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TOP STORY FOR THE WEEK 14 Sept - 18 Sept 2020
Grand Final Disaster in Victoria

By guest contributor Ken Atchison, principal, Atchison Consultants

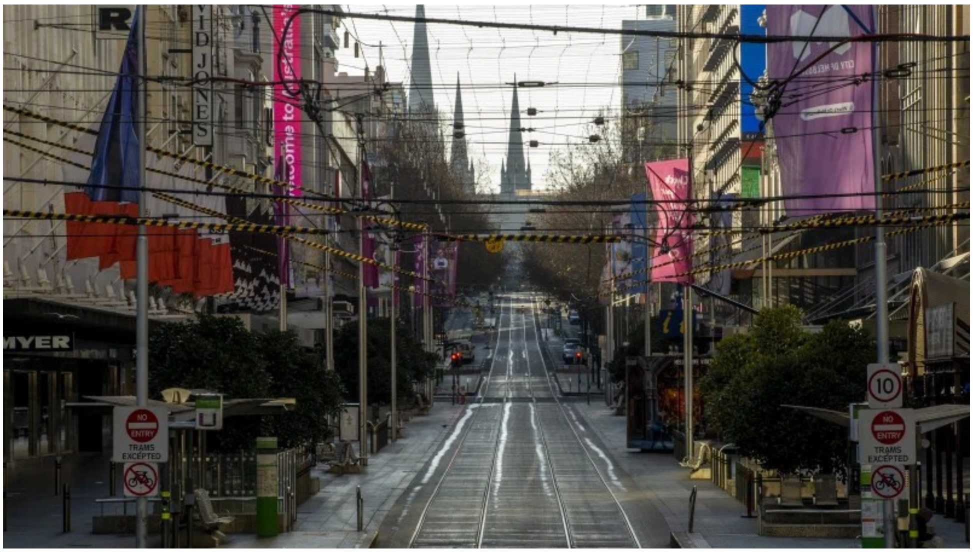
Loss of the AFL Grand Final from Victoria for the first time in a 124 year history is a disaster. It is symptomatic of decisions which will result in a higher cost of capital on all Victorian assets. The Victorian Government's brutal closure of the private sector in Victoria will have lasting impacts on investment returns.

The coronavirus pandemic is a health crisis but the Victorian government has also generated a financial crisis. AFL management has shifted the Grand Final and all its related activities from Victoria with very little difficulty. The AFL's actions demonstrate the relative ease with which businesses can shift the locations of their activities.

Revenue generated by the Grand Final at the MCG is estimated to be worth up to $50 million in the state, along with much employment. Over the year the loss of AFL games from Victoria is estimated at up to $340 million*. This is the headline evidence.

In a report for Melbourne City Council, PWC has estimated the pandemic and its associated restrictions in Victoria will result in up to 400,000 fewer jobs annually, as well as the loss of $327 billion in revenue over five years. In a state of 6.6 million people, 3.4 million are employed. 400,000 jobs represents a job loss of nearly 12% of the workforce. In Victoria, gross state product (GSP) in the year to June 2019 was $446 billion. A fall of up to 12.7% pa is projected for the 2020 financial year.

A support package of $3 billion from the Victoria Government will have a small impact. These declines could be permanent. While the Grand Final may return to Melbourne, many jobs will not. For many businesses and employees the shift interstate will be permanent.



* Harcourt, UNSW

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Debt will explode as the Victorian Government deals with commitments underpinning the COVID crisis. With revenue reduced by a minimum of 12.7%, state taxes will be increased. This assumes that the Victorian Government will attempt to achieve some financial order. It will not be able to fund recurrent expenses with recurrent taxation revenue.

A vicious cycle of higher debt and lower growth has commenced. Higher debt means less control over events; a government facing debt pressures will be unable to use fiscal policies to the same extent. A reduced ability to service that debt will leave less for other services.

Federal government transfers represent 50% of Victorian government revenue. Transfers will fall as GST collections fall. With a dramatic fall in employment in the state, numbers in the Victorian public service must fall. It had employed 9.4% of the Victorian workforce but will increase to 12.4% in two years, an unsustainable level. State taxes will need to increase by prospectively 25%.

A downgrade in credit rating of Victorian debt is inevitable. Net debt will increase to 20% of GSP and net interest will exceed 6% of revenue. Interest rates on debt will increase as spreads widen. Victoria's population will at best be static. If overseas students are hesitant to enrol with universities in Victoria, a declining population will emerge and there will be fewer taxpayers.

As the state's debt increases, the prospective impact of a change in interest rates and resulting debt-servicing costs are increased materially.

Individuals and institutions providing capital expect a return commensurate with the risks involved. When a state increases risk through policy and higher debt, investors will demand a higher premium. Investors have choices and will exercise the choices through alternative locations or opportunities. Capital markets will reflect these choices by moving away from Victorian assets as they lose their premier status.

Property investors will add 0.5% – 1.0% per annum to their return expectations. Uncertainty about taxes and Government decisions could add 1.0% – 2.0% to infrastructure funding models. Businesses will seek higher returns on equity of at least 1.0% per annum.

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