14,171 million. As can be seen from Chart 2.3 below, the majority of the Territory's liabilities are related to superannuation (60 per cent).

Note 1: Estimates for the cost of the Loose-Fill Asbestos Insulation Eradication Scheme Land were first included in the 2014-15 Budget Review.

Chart 2.3

Total Territory - Liability Types



Total liabilities increased by $2,044 million compared to the 2013-14 financial year result of $12,127 million. This was mainly due to a decrease in the estimated valuation of the superannuation liability at 30 June 2015 related to domestic interest rates remaining at historically low standards with a discount rate of 3.66 per cent. This has negatively impacted the valuation of the superannuation liability. The discount rate remains below the long-term budget valuation assumption of 6 per cent, as well as being below the discount rate of 30 June 2014 of 4.08 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

	2014-15 Actual $m	2013-14 Actual $m	2014-15 Annual Budget $m	2015-16 Annual Budget $m	2016-17 Forward Estimate 1 $m	2017-18 Forward Estimate 2 $m	2018-19 Forward Estimate 3 $m
Net Cash Flows from Operating Activities	128	443	84	-30	380	564	729
Net Cash Flows from Investments in Non-Financial Assets	-741	-621	-772	-1,022	-859	-718	-369
Cash Surplus (+) / Deficit (-)	**-613**	**-178**	**-688**	**-1,052**	**-479**	**-154**	**361**

Net Cash Flows from Operating Activities were $128 million, which is $44 million more than the 2014-15 Budget of $84 million and $315 million less than 2013-14 outcome of $443 million. This is mainly due to the impacts of the Asbestos Eradication Scheme and higher land settlements as discussed above.

Net Cash Flows from Investments in Non-Financial Assets was $31 million lower than the 2014-15 Budget of $772 million and $120 million higher than 2013-14 outcome of $621 million. The increase is largely attributed to the completion of major capital works including the National Arboretum, Canberra College - Phillip Campus, the Integrated Cancer Centre, the ESA Station Upgrade at South Tuggeranong and the Common Ground Supportive Housing.

Infrastructure Investment

Table 4.1
Total Territory - Infrastructure Investment

	2014-15 Actual $m	2013-14 Actual $m	2014-15 Annual Budget $m	2015-16 Annual Budget $m	2016-17 Forward Estimate 1 $m	2017-18 Forward Estimate 2 $m	2018-19 Forward Estimate 3 $m
Infrastructure Investment	420	510	620	699	691	636	521

The 2014-15 Whole-of-Government Capital Works Program Investment for the Territory was $420 million; this was $200 million less than the 2014-15 Budget estimate of $620 million and $90 million less than the 2013-14 infrastructure investment of $510 million.

Major infrastructure investment during 2014-15 included (values are whole of life project costs):

- Transport for Canberra – Majura Parkway – $288 million
- John Gorton Drive Extension to Molonglo 2 and Group Centre – $65 million
- Alexander Maconochie Centre – Additional facilities – $54 million
- Coombs P-6 School Construction Funding – $47 million
- Secure Mental Health Unit – $43 million
- Constitution Avenue – $42 million
- Health Infrastructure Program – $28 million
- The Canberra Hospital Redevelopment – $24 million
- Civic to Gungahlin Corridor Improvements – $20 million
- Calvary Public Hospital – Car park – $19 million
- ESA Station Upgrade and Relocation – Aranda Station – $19 million

Major infrastructure physically completed during 2014-15 included (values are whole of life project costs):

- Integrated Cancer Centre – Phase 2 – $20 million
- National Arboretum Canberra (Commonwealth Contribution) – $19 million
- ESA Station Upgrade and Relocation – South Tuggeranong Station – $17 million
- Canberra College Cares – New Building at Phillip Campus – $14 million
- Common Ground Supportive Housing – $14 million