Government Response to Pegasus Economics Report:

Review of the ACT Budget 2022-23

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Introduction

In its *Inquiry into Appropriation Bill 2022-2023 and Appropriation (Office of the Legislative Assembly) Bill 2022-2023*, the Select Committee on Estimates 2022-23 commissioned Pegasus Economics (Pegasus) to review the ACT's 2022-23 Budget[1], consistent with the Committee's resolution of establishment[2] (paragraph 5). Pegasus produced the *Review of the ACT Budget 2022-23* (the Pegasus Report) for the Committee's consideration, and a copy of the report can be found on the Legislative Assembly website[3].

The Pegasus Report provides a range of assessments regarding the 2022-23 Budget. As stated by Pegasus (page vi), the report has been prepared "... to assist the ACT Legislative Assembly's Select Committee on Estimates 2022-2023 in its consideration and review of the 2022-23 ACT Budget. The draft report was required to be produced within a week of the presentation of the Budget to the Legislative Assembly. It is based on a desk-top review of the available documentation".

The Government remains committed to open, transparent and accountable practices in its management of the Territory's public finances, ensuring that sustainable taxation revenues are closely aligned with service delivery levels that meet community standards. The independent review of the 2022-23 Budget undertaken by Pegasus provides a number of important observations regarding these activities. These observations are welcomed, and, in turn, the Government wishes to present this response to the matters raised by Pegasus' assessment for the Committee's consideration.

[1] https://www.treasury.act.gov.au/budget/budget-2022-23/budget-2022-23

[2] https://www.parliament.act.gov.au/parliamentary-business/in-committees/committees/select-committee-on-estimates-2022-2023#tab2002332-1id

[3] https://www.parliament.act.gov.au/parliamentary-business/in-committees/committees/select-committee-on-estimates-2022-2023#tab2002332-3id

Pegasus Economics Review of the ACT Budget 2022-23

Economic Forecasts
(Chapter 2, pages 2 to 7)

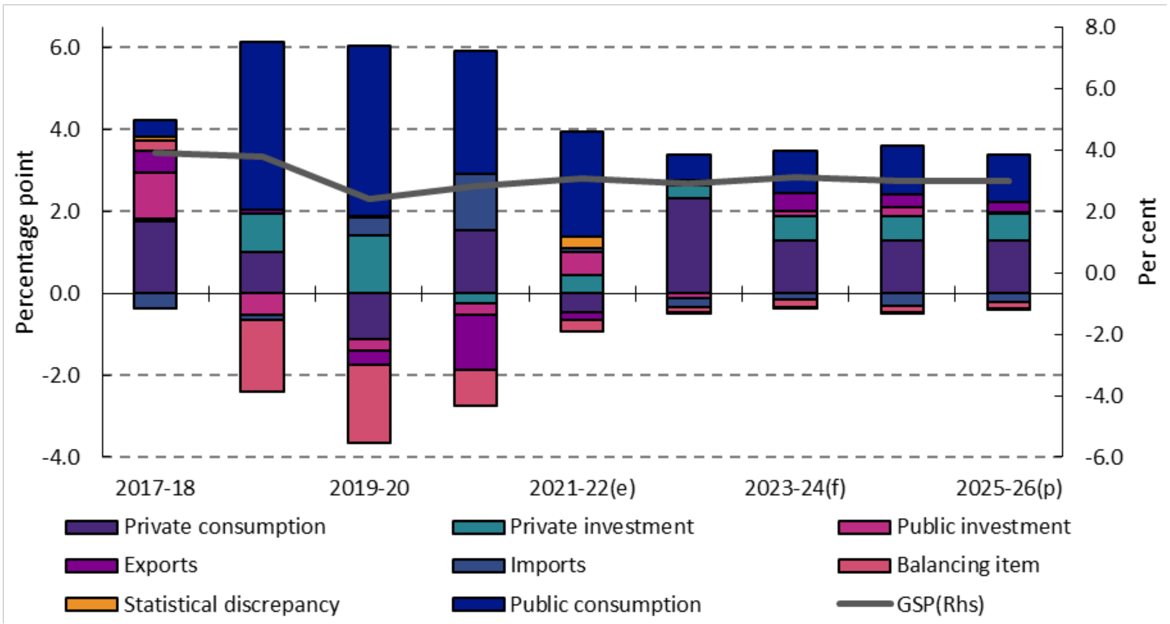
Economic diversification

Pegasus: "Since the onset of economic disruption caused by the COVID-19 pandemic, the ACT economy has become less diverse and more dependent on the public sector, with the Commonwealth and ACT governments' now accounting for more than 54 per cent of final demand" (page 5).

Response:

It is entirely appropriate that Government spending has made a greater contribution to economic activity over the pandemic period, with increased spending on the public health response and to support households and businesses through the pandemic, both nationally and in the ACT. This support has contributed to ongoing growth and jobs in the ACT at a time when private sector activity has been affected by the necessary public health restrictions in response to COVID-19. With the easing of restrictions, private sector activity is recovering, and government support is now targeted on very specific areas of need. The public health response is also evolving. As a result, the private sector is expected to make an increasing contribution to growth going forward as noted in Chart 1 below.

Chart 1: Contribution to GSP growth, ACT



Sources: ABS National Accounts: National Income Expenditure and Product; and CMTEDD estimates.

In addition, while Government spending increased as a proportion of total demand in the ACT economy during the pandemic, that spending has supported other industries that supply Government. Economic diversification is best measured by the value-added (or supply) from production that each industry makes to the economy.

The most recent data on industry value-added to June 2021[4] shows that 17 out of all 20 industry groups in the ACT have expanded their value-added over the past five years (Chart 2). Further, Public Administration and Safety (i.e., Government) has fallen as a share of total industry output from 33.4 per cent in June 2016 to 32.0 per cent in June 2021. Over the same period, Professional Services has grown from 8.4 per cent to 11.5 per cent of total industry value-add (Chart 3).

Chart 2: ACT Industry Groups – movement from June 2016 to June 2021

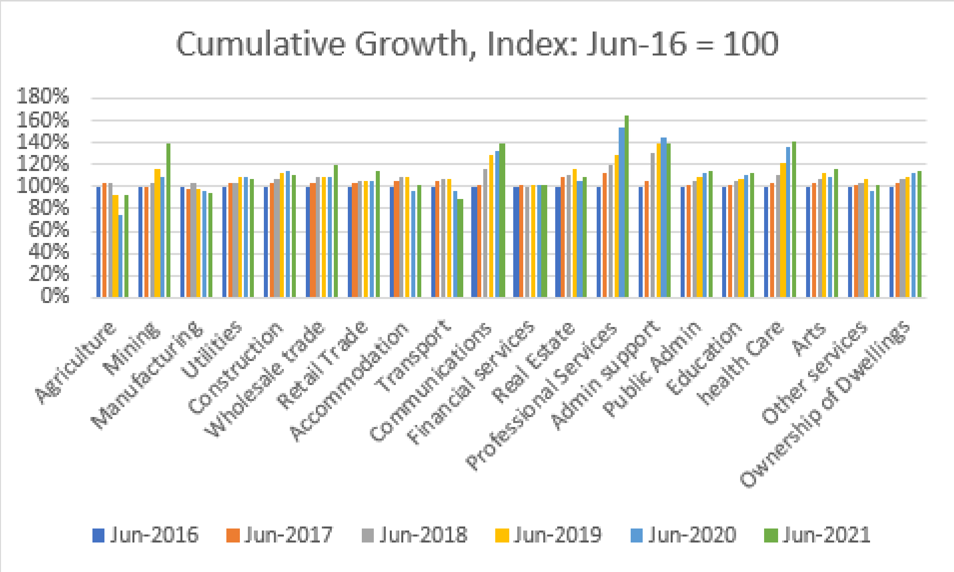
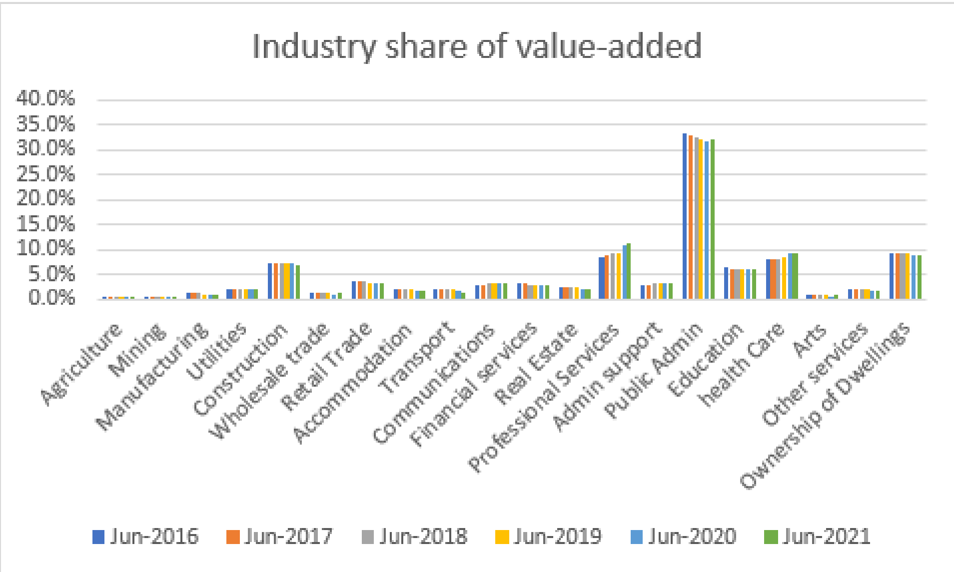


Chart 3: Industry value-added share – movement from June 2016 to June 2021

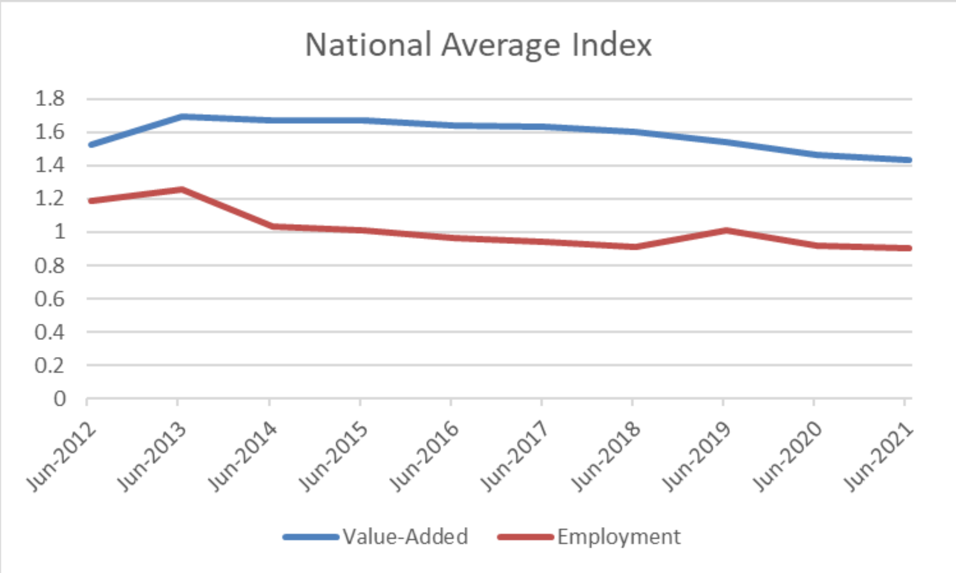


Economic diversity can also be measured based on the ABS methodology for the National Average

[4] Australian Bureau of Statistics (ABS) *Australian National Accounts: State Accounts,* https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-state-accounts/2020-21

Index[5] which compares a region's industry structure with that of the nation, with lower scores showing higher relative diversity. Using this approach, the ACT has improved its industrial diversity over the past 10 years relative to Australia's industry diversity both in terms of industry output (value-added) and employment (Chart 4).

Chart 4: National Average Index of Industry Diversity – ACT



Source: 5220.0 Australian National Accounts: State Accounts and 6291.0.55.001 Labour Force, Australia, Detailed

Consumer Price Index outlook

Pegasus: "If the Reserve Bank's and Commonwealth Government's most recent forecast for the CPI in 2022-23 are in the ballpark then it is highly likely the ACT forecast for the Canberra CPI in 2022-23 is too low" (page 6).

Response:

There is consistency across the ACT, Commonwealth Treasury, and the Reserve Bank of Australia (RBA) on the broad direction of inflation expectations, with annual CPI growth is expected to peak at the end of calendar year before moderating and then normalising.

There are a range of countervailing factors contributing to inflation, along with upside and downside risks.

- Petrol and food price pressures are expected to ease, with petrol prices having already fallen by around 16 per cent from the week ending 10 July to the week ending 21 August 2022, noting the excise discount is due to be removed in September. Flood affected food production is also anticipated to recover.

[5] 1381.0.55.001 - Research Paper: A Review of Selected Regional Industrial Diversity Indexes, 2011 (abs.gov.au)

- Electricity prices in the ACT are expected to decline over 2022-23 due to the ACT's contractual arrangements for the supply of green energy. In comparison, the rest of the country is likely to face strong price rises.
- The war in Ukraine and ongoing restrictions in China remain key risks.

Due to uncertainties with the inflation environment, the Budget Outlook included upside and downside scenarios, noting the forecasts reflect ACT Treasury's best central estimates at the time and the range of possible outcomes in the scenarios are consistent with Commonwealth Treasury and RBA expectations on inflation; this is a level of detailed analysis on economic forecasts not provided by any other State or Territory, or the Commonwealth. Those uncertainties are also demonstrated by the fact that the recent RBA inflation forecast of 6.2 per cent through 2022-23 referred to by Pegasus was a significant upgrade from its forecast available at the time of preparing the ACT Budget of 4.3 per cent[6].

Population growth outlook

Pegasus: "… the outlook for population growth presented by the ACT Government is optimistic compared to forecasts prepared by the Centre for Population (2022, page 6) that suggest more modest population growth for the ACT. While the Centre for Population is forecasting ACT population growth will increase following the pandemic, it is not expected to return to its pre-pandemic levels" (page 7).

Response:

The Centre for Population (CPOP) forecasts referred to by Pegasus use estimated resident population (ERP) data from the ABS as at 29 March 22, which is before the release of the 2021 Census data, and are based on the previous 2016 Census. As a result, the CPOP forecasts are not comparable with the ACT's population estimates, which use ERP rebased to the 2021 Census of Population and Housing (2021 Census).

The first stage of data from the 2021 Census, along with updates to ERP for Australia and the States and Territories, released by the ABS on 28 June 2022 showed:

- the ACT was the fastest growing jurisdiction in Australia since the 2016 Census, growing by 14.4 per cent or 57,102 people;
- population in the ACT had been growing at an average annual rate of 2.4 per cent over the five years between the 2016 and 2021 Censuses – 1 percentage point per annum higher than previously estimated; and
- there was a significant underestimation of the ACT's estimated resident population of around 21,800 people (or 5.1 per cent of the ACT population) as at June 2021.

With international borders now open again and greater mobility domestically, and reflecting the higher than previously estimated average annual growth rate over the five years to June 2021, the population growth rate is expected to progressively return to its long-run 15-year average growth

[6] RBA Statement on Monetary Policy – May 2022. https://www.rba.gov.au/publications/smp/2022/may/forecasts.html

rate, reaching 2 per cent by 2024-25.

- Higher levels of net overseas migration and net interstate migration are expected over the forecast period.
- It is assumed that net overseas migration will not reach pre-pandemic levels before 2026-27, as it is expected to take time for migration patterns to return to normal.

Table 2.2.2 of the 2022-23 Budget Outlook details the upside and downside population growth scenarios. The upside scenario assumes that lockdowns in China ease more quickly than in the baseline scenario, and that COVID-19 also has less of an impact on countries that are major sources of skilled migrants and tourists for Australia. This scenario forecasts an additional ¼ per cent growth over the period 2022-23 to 2025-26 over the baseline scenario.

The downside scenario assumes the inverse, with migration levels lower in the near term with students and skilled migrants returning more slowly than assumed in the baseline scenario. The downside scenario forecasts a reduction in population growth of ¼ to ¾ per cent over the budget and forward estimates period relative to the baseline scenario.

Housing Market Issues
(Chapter 3, pages 8 to 15)

Housing affordability

Pegasus: "The ACT Government contends that housing remains affordable in the ACT given the relatively high income levels. This statement is factually correct as the ACT enjoys the highest level of average weekly ordinary time earnings for adults working full time across all states and territories. However, it is also arguably the case that people on lower incomes, often suffering from socio-economic disadvantage, can no longer afford to reside in the ACT" (page 9).

Response:

As noted in the 2022-23 Budget Cost of Living Statement, housing costs are the most significant expense for households in Canberra and nationally. House prices and rents contribute to the high proportion of expenditure on housing. Despite median property prices being the third highest of all capital cities in the March quarter 2022 and median weekly rent being the highest of all capital cities, housing remains relatively affordable in the ACT compared to our income levels. In March 2022, the proportion of family income required to meet average loan repayments in the ACT was 27.8 per cent, compared with 37.3 per cent nationally, and the proportion of family income required to meet average rent payments was 22.5 per cent compared with 23.5 per cent nationally.

However, these aggregate measures do not capture the experience of all ACT residents and housing affordability is an issue for some lower income households. The Government is committed to increasing the supply of more affordable homes and supporting Canberrans to access the housing market.

The 2022-23 Budget included $140 million in new funding for social and affordable housing, with more than $45 million over four years to support housing affordability for low-to-medium income households (2022-23 Budget Outlook, pages 71 to 76). This includes further investment in public housing, changes to conveyance duty for owner-occupiers, releasing block 3 section 57 in Turner in 2022-23 as a site to pilot Build-to-Rent with an affordable rental component through a market process, and providing a time limited Lease Variation Charge discount to eligible Build-to-Rent developments that include a minimum of 15 per cent of dwellings as affordable rental. Further information on the Government's support for Build-to-Rent initiatives with affordable rental is here: https://www.treasury.act.gov.au/infrastructure-finance-and-reform/build-to-rent

Housing affordability is an issue across cities and regional areas around the country, not just Canberra. A wide range of factors have contributed to rising house prices including Commonwealth tax policy, historically low interest rates, financial deregulation, investor sentiment and increasing house sizes. The capital gains tax discount and negative gearing at the Commonwealth level in particular have encouraged investors to enter the housing market, increasing demand and prices.

While the Commonwealth Government is responsible for the primary levers that could be used to address housing affordability (CGT and negative gearing), the ACT Government is committed to increasing the supply of more affordable homes and supporting Canberrans to access the housing market.

Land tax and its effect on rental prices

Pegasus: "The potential problem arising from the application of land tax on rental properties in the ACT is that most of the impost is likely to be passed through to prospective renters in the form of higher rental prices" (page 9).

Response:

There are a wide range of factors that influence rental prices, including vacancy levels, demand, housing stock, the average income of residents and the costs associated with providing a property for rent.

Land Tax applies to residential ACT properties that are not a principal place of residence and are fit for occupation (including recently constructed dwellings). This includes rented properties, those that are vacant, properties owned by a corporation or a trustee, and any rented dwellings on the same property as your home (such as a granny flat).

Land tax, which is tax deductible, is not considered a significant contributor to high rental prices in the ACT. All States and Territories apart from the Northern Territory levy land tax on residential investment properties.

The key reason for increases in rental prices is a function of low rental vacancy rates, due to strong population growth. Rents are now rising in many states across Australia, where many areas are now also experiencing vacancy rates of just above zero. The ACT supports tenants through regulations that require landlords to justify increases in rent significantly higher than increases in inflation.

Data suggests rental investment returns remain high and that the ACT continues to be an attractive place to invest.

Investors would take land tax into account in their decisions to invest. Ultimately an investor will target an expected rate of return taking into account the rent they can charge and the outgoings they must pay. This will in turn influence the price they are willing to pay for an investment property.

In 2018, the ACT Government extended land tax to all properties that are not a principal place of residence, including vacant priorities. This change means that land tax also has a role in encouraging investment properties to be offered on the market (either for rent or sale) and not remain vacant.

- If land tax were not levied, investment property owners would have lower incentives to rent their property out. Any reduction in the supply of rental dwellings would further increase competition between tenants in the ACT's tight rental market.
- Available data suggests the proportion of vacant dwellings in the ACT is lower than other capital cities, and that the current economic incentives (such as land tax) have an impact on maximising the supply of properties available for rent[7].

Wellbeing – housing and home

Pegasus: "… 'Housing and home' is identified as one of the Wellbeing domains that has informed the development of policies in the Budget, the Budget Papers do not provide any specific indicators of Wellbeing in this domain" (page 10).

Response:

Pages 71 to 76 of the 2022-23 Budget Outlook present a summary of the Government's previous and current investments towards addressing the social housing needs of the Territory, providing avenues to address homelessness, and creating access to short-term emergency accommodation. The 2022-23 Budget includes $140 million in new funding for social and affordable housing, and the ACT has committed more than $1.4 billion towards generating new public housing over the ten years to 2025.

Embedding wellbeing in decision-making processes is a relatively new endeavour for governments, but is something that the ACT Government is committed to and making progress on ahead of other jurisdictions. The report notes the ACT is one of the few governments to incorporate a wellbeing framework into its annual budget. Page 59 of the 2022-23 Budget Outlook provides a brief summary of the milestones that the ACT has achieved to date.

In April 2021 the Government's released the first set of wellbeing data through the wellbeing data dashboard[8] and this will be updated periodically to show movement in aspects of wellbeing in the ACT over time. The 2022-23 Budget is the second time that wellbeing impact assessments have been part of the budget process to ensure that proposals before Government consider the wellbeing impacts on our community, institutions, and the environment. Wellbeing is further embedded in budget documentation, providing an overview of the wellbeing context of initiatives and the impact they will have across the community. In addition, the budget documentation

[7] 2020-21 Census, Search Census data, Australian Bureau of Statistics (abs.gov.au) - Unoccupied dwellings for the Greater city areas and the ACT

[8] https://www.act.gov.au/wellbeing/explore-overall-wellbeing

identifies areas across all investment categories, including in the case of housing, that the community indicated in budget consultation matter to wellbeing.

The linkages between the Wellbeing domains and their presentation in the budget papers will continue to evolve over time, and reporting of Wellbeing outcomes will similarly strengthen as the wellbeing evidence base continues to be built. Non-ACT government metrics of wellbeing in the Territory, such as from the University of Canberra's *Living Well in the ACT region survey*[9] and ABS data, will also be incorporated to as much as possible.

Land Supply – Land release

Pegasus: The Budget Papers state that the estimates reflect a steady schedule of land releases to meet forecast demand, "reflecting the upgrades to population growth" (ACT Government, page 374). It is difficult to reconcile this claim with the population growth assumptions in the Budget and land revenue for ACT Government PTEs and the ACT General Government sector dividends from land sales in the financial statements.

Notwithstanding these claims, there is some evidence that the supply of land for residential property development in the ACT is inadequate (page 11).

Response:

The ACT Government's Indicative Land Release Program (the Program) is refreshed each year and is adjusted in line with the Government's priorities to best respond to the circumstances impacting the Canberra community. The ACT Government is committed to improving housing availability, diversity, and choice to a growing population in Canberra.

Forecast population growth plays an important role in helping to shape the Program, along with a range of other considerations.

Program specific releases of public land are only one avenue of increasing housing supply to the market. Commonwealth land and contributions from the private sector through redevelopment opportunities within existing suburbs also contribute to housing supply. When this is taken into consideration, the supply of housing to the market is keeping pace with demand. In 2021-22, the Suburban Land Agency released 3,904 residential dwellings, including re-releases of previously deferred sites.

The residential land release program for the next five years targets the release of land for 16,417 homes to cater for new housing demand. In 2022-23, land is programmed for release to support 3,918 new homes.

To improve the supply of private rental accommodation and meet the diverse housing needs of the ACT's growing population, the 2022-23 to 2026-27 Program also highlights the Government's commitment to exploring the Build-to-Rent model as an option to provide long term affordable rental choices. A prospectus has been released, particularly targeted to long-term investors and partners interested in pursuing the Build-to-Rent model in the ACT.

[9] https://www.canberra.edu.au/research/institutes/health-research-institute/living-well-in-the-act

While the ACT Planning Strategy 2018 aims to deliver 70 per cent of new housing within Canberra's existing urban footprint, it is recognised that maintaining a supply of homes in a variety of greenfield locations and price points contributes to making Canberra an attractive place to live. As a result, the Program continues to set ambitious targets for the delivery of detached dwellings.

Land supply – Prices

Pegasus: "If the supply of residential land is constrained resulting in relative scarcity, this in turn will put upward price pressure on residential land. As a major input into the price of residential property, relative scarcity in the supply of residential land can also be expected to feed into higher residential property prices. ACT Government agencies benefit from the high land prices generated by the mismatch between supply and demand" (page 12).

Response:

There is limited evidence provided in the report to support this assertion.

In a period of weak population growth from border closures, the recent strong house price growth in the ACT and across all of Australia has been driven by supportive fiscal policies and unprecedented expansionary monetary policy, including record low interest rates.

Property transactions reflect both established dwellings and new dwellings. Land release is a small part of the volume of transactions.

- The number of properties being sold in 2021-22 was under 9 per cent of the total dwelling stock.
- The number of dwellings increased by around 3 per cent from new constructions.

Privately owned land in key urban infill localities outweighs the inventory of ACT Government property holdings in these areas and will play an increasing role in delivering residential supply in the existing urban footprint of Canberra.

The Government's land release program supports housing diversity and affordable housing choice, with a range of different dwelling types supporting the overall residential release target. In 2022-23, the Government is targeting the release of 799 single dwellings, and 3,119 multi-unit dwellings.

Land release is only one part of the supply side for new dwellings, as house construction needs to take place.

- With the industry being at capacity not just in the ACT but in other jurisdictions, this indicates that there is a limit to the number of dwellings that can be built at any one time. In addition, completion of new residential dwellings has slowed as a result of COVID-19 impacts, including labour and material shortages.
- In addition, there have been significant increases in construction costs that are affecting residential property prices.

It should be noted there are significant costs associated with land development and that revenue received helps support services and infrastructure for a growing population, including roads and public transport, public schools, and other community infrastructure and services.

Affordable and social housing supply

Pegasus: "Regardless of their effectiveness, the scale and timing of the new measures is unlikely to have a significant impact on equitable access to housing in the ACT. [Pegasus quoting chief executive of the Real Estate Institute ACT, Michelle Tynan]: "... the delivery of 75 to 150 affordable homes outlined in the Budget will not adequately address the waiting list of over 3,000 registrations for affordable and social housing in the ACT" (page 14).

Response:

The ACT spends the second highest per capita on social housing ($328.36 per person) after the Northern Territory and almost double the national average ($174.73 per person)[10] and the ACT has the highest number of public housing dwellings relative to population of any jurisdiction in Australia at double the national average. However, there remains the need to increase the number of affordable housing options in the ACT.

The 2022-23 Budget provides an additional $30 million to support the Government's commitment to increase the public housing stock by 400 dwellings by 2024-25, bringing its total funding commitment to this target to over $200 million. The Budget also provides a time-limited Lease Variation Charge discount to eligible Build-to-Rent developments that include a minimum of 15 per cent of dwellings as affordable rentals and are managed by Community Housing Providers. The Government is also considering further initiatives to expand the supply of community housing in Canberra.

More broadly in relation to affordable housing, the ACT Government is committed to dedicating 15 per cent of the Indicative Land Release Program to public, community and affordable housing and, as part of this commitment, has set an annual community housing target to provide additional affordable rental properties managed by registered community housing providers (a target that has been exceeded since it was announced in the Housing Strategy in 2018). The Government is also seeking to leverage the emerging rollout of Commonwealth Government shared equity home purchase support to maximise opportunities for Canberra residents.

Public housing stock

Pegasus: "The available evidence suggests the stock of public housing has not kept pace with ACT population growth, and has remained stagnant at around 11,000 dwellings since 2011 while the ACT resident population has grown by just over 23 per cent between 2011 and 2021" (page 14).

Response:

As noted above, based on the latest published data on the number of public housing dwellings in states and territories[11] and population[12], the ACT has the highest number of public housing

[10] Report on Government Services 2022: Refer part G, section 18 - Housing

[11] Report on Government Services 2022: Refer part G, section 18 – Housing (Table 18A.3)

[12] ABS Population 2021 Census

dwellings relative to population of any jurisdiction (23.9 dwellings per 1,000 people compared to 11.8 nationally).

Since 2011-12, the average number of public housing dwellings in Australia has declined by 9 per cent with a reduction in the public housing stock in all states and territories of between 1 per cent (ACT and Victoria) and 37 per cent (Tasmania), with the public housing stock only increasing in Queensland (a 1 per cent increase over 10 years)[13] (Table 1).

Table 1: Time series – number of social housing dwellings (reproduced from Table 18A.3 ROGS 2022

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Australia
Number of dwellings: 2012	112,310	64,768	51,793	33,896	40,906	11,203	10,950	5,080	330,906
Number of dwellings: 2021	96,728	63,921	52,195	31,919	31,938	7,031	10,859	4,929	299,520
Percentage change	-14%	-1%	1%	-6%	-22%	-37%	-1%	-3%	-9%

The ACT Government has made a significant investment in public housing renewal, representing more than a $1.2 billion investment over the 10 years from 2015-25, with the current Growing and Renewing Public Housing Program expected to add 400 additional dwellings to the public housing portfolio and renew 1,000 existing public housing properties by 2024-25.

The age of the average public housing property is now 33.6 years. Without this investment, the average age in 2022 would have instead reached 42.4 years. The average age at the end of the Growing and Renewing Public Housing Program is estimated to be 30-31 years old.

The Government has also increased the supply of Adaptable housing by approximately 200 per cent over the same period, from 308 adaptable housing dwellings in 2014 to 922 adaptable housing dwellings in 2022.

Fiscal Position
(Chapter 4, pages 16 to 23)

Financial statement presentation

Pegasus: "While the ACT Government states that the financial statements included in the Budget papers are consistent with the requirements of the Uniform Presentation Framework agreed by the Heads of Treasury (ACT Government, 2021, page 6), discretion has been exercised in the adoption of some assumptions and inclusion of certain transactions in the reported fiscal position. As in previous years, the reported deficit is reduced by a sizeable superannuation adjustment" (page 17).

Response:

Key accounting treatments are at Appendix G of the 2022-23 Budget Outlook. This includes the basis of financial estimates preparation, changes to presentation that have been adopted in these budget statements and details about the adoption of Australian Accounting Standards as part of the

[13] Report on Government Services 2022: Refer part G, section 18 – Housing (Table 18A.3)

2022-23 Budget.

AASB 1049: Whole of Government and General Government Sector reporting (AASB 1049) is adopted as the basis of accounting and presentation in the consolidated budget financial statements. The only deviation from AASB 1049 is the inclusion of the superannuation return adjustment to the Uniform Presentation Framework Net Operating Balance to obtain the Headline Net Operating Balance (HNOB).

The ACT Government's superannuation arrangements are unique in that we do not operate a dedicated superannuation scheme for our employees. Since October 2006, ACT Government employees have been able to make their own choice of superannuation fund, with the Commonwealth Public Sector Superannuation Accumulation Plan being the default scheme from July 2005 until October 2006. Prior to that time, ACT Government employees participated in the Commonwealth Government's defined benefit employee superannuation schemes, including the Public Sector Superannuation Scheme and the Commonwealth Superannuation Scheme. As a result, some past and current ACT employees continue to be members of the Commonwealth defined benefit superannuation schemes.

The Government recognises a defined benefit superannuation liability on behalf of those employees and is setting aside funds in the Superannuation Provision Account to assist in meeting those liabilities in the long term. As a result, the accounting treatment for the defined benefit superannuation liabilities differs from that in other States and Territories.

Under the Uniform Presentation Framework (UPF), the superannuation expense associated with the defined benefit superannuation liability is reflected in the Net Operating Balance. However, any investment earnings from funds set aside in the Superannuation Provision Account that are classified as capital gains are excluded from revenue. To ensure that the defined benefit superannuation expenses and revenue are reported on a consistent basis, a Superannuation Return Adjustment is included to produce the Headline Net Operating Balance (HNOB). The superannuation return adjustment, when combined with income earnings recognised in transaction revenue, equates to the total target investment return objective for the financial investment assets set aside in the Superannuation Provision Account (CPI + 4.75 per cent). Over the past 26 years to 30 June 2022 the SPA has achieved an investment return of CPI + 4.92 per cent per annum, a higher rate of return.

The Government considers that the HNOB provides the most relevant and meaningful information for making long-term budget allocation decisions, and the inclusion of the full amount of the long-term investment earnings is necessary to provide an accurate assessment of the longer-term sustainability of the budget position. This presentation and HNOB measure has been in place since 2006-07.

The Government also publishes the operating outcome and the superannuation return adjustment as separate lines within the Budget, providing transparency on the Net Operating Balance position consistent with the UPF.

Budget position – medium term forecasts

Pegasus: "The ACT Budget is particularly dependent on Commonwealth funding and growth in the Australian Public Service. A return to surplus for the ACT Government will require favourable economic circumstances and considerable fiscal discipline over a long period of time (page 18).

Response:

The ACT economy has outperformed expectations, demonstrating resilience and flexibility in the face of the COVID-19 pandemic and other adverse global and national events.

The central estimates in the Budget Outlook are for the economy to continue to grow at a robust rate of 3 per cent over the forward estimates.

As already noted, there are upside and downside risks to the Budget economic forecasts, and these are reflected in the scenarios in the Budget Outlook.

In relation to Commonwealth government impacts on the ACT economy, the economic forecasts assume a modest 1.6 per cent per annum growth in Commonwealth Government consumption across the forward estimates period, compared with its long-run average growth rate of 3.8 per cent. This recognises likely Commonwealth budget restraint, but there is also some upside risk depending on changes in Commonwealth consumption and employment patterns.

In addition, payments from the Commonwealth are expected to be $818.4 million higher from 2022-23 to 2024-25 compared to the 2021-22 Budget, largely due to increases in GST revenue grants from stronger household consumption expenditure and the updated estimates of the ACT's population as a result of the 2021 Census increasing our share of GST revenue.

Strength of the Territory's financial position

Pegasus: "The fact remains that over the Budget and forward years net debt and net financial liabilities are growing while net worth is falling slightly in absolute terms. While the key balance sheet measures can vary from year to year with changes in underlying assumptions, the long-term trend shows a deterioration in the Territory's indebtedness and financial obligations" (page 19).

Response:

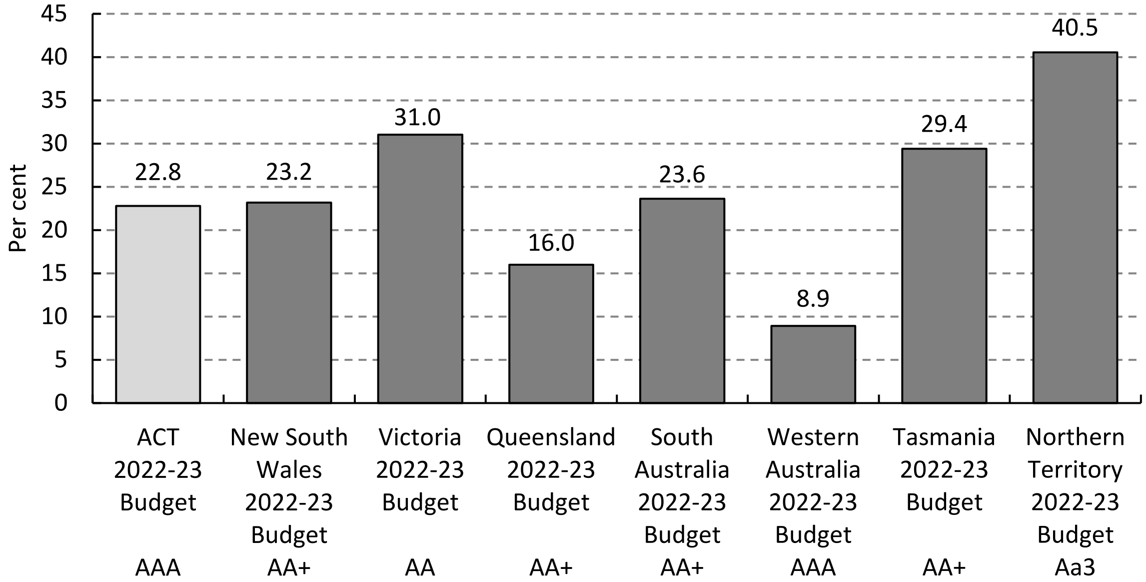
The Government is committed to the principles of sound fiscal management and is continuing to balance strategic investment needs and improving the fiscal position by progressively narrowing the deficit and reducing debt over the long term. The net debt position of governments across the world have worsened during the pandemic. The ACT is in a strong position relative to the other Australian states and territories which is reflected in the fact that we retain a S&P AAA credit rating.

While our net debt position has recently deteriorated, the ACT is well placed to service that debt and to reduce it over time. The growth in debt reflects the ACT Government's significant investments in infrastructure to meet the needs of a growing population. While these investments require borrowing to meet the upfront cost of their construction, the community benefits generated by these investments will extend for many years during which a growing tax base will support the Government's ability to meet its debt obligations.

While Net Financial Liabilities are estimated to increase over the forward estimates, the ACT has the third lowest ratio of net financial liabilities to Gross State Product of all Australian jurisdictions after

Western Australia and Queensland, as well as a AAA credit rating (reproduced below as Chart 5).

Chart 5: Net Financial Liabilities to Gross State Product (GSP) Ratio



Source: Reproduction of Figure 8, ACT Government 2022-23 Budget Statements B. All credit ratings are Standard & Poor's credit ratings, except Northern Territory which is a Moody's credit rating.

Net worth is the broadest measure of the balance sheet, taking into account the value of all assets less liabilities. In the 2022-23 Budget the net worth estimated outcome for 2021-22 is $1.4 billion higher than the original budget estimate mainly due to the revaluation of ACT Government assets associated with stronger growth in the value of properties. Net worth is forecast to increase in 2022-23 by $1.5 billion over the June 2022 estimated outcome.

Other sustainability measures

Pegasus: "Pegasus undertook analysis of the capacity of the General Government sector to meets its financial obligations using similar ratios [to those employed by the ACT Auditor-General].

The coverage of assets to liabilities falls over the Budget and forward years from about 1.8 times in 2022-23 to about 1.6 times in 2025-26.

The ratio of short-term assets to short term liabilities also deteriorates over the Budget and forward years.

Financial assets are forecast to exceed net financial liabilities by approximately 2.0 times in 2022-23 to approximately 1.7 times in 2025-26.

This analysis reinforces the suggestion that the ACT Government's financial position is deteriorating over the medium term" (page 22).

Response:

The forecast coverage of assets to liability and ratio of short term assets to short term liabilities is an improvement on the 2021-22 Budget update.

The Government recognises the importance of managing the Territory's finances in a sustainable way; however, as experienced by almost all governments around the world, the COVID-19 pandemic has required significant action and expenditure to reduce transmission rates, bolster health systems, and protect as many jobs as possible. This investment has avoided a more significant and more prolonged depressed economic environment.

The Government's fiscal strategy as outlined in the 2022-23 Budget Outlook is:

- supporting the continuing public health response to the COVID-19 pandemic;
- delivering high quality services such as health and education for a growing population;
- building on the economic and jobs recovery by diversifying our economy and ensuring we have the skilled workforce to support that diversification;
- continuing to improve our fiscal position by progressively narrowing the deficit and reducing debt over the long term; and
- strategically investing in infrastructure that improves wellbeing and supports economic growth and jobs in the longer term.

Commonwealth budget repair and the associated risk to the ACT budget position, and return of the ACT budget to surplus

Pegasus: "Budget repair by the Commonwealth will require complementary adjustments to the ACT Budgets if the Territory's fiscal position is not to deteriorate further" (page 23).

Pegasus: "The ACT Government has indicated in the Budget Outlook that the path back to a balanced budget will continue to be a focus for the Government over the medium-term. However, we could however find no evidence in the Budget Papers of any articulated strategy for reducing the Territory's debt burden or a timeframe for the return to surplus" (page 23).

Response:

As noted earlier, the economic and fiscal forecasts in the Budget Outlook factor in more modest Commonwealth expenditure in the ACT as the Commonwealth seeks to improve its fiscal position, and there are also some upside risks to both Commonwealth expenditure and payments from the Commonwealth that have the potential to improve the ACT's fiscal position.

In addition, the 2022-23 Budget indicates that the stronger-than-expected economic recovery in 2021-22 has led to a better-than-expected fiscal position, with the deficit in 2021-22 now estimated to be $580.4 million, $371.1 million lower than forecast at the time of the 2021-22 Budget. Since the 2021-22 Budget was delivered in October 2021, the ACT Budget position has improved by over $800 million over four years.

This improved fiscal position is also expected to continue in the coming years, with deficits now expected to be lower than previously estimated and progressively reducing to $229.4 million in 2025-26. This demonstrates a steady trajectory of fiscal repair over time.

As outlined above, the Government's fiscal strategy is to continue this fiscal repair by progressively narrowing the deficit and reducing debt over the long term, while strategically investing in infrastructure that improves wellbeing and supports economic growth and jobs in the longer term.

Revenue
(Chapter 5, pages 24 to 29)

Taxation reform and rates settings

Pegasus: "Consistent with the objectives of the tax reform, the Budget shows own-source taxation revenue from general rates increasing over future years while revenue from commercial and residential conveyances is contracting. In nominal dollars, the increase in rates exceeds the decline in stamp duties. However, this ignores the growth that could have been expected in both revenue sources over the period without the change in policy" (page 26).

Pegasus: "… general rates are not rising quickly enough to replace the amount of revenue lost from changes in commercial and residential conveyance thresholds and rates" (page 27).

Response:

Revenue neutrality of tax reform is a key driver of expected growth in general rates and movements in conveyance duty revenue. However, there are also other non tax reform related factors that influence changes in general rates and conveyance duty revenue.

Without tax reform, general rates revenue would increase in line with changes to WPI and increases in the number of rateable properties, and conveyance duty revenue would be affected by price and turnover changes. These revenue drivers are still relevant even with tax reform, influencing the changes in general rates and conveyance duty revenue over the forward estimates.

The ACT tax reform program is designed to be revenue neutral in aggregate, over the full transition from insurance and conveyance duty to general rates. A study released in August 2020 demonstrated the tax switch has been broadly revenue neutrality to date[14].

The Government has set out that during stage 3 of tax reform:

- Residential conveyance duty tax rates will decrease at a rate set to offset increases in revenue from residential general rates above the increase in the WPI. The reduction in residential

[14] August 2020, ACT Government Revenue Neutrality Paper: https://www.treasury.act.gov.au/__data/assets/pdf_file/0003/1618410/revenue-neutrality-paper-in-the-act-government.pdf

conveyance duty in 2022-23 is the change in the lowest marginal tax rate from 0.68 per cent to 0.6 per cent for owner-occupiers.

- The commercial conveyance duty tax-free threshold will increase to reach $2 million in 2025-26 and this revenue loss is expected to broadly offset increases in commercial rates over stage 3.

In the absence of tax reform, revenue collected from residential conveyance duty would have been $120.3 million higher in 2021-22 and $523.9 million higher over the budget and forward estimates period from 2022 23 to 2025-26.

In addition, in the 2022-23 Budget, on top of the stage 3 reductions in conveyance duty rates, the Government has increased the lowest threshold for residential conveyance duty, to improve housing affordability for lower income households in the ACT.

Using the share of total own source revenue to measure the effectiveness and revenue neutrality of tax reform is flawed, as there are other own source revenue streams outside of the scope of the tax reform program.

A key reason for the fall in the share of rates and duty combined of total own source revenue is the strong growth in payroll tax, which reflects the growth in economic activity and jobs. Further, as noted above, without tax reform, general rates would increase by WPI, not by the average growth rate of own source revenue.

Cost of living

Pegasus: "… in 2024-25, the WPI for the ACT is expected to exceed the Canberra CPI based on the ACT Government's economic projections. While on average, ACT residents in the workforce should be able to offset ACT Government tax increases indexed to the ACT WPI through wage and salary increases, ACT residents whose primary source of income are social security benefits indexed to the national CPI could be relatively worse-off in real terms" (page 28).

Response:

The ACT Government provides a wide range of concessions and assistance to lower income and vulnerable households. Many households whose primary source of income are social security benefits are shielded from changes to taxes and fees. Notably, pensioners, people suffering hardship, and anyone aged 65 or over may be eligible to defer their general rates. This means that rates do not need to be paid until the property is sold, and only a low rate if interest is incurred. Pensioner Centrelink Card holders receive a 100 per cent discount on motor vehicle registration, driver licence renewal and public transport fares. Table 2 shows a summary of some of the assistance available and the estimated annual costs.

Table 2 – Summary of assistance available and estimated annual take-up and costs

Assistance	Description	Estimated take up 2022-23	2021-22 $'000	2022-23 $'000
Ongoing support				
Pensioner General Rates Rebate, FESL Rebate	50 per cent rates rebate up to $750 per year, $98 FESL rebate per year.	15,800 households	11,400	11,500
Utilities Concession	$750 rebate on utility bills.	31,200 households	23,300	23,400
Conveyance duty concessions	Up to 100 per cent discount on conveyance duty payable.	6,600 households	85,500	89,900
Spectacles Subsidy Scheme	Subsidy up to $200 on spectacle purchases once every two years.	9,900 spectacles	1,700	1,700
Taxi Subsidy Scheme	Assistance for people with a disability or significant mobility restriction.	86,200 trips	2,100	2,100
Motor vehicle registration concessions	Up to 100 per cent discount on motor vehicle registration fees.	66,000 registrations	12,300	12,500
Driver licence concessions	Up to a 100 per cent discount on driver licence fees.	7,900 licences	1,900	2,000
Public transport concessions	Reduced or free fares on Transport Canberra bus and light rail services.	5.5 million trips	4,000	9,200
Temporary support				
Residential tenancy relief	Land tax and rates rebates for landlords who reduced rents for affected tenants.	0 households[2]	1,500	0
Utilities Concession	$250[1] additional rebate on utility bills in 2021-22, additional $50 in 2022-23.	31,200 households	7,800	1,560
Total			**151,500**	**153,860**

Notes:

1. In 2021-22, the Government provided an additional temporary $250 rebate under the Utilities Concession in response to impacts of increased electricity prices and COVID-19 on vulnerable households. In 2022-23 the Government is providing an additional temporary $50 rebate in response to rising consumer prices.
1. Residential land tax and rates tenancy relief, provided in response to the August 2021 COVID-19 lockdown, ended on 31 December 2021.

Source: Reproduction of Table 3.3.1, 2022-23 Budget Outlook.

Dividend presentation

Pegasus: "Generally, there is a case for greater transparency in the presentation and explanation of the flows expected from dividends. In this regard, the ACT Government's policy in respect to dividends is unclear' (page 29).

Response:

The ACT Government's dividend policy is set out in notifiable instruments published on the ACT Legislation Register and in each entity's annual report:

- Icon Water maintains a dividend policy of 100 per cent distribution of net profit after tax less gifted asset revenue. An interim, fully authorised dividend is declared and paid in June with a provision made for the payment of a final dividend in October (see page 27 of the 2020-21 annual report).

- The City Renewal Authority pays the Territory a dividend of 100 per cent of net profits after tax (see page 95 of the 2020-21 annual report).

- The Suburban Land Agency operates under a policy of declaring a dividend of 100 per cent of its net profit after tax to the ACT Government (see page 96 of the 2020-21 annual report).

The key reason for the variability in dividend income referred to in the Pegasus report is the uncertainty associated with impact of the COVID-19 pandemic on the housing market and the broader ACT economy in general.

The budget statements for each entity show the estimates for dividends approved and cashflows for payment of dividends. It is not possible to estimate the components of each of these figures with sufficient reliability to provide any further meaningful explanation of the flows expected from dividends.

The financial statements sections of the budget statements of Icon Water, the City Renewal Authority and the Suburban Land Authority contain information on forecast dividends approved and paid for the current financial year.

Expenditure
(Chapter 6, pages 30 to 36)

Growth in expenses

Pegasus: "Forecast expenses for 2022-23 of $7.8 billion have been held at about the same level as the expected 2021-22 outcome. The forecasts show growth over the period of 7.0 per cent on the estimated outcome for 2021-22, or an annual growth rate of 1.75 per cent. This is a very modest increase given the assumptions for population growth and inflation in the Budget" (page 30).

Response:

In 2020-21 and 2021-22, all jurisdictions invested heavily in their COVID-19 responses (both through public health and economic stimulus measures). Many of these programs are short-term responses. The progressive cessation of these programs will result in below average expenditure growth rates across the forward estimates.

While expenses will grow, doing so at a rate below the rate of growth of revenue will support the Government achieving the path back to budget balance which continues to be a focus for the Government over the medium term.

Environmental protection function

Pegasus: "Forecasts for the environment protection function may justify some further explanation. The Budget Papers show an increase in spending from the estimated 2021-22 outcome to $287.5 million in 2022-23 falling across the forward years to $173.5 million in 2025-26. The forecast decline of over $100 million over the forward years is difficult to understand in terms of the Government's commitment to the environment and the prominence of the environment in the Wellbeing domains" (page 32).

Response:

The numbers cited by Pegasus relate to General Government Sector (GGS) expenses by function (Budget Outlook page 217). There are no reductions in base funding for environment protection functions across the forward estimates, and the profile represents the impact of one-off initiatives and the classification of Large-Scale Generation Certificates (LGCs).

The increase in Environmental protection expenses in 2022-23 is mainly driven by the Sustainable Household Scheme, Vulnerable Household Energy Support Scheme and development of an Integrated Energy Plan, all of which involve significant investment this financial year as the Government builds on the success of existing climate action programs and invests in new ones. Funding for these initiatives reduces over the forward estimates as they are not ongoing schemes.

The decrease in expenses from 2023-24 is driven primarily by the classification of the surrender of LGCs. Expenses related to the surrender of LGCs are included in the Environmental protection function up to an including 2022-23, but are accounted for in a central provision from 2023-24 onwards and classified against the Economic affairs function. The expense is non-cash in nature. These expenses do not have a net impact on the budget as there is offsetting revenue associated with the receipt of the certificates.

Wellbeing domains – spending

Pegasus: "At this stage, the Budget documents only allocate new expenditure to [the Wellbeing] domains. It is not possible from the Budget documents to determine how much of the Territory's ongoing base funding contributes to each of the domains. Nor is it possible to identify the impact of the Territory's revenue settings on the Wellbeing domains" (page 35).

Response:

As noted in the earlier response on Wellbeing matters, the linkages between the Wellbeing domains and their presentation in the Budget Papers will continue to evolve over time, and reporting of Wellbeing linkages to base funding and revenue streams will also be explored.

That said, the annual Budget documentation cannot, from a practical point of view, provide an itemised account of all base expenditure and revenue, along with associated wellbeing domain links. In the 2022-23 Budget, the Women's Budget Statement provided an overview of the impact of existing funding as well as new funding across each of the 12 wellbeing domains for initiatives with a specific impact on women.

Capital Works and Infrastructure (Chapter 7, pages 37 to 42)

Capital works forecasts

Pegasus: "One consistent pattern in the forward estimates for capital works program forecasts is the eventual decrease in spending across the forward years that is never actually realised. The Committee might wish to inquire of officials how far into the future the planning timeframe for the capital works program extends" (page 38).

Response:

The capital works program is a five-year rolling program with new initiatives put in place by the Government each year. The forward estimates in a particular budget reflect decisions made in that budget year and expenditure commitment on existing projects put in place in previous years. These estimates are revised in budget review and the annual budgets to reflect new budget decisions.

The capital works program is guided by the ACT Infrastructure Plan which includes projects for which funding has been allocated (current works-in-progress and new works from the 2022-23 Budget), and potential future projects which could be considered in the medium term (within five years), and long term (beyond five years, out to the 2030s). While this plan informs longer-term decision making, the Budget estimates generally do not reflect expenditure for specific projects until they have been agreed by Cabinet. The introduction of a particular initiative in a budget is decided primarily on the basis of community needs, economic circumstances, budget priorities and industry capacity.

The flexibility of the capital works program allowed the Government to respond quickly at the onset of COVID-19 to support the community by bringing forward many smaller projects for fast-tracked delivery to offset delays in larger projects. At the same time, by reconfirming major projects, the Government remains focused on building long-term growth capacity to reach the target of 250,000 jobs in Canberra's labour market by 2025.

Roads projects

Pegasus: "The Committee asked Pegasus to provide advice on the split between capital funding and maintenance for ACT road funding in the Budget. The Budget papers do not provide a separate focus on road works and projects. In addition, the Budget papers do not separately identify what provision has been made in the Budget or forward years for maintenance of existing and new roads" (page 41).

Response:

The estimated outcome for roads maintenance investment for 2021-22 is approximately $49 million largely made up of Municipal and Territorial Road pavement, traffic signal and streetlights and bridges and structure works. Base funding over the forward estimates is expected to continue in line with the 2021-22 estimated outcome and is subject to annual indexation.

The Budget provides details of appropriation for specific road projects. These details can be obtained through the Capital Works Program master data table located at https://www.treasury.act.gov.au/budget/budget-2022-23/budget-2022-23/capital-works-program

Specific funding for road projects is located under the broader project type 'transport'.

Capital Works Reserve

Pegasus: "… the Committee may wish to investigate the operation, including processes for reporting usage of the [Capital Works Reserve]. … Pegasus suggests it explores with the ACT Government and officials:

- Criteria established to assess claims on the reserve
- Authority to approve such claims
- Assurance over the usage of the appropriation

In regard to the latter, the Committee may wish to approach the Auditor-General to review the usage of the Reserve." (pages 41-42).

Response:

The accountability and transparency over the use of funds from the Capital Works Reserve is governed by the *Financial Management Act 1996* (FMA):

- the power to authorise payments from the Reserve is vested in the Treasurer under section 18E;
- the Treasurer must notify the Assembly of details on payments from the Reserve in the quarterly financial statements under sections 18G and 26; and
- the Territory's financial operations in a year are reported in the annual financial statement prepared by the Under Treasurer and audited by the Auditor General. Both the annual financial statement and the Auditor-General's opinion on the statement are presented by the Treasurer to the Assembly (sections 22 to 25 of the FMA).

Section 18E empowers the Treasurer to authorise a capital works advance to an entity for an approved capital works project subject to the following conditions:

1) there is an immediate requirement for the capital works advance to be made to the entity;

2) the capital works advance is required in addition to the entity's capital works budget for the financial year; and
3) the capital works advance will not result in total funding for the project exceeding the total amount budgeted for the project:
    - this condition is satisfied through a corresponding reduction, in the same amount as the capital works advance, in future budget funding allocation for the project; and
    - the total amount of capital works advances authorised in a financial year does not exceed the total amount appropriated for the Reserve in that year.

Section 18G(2) of the FMA requires a reconciliation of the capital works reserve of amounts appropriated, advances authorised, any reductions in advances and the amount of reserve remaining.

A reconciliation of the capital works reserve of amounts appropriated, advances authorised, any reductions in advances and the amount of reserve remaining is included in the Quarterly Consolidated Financial Reports, available on the Treasury Publications website[15].

In 2021-22, $45.9 million was appropriated under Section 18E of the FMA:

- $11.4 million to Housing ACT for the for the Securing high quality public housing project; and
- $34.5 million to Major Projects Canberra for the Light Rail 2A and Canberra Hospital Expansion projects.

Assets and Liabilities (Chapter 8, pages 43 to 49)

Net debt

Pegasus: "In both absolute and relative terms, the ACT's net debt in 2022-23 is lower than had been forecast in the 2021-22 Budget, but the trend remains persistently upwards: in absolute terms, net debt at the close of the 2025-26 fiscal year is forecast to be nearly double that of the estimated debt for 2021-22" (page 43).

Response:

Net debt in 2021-22 is now estimated to be $725.2 million lower than was originally forecast in the 2021-22 Budget.

Net debt is forecast to increase over the forward estimates period, reflecting the Government's support for the community and business sector response to the COVID-19 pandemic and its infrastructure investment program.

Key infrastructure policy decisions include the expansion of the Canberra Hospital, extending Light Rail to Woden, new CIT Woden Campus and Public Transport Interchange, new schools in

[15] https://www.treasury.act.gov.au/publications

Strathnairn, Whitlam, Taylor and Kenny as well as expansion and modernising existing schools. These investments are necessary to support the needs of a growing population. While these investments require borrowing to meet the upfront cost of their construction, the community benefits generated by this infrastructure will extend for many years during which a growing tax base will support the Government's ability to meet its debt obligations.

In 2020-21 there was additional expenditure to support COVID -19 impacts of over $475 million for direct payments and tax relief measures to support local Canberra business as well as $90 million additional expenditure for Health programs.

Net debt is, however, now forecast to be lower each year over the forward estimates than forecast at the 2021-22 Budget Review.

The Government is committed to the principles of sound fiscal management including balancing strategic investment needs and maintaining a sustainable level of borrowings.

Public debt interest

Australian interest rates are rising. As interest rates continue to rise, the ACT will be faced with higher public debt interest bills. The Budget Papers do not indicate any long-term strategy for paying down the stock of accumulated debt" (page 44).

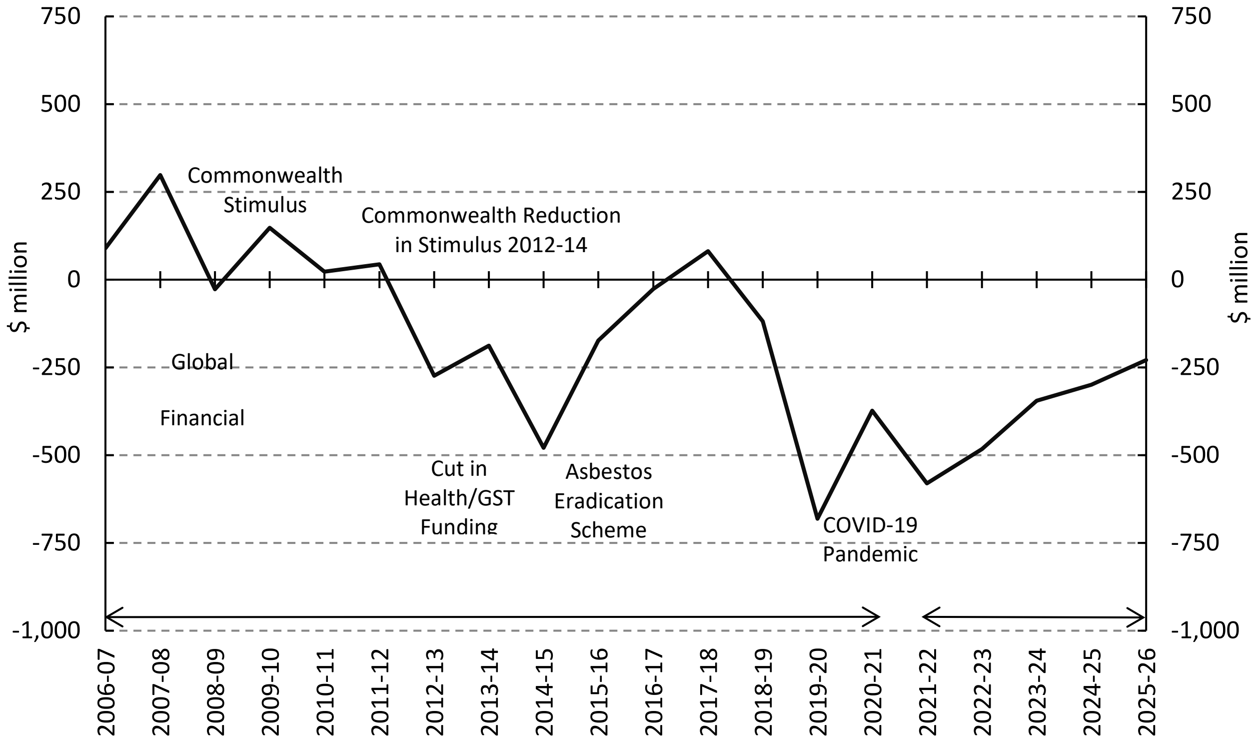
Response:

As noted, the Government is committed to continuing fiscal repair by progressively narrowing the deficit and reducing debt over the long term, while strategically investing in infrastructure that improves wellbeing and supports economic growth and jobs in the longer term. As the health and economic impacts of the COVID-19 ease, the Government will reduce the deficit gradually having regard to the pace of our economic recovery, while ensuring that high quality essential services can continue to be provided to the people of the ACT. This will provide capacity over time to reduce debt including through operating cash surpluses and asset sales.

The Government has demonstrated its capacity improve the fiscal position following economic and fiscal shocks. After each significant shock – from the Global Financial Crisis, Commonwealth reductions to GST and health funding, and the Asbestos Eradication Scheme – the Territory's budget has returned to broad balance.

Now following the most significant impacts associated with COVID-19, our fiscal position is showing clear signs of recovery, which is expected to continue in the coming years. The Headline Net Operating Balance deficits are now estimated to be lower than previously expected and progressively reducing to $229.4 million in 2025-26 (Chart 5). Relative to the 2021-22 Budget, all key balance sheet metrics for 2022-23 and outyears – net debt, net financial liabilities and net worth – are also improved.

Chart 6: Historical presentation of ACT Headline Net Operating Balance

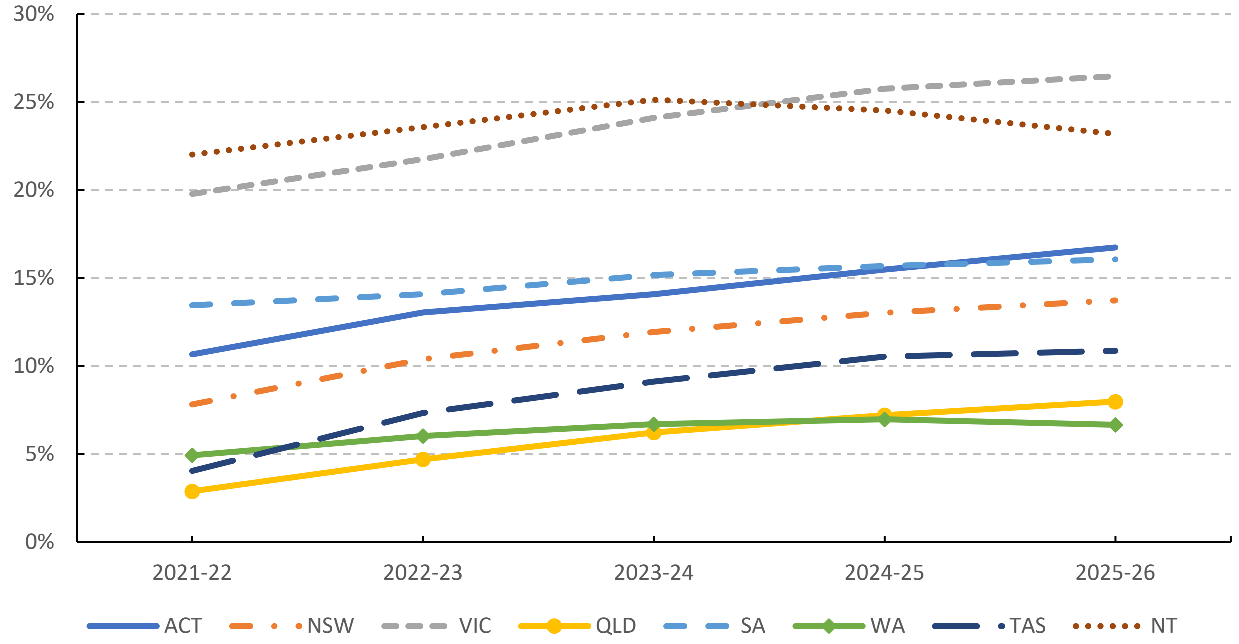


As noted previously, the Government has balanced the need to continue to improve our fiscal position with the need to invest in services for a growing Canberra. The investments being made through the 2022-23 Budget are essential as we build on our response to circumstances resulting from the pandemic, meeting the needs of a growing population and to paving the way for a stronger, more vibrant and liveable Canberra, both now and into the future.

In addition, the Government is aware of the disproportionate intergenerational impact that downturns have on the prospects of young people. Therefore, while stabilising debt over the medium to long term remains important, investment in skills development and ensuring economic opportunities for young people is an important element in achieving intergenerational equity.

In this context, the Government’s borrowing requirements will be determined by the range of initiatives delivered in each budget, and it may be necessary to increase debt levels to deliver productive investments that align with the Government’s priorities (i.e. primarily the delivery of economic benefit, but also investments that improve the wellbeing of the Territory’s population). As illustrated in Chart 7, net debt as a percentage of GSP is seen to be rising for most jurisdictions.

Chart 7: Net Debt to GSP – Interjurisdictional comparison



Source: Relevant jurisdiction's most recent budget papers.

The Government has and will continue to apply the principles of responsible and prudent financial management in the development of this and future budgets, and in the delivery of community infrastructure across the forward estimates. The Government has well established cash and debt management policies and processes applied to all financial activities, including the infrastructure investment program, which (coupled with longer-term documents, such as the *ACT Infrastructure Plan*) also provides local industry with planning and investment certainty and additional economic benefits.

As the budget returns to broad balance over time, operating cash surpluses will be used to fund initiatives, reducing the need for new borrowings.

Net financial liabilities

Pegasus: "Continued growth in the ratio of net financial liabilities to GSP is not desirable in terms of the sustainability of the ACT Government's debt. The ACT Government has in the past argued that its borrowings should be looked at in the context of a growing economy and budget, rather than as absolute figures in isolation (ACT Government, 2019, page 295). Considering rising interest rates and the steady growth in net financial liabilities to GSP, this may not be sustainable into the medium and longer term" (page 46).

Response:

Net financial liabilities (NFL) take into account unfunded superannuation liabilities as well as net debt. Net financial liabilities are calculated as total liabilities less financial assets (such as cash reserves and investments). It includes all non-equity financial assets but excludes the value of equity held by the General Government sector in public corporations.

The growth in net financial liabilities is due to the increase to the superannuation liability and net debt. As noted earlier, the increase in net debt reflects the Government's response to the COVID-19 pandemic and its infrastructure investment program.

For further details – see above in "Strength of the Territory's financial position" (page 16)

Net worth

Pegasus: "While the Territory maintains a strong net worth in absolute terms, there has been a long-term decline in net worth as a proportion of GSP. In the absence of corrective measures to improve the value of the ACT Government's assets or reduce liabilities, that trend is likely to continue" (page 47).

Response:

Net worth is the broadest measure of the balance sheet, taking into account the value of all assets less liabilities.

In the 2022-23 Budget the net worth estimated outcome for 2021-22 is $1.4 billion higher than the original budget estimate mainly due to the revaluation of ACT Government assets associated with stronger the increase in the value of properties. Net worth is forecast to increase in 2022-23 by $1.5 billion over the June 2022 estimated outcome.

Presentation and valuation of superannuation liability

Pegasus: "If the long-term financial assumptions are to be changed from one Budget to the next, it would aid transparency and allow the impact of other changes to be identified if the liabilities were reported both on the new basis and the previous basis. This is particularly important in the current environment where higher than anticipated inflation will impact on actual indexation of pensions and result in an increase in the estimated liability" (page 48).

"Commonwealth Government bond rates have increased in 2022 but at 3.2% per annum at the time of writing remain well below the valuation discount rate of 5% per annum" (page 52).

Response:

The superannuation liability is valued at the end of the financial year in-line with Australian accounting standards.

There have been significant changes in Australian economic parameters, including both inflation and interest rates, over the past three financial years. The financial assumptions adopted for the superannuation liability valuations must be reviewed every year and the assumptions adopted at financial year end must be based on market expectations for the period over which the obligations are to be settled. This has resulted in volatility in the valuation of the superannuation liability from year to year.

The Pegasus report refers to a Commonwealth Government bond yield of 3.2 per cent and considers the long-term discount rate assumption of 5 per cent as too high.

As the employer superannuation obligations will settled many years into the future, the 2022-23 Budget and forward year estimates adopt longer-term financial assumptions to determine the ultimate cost of the financial obligation and avoid unnecessary valuation volatility from year to year.

The long-term discount rate assumption of 5 per cent is consistent with the long-term assumption used by the Commonwealth Government to estimate the liability valuation for their Commonwealth Superannuation Scheme and Public Sector Superannuation Scheme defined benefit employer superannuation liabilities.

- The discount rate adopted for the liability valuation at financial year end is referenced to the yield on the Commonwealth's 2047 maturity bond, not the yield on a 10-year Commonwealth bond which it appears Pegasus has quoted.
- The yield on the 2047 bond reached almost 4.5 per cent in June.
- The liability valuation at 30 June 2022 outlined in the 2022-23 Budget estimated the bond yield (discount rate) to be 3.75 per cent. The actual bond yield at 30 June 2022 was 3.90 per cent.
- Domestic interest rates have been volatile over the financial year and this is expected to continue. If wage pressures emerge and high inflation persists, longer-term interest rates may again test the recent peak rates experienced in June.

The demographic assumptions adopted for the liability valuations are reviewed and updated every three years for the triennial liability valuation reviews. As the annual liability valuation reviews maintain the same demographic assumptions, and incorporate assumptions around membership experience, the annual liability valuations are materially impacted by the changes in the financial assumptions.

The annual liability valuation reviews are published on the Treasury Publications website[16].

The Government supports the Pegasus finding (page 49) that there is no indication that the ACT will have any difficulties in meeting its unfunded superannuation obligations, which will emerge as a requirement to meet benefit payments over a period of more than 50 years, noting the projection of benefit payments are largely unchanged from the 2021-22 Budget.

Addressing the superannuation liability

Pegasus: "In Pegasus to the Legislative Assembly on the 2020-21 Budget (Davey, Fisher, Antcliff, & Kaufmann, 2021), we noted that "without a significant increase in investment returns or additional contributions, the ACT Government seems unlikely to achieve its goal of full funding of the superannuation liability by 2030". Our concerns in this regard remain" (page 48).

Response:

A long-term objective of the Government's fiscal strategy is to maintain a strong balance sheet with

[16] https://www.treasury.act.gov.au/publications

an underlying financial objective to fully fund the Territory's unfunded defined benefit CSS/PSS superannuation liability by 2030.

- The funding plan includes the provision of annual capital injection appropriation to the Superannuation Provision Account to meet the annual emerging cost benefit payments to the Commonwealth, and therefore allowing the portfolio of investment assets to grow over time through the re-investment of investment income and capital gains.
- Once full funding is achieved, the portfolio of investment assets will be used to fully fund the ongoing annual emerging cost payments to the Commonwealth, with annual capital injection appropriation ceasing.

S&P Global Ratings views the Government's plan to extinguish the defined benefit superannuation liability over time as credible and is a positive contribution to the Territory's AAA credit rating. To date, the liability funding plan has been successful.

- Over the past 26 years the financial investment assets set aside in the Superannuation Provision Account have grown from approximately $223 million to $4.9 billion, with the investment portfolio achieving an investment return of CPI + 4.92 per cent per annum (7.51 per cent per annum nominal) and generating $3.9 billion in investment earnings.
- The return achieved over time is more than the current long-term investment return objective of CPI + 4.75 per cent per annum.

Achieving full funding by 2030 will depend on a range of factors including:

- the demographic assumptions and future experience of the underlying ACT employee membership of the Commonwealth's defined benefit superannuation schemes;
- the ongoing global and Australian economic environment and domestic economic factors including inflation and interest rates;
- the financial assumptions adopted for the valuation of the superannuation liability;
- Government employment policy;
- Budget appropriation support; and
- investment returns.

Based on current assumptions it is estimated that the funding percentage will grow from 48 per cent at June 2022 to 70 percent by June 2026 (Table 3.8.7, page 290, 2022-23 Budget Outlook).

Budget Accounting, Classification and Valuation Issues (Chapter 9, pages 50 to 54)

Disclosure of key accounting principles

Pegasus: "…other than key accounting policies and assumptions adopted in preparing the statements, except in respect to Service Concession Arrangements and Concessional Loans, Appendix G, key underlying accounting policies and assumptions have not been disclosed. In addition, … there is no disclosure of key assets such as investments and loans, investments in other public sector entities, and produced and non-produced property plant and equipment, nor key liabilities such as advances received, borrowings, superannuation and employee compensation" (page 50).

Response:

As noted previously, key accounting treatments are outlined in Appendix G of the 2022-23 Budget Outlook, including the basis of financial estimates preparation, any changes to current statement presentation, and the adoption of relevant Australian Accounting Standards. Additionally, AASB 1049: Whole of Government and General Government Sector reporting represents the basis for preparation of consolidated budget financial statements.

In this context, there is no specific Australian accounting standard or authoritative view for the preparation and presentation of prospective financial statements. On this basis, the Territory's budget papers have been prepared having regard to applicable Australian Accounting Standards.

The Consolidated Annual Financial Statements are published annually on the Treasury Publications website[17]. These statements, covering the General Government Sector, the Public Trading Enterprise sector and the Total Territory Sector, include disclosure of accounting treatments used in their preparation.

The Territory Government's financial statements show the assets, liabilities and equity (reflected in the Balance Sheet), revenue and expenses (reflected in the Operating Statement) and receipts and payments (reflected in the Statement of Cash Flows) that are attributable to the General Government Sector (GGS) and Public Trading Enterprises (PTE) sector activities of the Government.

These have been determined in accordance with the principles used in the Government Finance Statistics conventions of the Australian Bureau of Statistics. This disaggregated information includes transactions and balances between sectors (but excludes transactions between entities within each of these). The aggregate of the GGS and PTE amounts may therefore vary from the consolidated total for the Territory due to consolidation eliminations.

Superannuation return adjustment

Pegasus: "Our report on the 2020-21 Budget commented on the inconsistency in assumptions used in calculating the anticipated returns and the superannuation return adjustment. We note that the current Budget has adopted consistent return assumptions. However, it remains our view that, if a superannuation return adjustment is to be included, it should be calculated on a basis that would effectively replicate the position of a partially funded superannuation scheme" (page 51).

[17] https://www.treasury.act.gov.au/publications

Response:

As noted previously, unlike other Australian States and Territories, the ACT does not administer any superannuation schemes on behalf of employees.

The defined benefit employer superannuation obligation is a liability to the Commonwealth, in respect of current and former ACT employees who are members of Commonwealth defined benefit superannuation schemes. The administration of these schemes is undertaken by the Commonwealth Superannuation Corporation with all benefits paid to entitled ACT scheme members by the Commonwealth Superannuation Corporation.

As the ACT does not administer a superannuation scheme, Australian accounting standard (*AASB119 Employee Benefits*) requires the superannuation liability interest cost expense to be estimated on the total liability obligation, without any recognition of the financial investment assets that are held against the liability in the Superannuation Provision Account. The financial investment assets in the Superannuation Provision Account are therefore not able to reduce the superannuation liability (net defined benefit liability) and reduce the estimated interest cost expense as there are no scheme or plan assets.

Under the Uniform Presentation Framework (UPF), only investment income such as interest and dividends earned on the financial investment assets set aside in the Superannuation Provision Account can be included as revenue. Any investment earnings that are classified as capital gains are excluded from revenue and are reflected as other economic flows which are not included in the UPF Net Operating Balance. Conversely, the superannuation expense associated with the defined benefit superannuation liability directly impacts on the UPF Net Operating Balance. This means that the GGS UPF Net Operating Balance comprises the gross superannuation expense offset only by the investment income component of earnings on the Superannuation Provision Account's financial investment assets.

The total investment returns recognised in the Headline Net Operating Balance ensure superannuation expenses and the associated investment revenue are reported on a more consistent basis. This is achieved by adding back the superannuation return adjustment which represents the capital gain investment earnings excluded from revenue. The investment income equates to the total target investment return objective for the financial investment assets set aside in the Superannuation Provision Account of CPI + 4.75 per cent. The SPA investment portfolio has achieved an investment return of CPI + 4.92 per cent per annum over the past 26 years to 30 June 2022, which currently exceeds the long-term investment return objective.

The Government considers that the Headline Net Operating Balance provides the most relevant and meaningful information for making long-term budget allocation decisions, and the inclusion of the investment earnings is necessary to provide an accurate assessment of the longer-term sustainability of the budget position. This Headline Net Operating Balance presentation has been in place since 2006-07.

Light rail service payment arrangements

Pegasus: "Appendix G indicates that in respect to Light Rail – Stage 1 that although the Government will make service payments over the life of the long-term contracts with the consortia, the infrastructure will only become ACT assets at the end of these contracts. It is unclear to Pegasus as to the length of term of these contracts and the schedule for taking these assets and liabilities on to the balance sheets.

It is unclear therefore, as to whether the assets and liabilities associated with Light Rail – Stage 1 have been recognised in the General Government and Consolidated Balance Sheets" (page 53).

Response:

The assets and liabilities associated with the Light Rail - Stage 1 have been recognised in the 2022-23 ACT Budget in the Public Trading Enterprise Sector (PTE) which then flows through to the Total Territory Budget. As such, they are not recognised in the General Government Sector (GGS).

The completed Light Rail – Stage 1 assets and associated liabilities were initially recognised by Transport Canberra and City Services (TCCS) in 2018-19 as leased assets and leased liabilities. The Light Rail – Stage 1 leased assets and associated leased liabilities were transferred from TCCS to Transport Canberra Operations (TCO) in 2019-20. With the introduction of AASB 1059 'Service Concession Arrangements: Grantor' in 2020-21, TCO reclassified the Light Rail – Stage 1 leased assets and associated leased liabilities to Service Concession Assets and associated Service Concession Liabilities. TCO is in the Public Trading Enterprise Sector of the ACT Government.

Under AASB 9 the key impacts of Light Rail Stage 1 are:

- an increase in net debt of the PTE sector of $330.9 million on commencement 1 July 2019 which will reduce over time as lease liabilities are settled;
- recognition of assets and liabilities (see Table 3 below); and
- recognition of additional service concession related expenses of $60 million relating to finance costs, services expenses and depreciation in the PTE sector at 1 July 2019.

The operation of Light Rail Stage 1 function was transferred to Transport Canberra Operations on 1 July 2019 and the total value of the net assts transferred was $403.8 million.

Table 3: Net Assets Transferred to Transport Canberra Operations

	Transferred Amounts 2020 $'000
Assets	
Cash and Cash Equivalents	6,129
Receivables	98
Inventories	149
Other Assets	794
Property, Plant and Equipment	732,297
Intangible Assets	1,224
Capital Works in Progress	1,407
Total Assets Transferred	**742,098**
Liabilities	
Payables	13,430
Lease Liabilities	323,568
Employee Benefits	1,288
Total Liabilities Transferred	**338,286**
Total Net Assets Transferred	**403,812**

Source: Reproduced from page 169 of the TCCS Annual Report 2019-20.

Technical adjustments

Pegasus: "Whilst this is not unusual in other jurisdictions, for instance, the re-phasing of appropriations and the movement of previous decision to out years, the level of adjustments appears substantial" (page 54).

Response:

Technical adjustments by definition reflect those items impacting agencies for material, non-discretionary changes in the net cost (or timing) of expenditure on existing programs or capital projects and revenue and expenses where parameter assumptions have changed. Technical adjustments are adjustments which are typically outside the Government's control and are not triggered by an explicit decision by Cabinet and can result in appropriation variations.

Technical adjustments since the 2021-22 Budget are summarised in Table 3.1.2 (page 53) of the Budget Outlook, and more detail on the changes since the 2021-22 Budget Review is shown in Table 3.1.1 (page 54).

The revenue technical adjustments in the 2022-23 Budget include revised estimates of own source taxation revenue, GST and other Commonwealth grant revenue and dividends from the Suburban Land Agency and Icon Water. Predominantly these adjustments reflect changed assumptions regarding economic parameters including land sales.

The expenses technical adjustments are driven in part by changes in the superannuation liability expense and interest costs, again reflecting changed economic parameters. Other expense adjustments reflect reprofiling adjustments. As may be anticipated, workforce impacts associated with COVID-19 have resulted in project and program delays across government, resulting in the high number of adjustments observed. As workforce disruptions ease, it is expected that the number of technical adjustments impacting the budget will decrease.

Changed parameters relating to large-scale generation certificates are also large, but do not have an impact on the Headline Net Operating Balance as the revenue and expenses associated with receiving and surrendering certificates offset each other.

Discount rates

Pegasus: "It is unclear from the Budget Papers as to what discount rate has been applied to the long-term service concession contracts liabilities … , it appears no such liabilities have been brought to account" (page 54).

Response:

Service Concession liabilities have been bought to account for Light Rail Stage 1 in Transport Canberra Operations and for the Housing Asset Assistance Program properties in Housing ACT.

The Lease Liability is initially measured at the present value of the remaining lease payments at the commencement of the lease. The discount rate is the rate implicit in the lease or, when not included in the lease agreement, the incremental borrowing rate published by ACT. Lease liabilities are subsequently measured at amortised cost using the effective interest rate method[18,19].

[18] Community Services Directorate Annual Report 2020-21 p.411
[19] Transport Canberra and City Services Annual Report 2020-21 p. 145

Supplementary information – additional questions asked of Pegasus by the Committee

Wage increases for ACT Public Servants

Pegasus: "According to page 218 of the Budget Outlook, ACT public servant employee expenses are forecast to grow by $57.7 million in the 2022-23 Budget compared to the 2021-22 estimated outcome, with the increase attributed to "a combination of changes in staffing numbers and changes in costs. The Budget Outlook provides very little detail in relation to wage increases for ACT public servants." (Page 1, Supplementary A).

Response:

The increase of $57.7 million from the estimated outcome to the 2022-23 Budget is attributable to new budget initiatives in the Justice and Community Safety and Education Directorates offset by reductions in Health Directorate and Canberra Health Services reflecting the expected response requirements to the COVID-19 pandemic during the 2022-23 financial year. Similar movements in employee expenses would be expected in any budget update as a consequence of wage growth combined with Full-Time Equivalent staffing movements.

Specific details in relation to wage increases (i.e., indexation increments and timing) for the ACTPS may be found in the Administrative and Related Classifications Enterprise Agreement 2021-2022 or any associated directorate/agency specific enterprise bargaining agreements (EBAs). The Statement of Risk section in the 2022-23 Budget Outlook notes that, given COVID-19 impacts on EBA negotiation processes, for those enterprise agreements with an expiry date of 31 October 2021, the Government elected to 'roll over' current arrangements until 31 October 2022, with largely no change (i.e., with indexation uplifts of a similar magnitude and timeframe to those previously applied).

Under the Administrative and Related Classifications Enterprise Agreement 2021-2022, from a wages 'starting point' of 10 June 2021, the rollover increments were increases of 1.35 per cent on 9 December 2021 and a further 1.35 per cent on 9 June 2022.

The Budget includes a provision to account for future wage increases in the absence of specific enterprise agreement outcomes. This provision extends from the 2022-23 financial year across the forward estimates (to 2025-26). Once future outcomes are known, the provision will be allocated to offset impacts associated with wage cost increases associated with new enterprise bargaining outcomes.

Future increases will be incorporated into estimates as expiring EBAs are progressively replaced by new agreements.