PITCHER PARTNERS
ACCOUNTANTS • AUDITORS • ADVISORS

# Victorian State Budget

*Road work ahead. On the move.*

## 2017-18

Tuesday 2 May 2017

an independent member of
BAKER TILLY
INTERNATIONAL

ON THE MOVE

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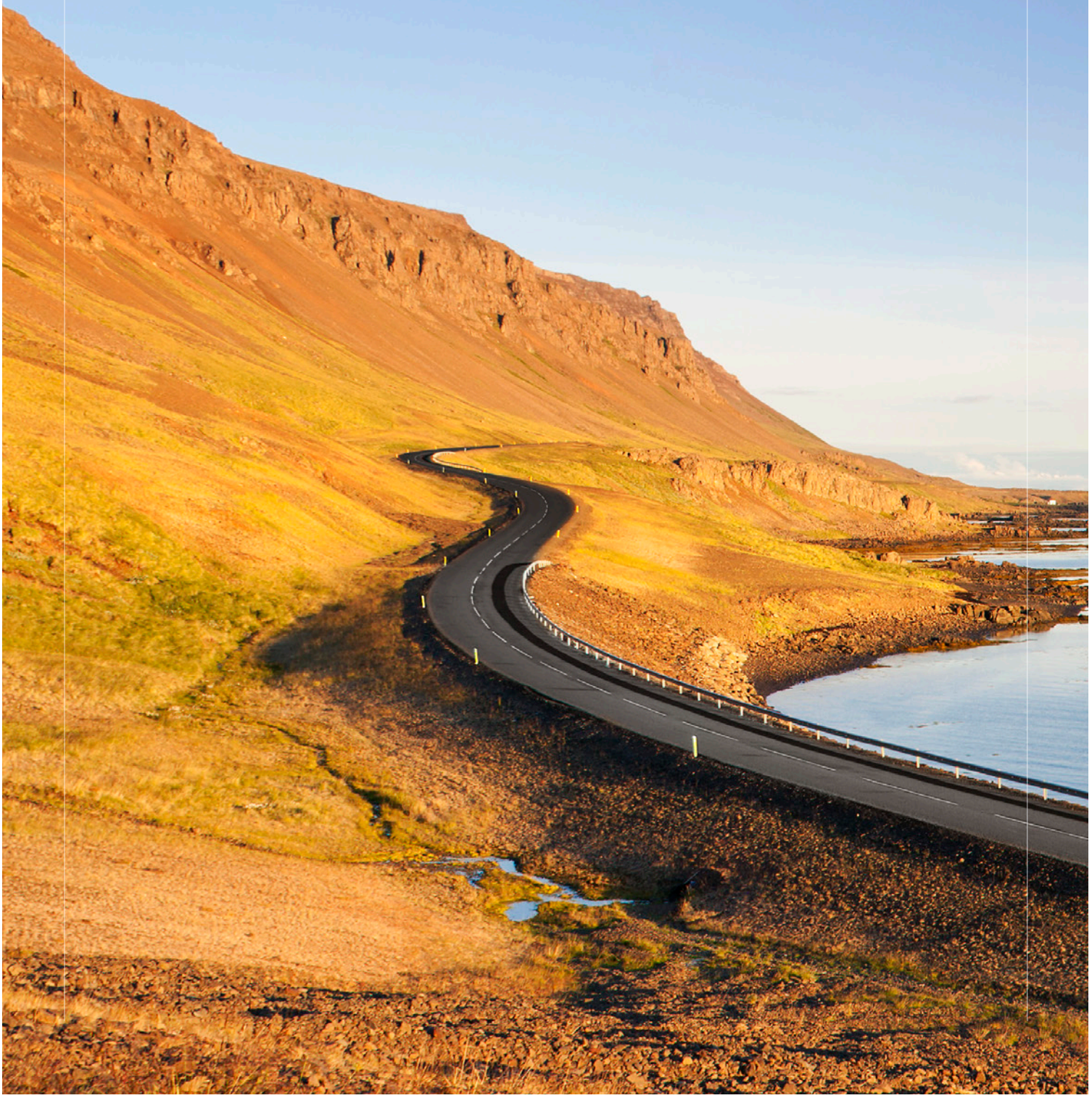
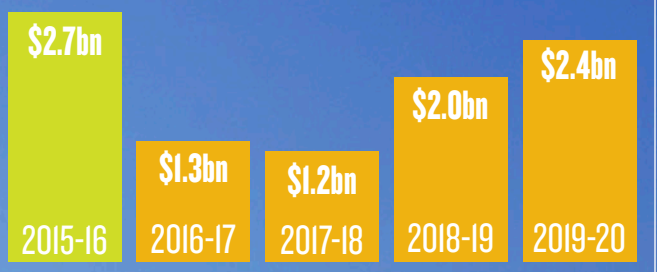
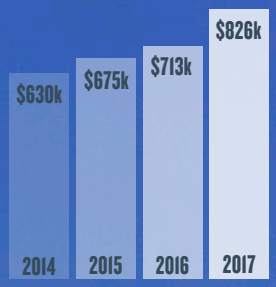


## BUDGET OPERATING SURPLUSES




**127,500**
Population growth



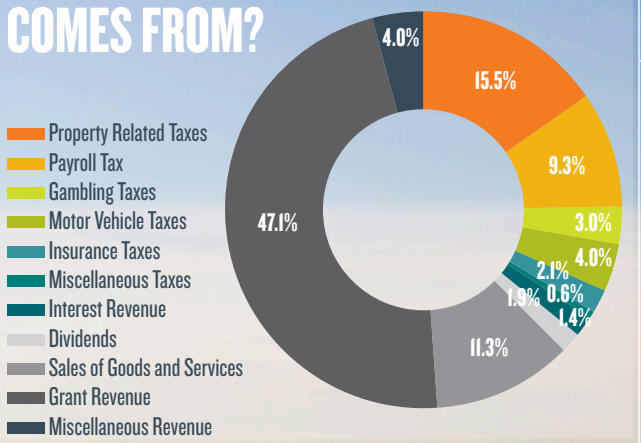

Median house price

# Victorian State Budget 2017-18 Highlights

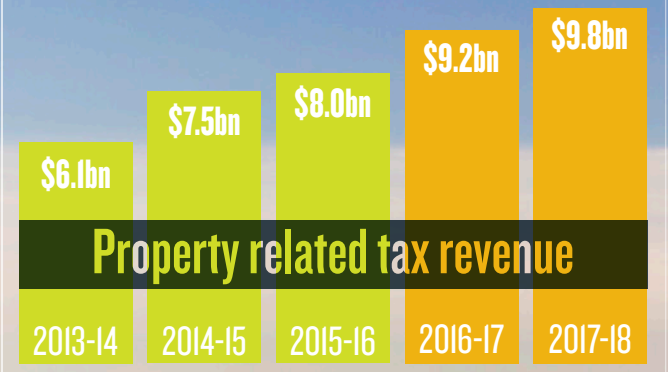
ON THE MOVE

**2.75%**
Economic growth 2017-18

## WHERE THE MONEY COMES FROM?




**8.6%** ↑ government infrastructure investment




**1%** NEW TAX
vacant residential property tax for inner and middle Melbourne

**1%**
duty increase on new passenger vehicles

Abolish stamp duty for first homes below
**$600k**

Payroll tax threshold up to
**$650k**
by 1 July 2018

## WHERE THE MONEY GOES?

### HEALTH

HOSPITAL

**$2.9bn**
$1.3bn to fund additional hospital admissions

### EDUCATION

**$1.3bn**
$685m for new schools and upgrades

### JUSTICE FOR ALL

SAFE PLACE

**$3.9bn**
$2bn to Victoria Police, over 2700 new officers

### INFRASTRUCTURE

**$10.1bn**
$1.45bn to regional rail projects

# Budget overview

The Andrews Government has continued its focus on spending in the areas of health, education and community infrastructure in its third Budget, handed down by Treasurer Tim Pallas on 2 May. At the same time, the Budget allocates significant funds for law and order projects, including a range of initiatives that seek to tackle the issue of family violence.

The government's spending commitments continue to be supported by a strong tax revenue position, which will generate total operating surpluses of $9.6bn over the forward estimates period.

The government's investment in infrastructure is set to increase quite dramatically over the next five years. In last year's Budget it was estimated that spending on infrastructure would average $7.4bn a year over the following 4 years.

The average per annum spend identified in this year's Budget is now $9.6bn, representing an increase of more than 20% over last year's forward estimates. The increased funding will be allocated to schools, hospitals, urban and regional road and rail transport projects, as well as other community infrastructure projects such as the ongoing upgrade of Melbourne Park.

Law and order has been in the news in recent times, and the government has allocated $2bn in this Budget to recruit new police and upgrade police stations, as well as $1.9bn to deliver on the 10-year strategy Ending Family Violence: Victoria's Plan for Change, released in November 2016.

*We commend the government for its continuing commitment to deliver major projects for Victoria, which will in turn create opportunities for our clients to engage with the government on the delivery of those projects.*

Despite the continued upswing in tax revenue, the operating surplus for the 2016-17 year has been revised downwards quite significantly from the $2.9bn stated in last year's Budget to $1.3bn. Although the Budget papers predict an ongoing surplus position each year over the forward estimates period, it is not until 2020-21 that the annual surplus returns above the $2.5bn mark.

*It will be important for the government to ensure that its spending is kept sufficiently in check to avoid sliding into a deficit position in the lead up to the next election in November 2018.*

ON THE MOVE

Property-related taxes are set to make up more than 45% of the total tax revenue in 2017-18. As a clear sign of the government's ever-increasing reliance on property taxes to fund its spending commitments, land transfer duty will overtake payroll taxes as the biggest piece of the state taxes pie. Estimated property taxes revenue of $9.8bn in 2017-18 is set to increase by a further 19% to $12.1bn in 2020-21.

The government had already announced changes to stamp duty leading up to this year's Budget, and Pitcher Partners remains concerned about the impact of those changes on the Victorian property market. In particular, the removal of the off-the-plan concession for residential and commercial property investors from 1 July has the potential to severely impact the ongoing demand for new development stock, which could in turn have negative flow on effects for developers and a range of other businesses that service the property development industry.

On the other side of the coin, many of our clients will welcome the announcement that the government intends to accelerate the planned increase in the payroll tax threshold, such that it will be $650,000 from 1 July 2018. Although this threshold is still relatively modest when compared to other states, the increase will translate into real savings for middle market businesses that are seeking to grow and expand their workforce.

The 25% reduction in the payroll tax rate from 4.85% to 3.65% for employers with at least 85% of employees in regional areas is a significant change that is clearly aimed at encouraging businesses to employ regional Victorians. It is unclear, however, how many businesses will be able to satisfy the 85% threshold as many workers now travel some distance to their place of employment and don't necessarily live in the same area that their employer is based in.

*If the 25% payroll tax rate reduction were to be applied across the board to all Victorian employers, that would provide a significant stimulus to the Victorian economy by allowing increased employment, without a corresponding increase in cost.*

Overall, the state's financial position remains strong and continues to be sustained by a buoyant property market, which replenishes the government's coffers each year through increased property taxes revenue. That in turn is allowing the government to fund the spending programs announced in both the current and previous Budgets.

*In that context, we continue to believe that the strong Budget position should be viewed by the Andrews Government as an opportunity to provide further targeted tax relief to the middle market businesses that are the backbone of Victoria's economy.*

RESIDENTIAL ZONE
PLEASE BE RESPECTFUL

# Changes that will affect property acquisitions and holdings

The Victorian Government has confirmed several changes to property taxes, which will have implications for property developers and investors.

As expected from announcements earlier in the year, the Budget introduces a number of property-related measures that are aimed at increasing the supply and improving the affordability of housing in Victoria.

These measures include abolishing stamp duty for first-time buyers of homes up to $600 000 (with a tapered discount applying between $600,000 and $750,000) and doubling the First Home Owner Grant to $20,000 for new homes in regional Victoria. The government has also announced a new program known as HomesVic, under which the government will co-purchase properties with first home buyers.

However, there are also significant changes that will affect property investors. From 1 July 2017, the off-the-plan stamp duty concession will only be available for home buyers who qualify for the principal place of residence stamp duty concession or those who are eligible for the first homebuyer stamp duty concession.

This means that investors will no longer be able to benefit from the off-the-plan concession; the amount of stamp duty payable on investment properties purchased off the plan will significantly increase. It is unclear whether there will be accompanying transitional provisions that protect existing contracts that have not yet settled. In particular, it is not yet clear whether investors who have signed a contract to purchase a property prior to 1 July will be able to nominate a new purchaser after that date without losing access to the off-the-plan concession.

The stamp duty exemption for transfers of investment properties between spouses will also be abolished from 1 July 2017, which may affect financial planning opportunities for our clients. An exemption will remain in place for properties occupied as the principal place of residence. At this stage it is unclear whether the property will need to be the principal place of residence of the transferor or the transferee for the exemption to be available, as the amending legislation is yet to be released.

Further, from 1 January 2018, a new vacant residential property tax will be imposed on owners who leave their properties vacant for more than six months in any calendar year. The tax rate will be 1% of the capital improved value of the property. Various exemptions will be available, including for deceased estates, holiday homes, and homes owned by Victorians who move temporarily overseas.

In addition, property valuations for land tax will occur annually rather than every two years from 2019. Although this should minimise large spikes in land tax bills, the change will create an additional cost for land owners by requiring them to review their property valuations more frequently.


# *What this means for you*

*Developers of residential and commercial properties in Victoria should consider the impact the removal of the off-the-plan stamp duty concession for investors will have on their future developments and sales. Significant duty savings could be achieved if property acquisitions are made prior to the removal of the concession.*

Conversely, there will be a significant increase in the duty payable for purchases of investment properties off-the-plan after 1 July 2017. By way of example, an investor who purchases a property with a contract price of $2.4m before 1 July can expect to pay around $200,000 in stamp duty on the transfer. After 1 July 2017, the same investor will pay around $300,000 of duty on the same transfer, representing a $100,000 increase in duty payable.

It will be important for investors to confirm the total amount of stamp duty (including any applicable foreign purchaser duty) they will need to pay before they proceed with their next acquisition. Investors should also ensure that there will be no adverse consequences for nominations made on or after 1 July under contracts entered into prior to that date.

In addition, the introduction of the vacant residential property tax and the removal of the stamp duty exemption for transfers between spouses and de-facto partners should be carefully considered in business and financial planning.

On a more positive note, the abolition of stamp duty for first homebuyer purchases under $600,000, combined with the doubling of the First Home Owner Grant for buyers in regional Victoria, will create further investment and planning opportunities for developers, especially in Melbourne's growth areas. The off-the-plan concession will also remain available for home buyers of properties with a dutiable value of up to $750,000.

# Payroll tax

The Andrews Government has announced an increase in the payroll tax-free threshold for all businesses, a reduction in the payroll tax rate for eligible regional businesses, and an increase in annual payroll tax liability threshold so that more businesses can opt for an annual payroll tax lodgement.

## Payroll tax-free threshold

The payroll tax-free threshold will be increased from $575,000 to $625,000 with effect from 1 July 2017, and to $650,000 with effect from 1 July 2018.

## *What this means for you*

*Based on the current rate of payroll tax of 4.85%, this change represents an annual saving of $2,400 per annum per business group in Victoria as of 1 July 2017, and a further saving of $1,200 as of 1 July 2018.*

Compared to the rest of Australia, after this change Victoria will have the second lowest payroll tax-free threshold in the country, with South Australia being the lowest at $600,000 and ACT being the highest at $2m. However, the Victorian threshold will still be significantly less than the current national average of $1.078m.

Whilst the accelerated increase in the payroll tax-free threshold is a welcome change that will generate real savings for middle market businesses, to make a real impact and attract more businesses to operate in Victoria, the government should consider increasing the payroll tax-free threshold further to the national average.

# Payroll tax rates

The payroll tax rate will be reduced by 25% from 4.85% to 3.65% for businesses where at least 85% of their employees are 'regional employees'.

## *What this means for you*

*This change is great news for eligible regional businesses. They will enjoy the lowest payroll tax rate in the country.*

For example, a business group that from 1 July 2017 pays annual wages of $1m, will benefit from a $4,500 annual reduction in payroll tax. From 1 July 2018, due to the increase in the threshold, the benefit will be $4,200. A business group that from 1 July 2017 pays annual wages of $3m, will benefit from a $28,500 annual reduction in the payroll tax. From 1 July 2018, due to the increase in the threshold, the benefit will be $28,200.

On the other hand this measure is likely to increase compliance costs for those businesses that are not wholly in regional Victoria, and that will subsequently need to monitor whether they qualify for the concession. At this stage there are no details on how the change is proposed to be administered and who will qualify as 'regional employee'. However, the administration might be particularly complex where a business employs both regional and non-regional employees and their numbers fluctuate over the course of the year.

# Annual payroll tax liability threshold

More businesses will be eligible to opt for annual payroll tax payments rather than monthly payments, due to the increase in annual payroll tax liability threshold from $10,000 to $40,000.

## *What this means for you*

*From 1 July 2017, based on a $10,000 annual payroll liability, only business groups which pay annual wages under $830,000 would have qualified for annual payroll tax payments. The Budget change will mean that business groups with an annual payroll under $1.449m will now be able to opt for annual payroll tax returns.*

Furthermore, due to the threshold increase from $625,000 to $650,000 from 1 July 2018, businesses that pay annual group wages under $1.47m will be able to opt for annual payroll tax returns, compared to businesses with annual group wages of $856,000 that previously qualified.

This is a welcome change for small businesses that will benefit from the reduced costs of compliance with payroll tax, as they will no longer be required to prepare and lodge monthly payroll tax returns.

# Infrastructure – investing in the future and in regional Victoria

The government is forecasting a 28% increase in infrastructure spending during the 2017-18 financial year in comparison to last year's Budget.

Infrastructure projects deliver multiple benefits to the state. They create jobs, enable the provision of services, allow efficiencies and improve the social amenity of the state generally.

Given the time lags often involved between the announcement of a project and its delivery, it is pleasing to see that new projects have been announced in the current Budget. Importantly, the announcement of new projects ensures that there is a pipeline of work and opportunities for businesses in the state into the foreseeable future.

This is will continue to be important as jobs are shed in industries such as the automotive manufacturing sector, which will cease production in Victoria within the next 6 months. As previously announced projects have come on line, this has contributed significantly to the prosperity of the Victorian economy.

Approximately $11.4bn is earmarked for infrastructure investment during the 2017-18 financial year. Of this, approximately $9.3bn relates to existing projects and $2.1bn relates to new projects. As the table below shows, this represents a 28% increase from the previous Budget estimates.

### Infrastructure investment by total estimated investment – summary ($ thousand)

| Sector | Estimated expenditure 2016-17 | Estimated expenditure 2017-18 |
|---|---|---|
| **General government** | | |
| New projects | 1,404,468 | 1,215,269 |
| Existing projects | 3,021,786 | 4,708,066 |
| **Public non-financial corporations** | | |
| New projects | 967,305 | 875,395 |
| Existing projects | 3,468,033 | 4,550,722 |
| Total new projects | 2,371,773 | 2,090,664 |
| Total existing projects | 6,489,819 | 9,258,788 |
| Total projects | 8,861,592 | 11,349,453 |

# Transport infrastructure

Transport continues to be a key component of the infrastructure initiatives announced by the government. It is the one area that is always guaranteed to attract the attention of voters, for better or for worse, which is understandable as it impacts all levels of the community.

As always, the delivery of a safe, reliable and efficient transport system provides multiple benefits to the community. A number of projects such as the level crossing removals and road widening projects are up and running, and work on the Metro Rail project has also commenced.

The government is to be commended for its continued efforts to improve the transport infrastructure of the state for the benefit of all Victorians. The key projects announced in the current Budget cover both road and rail initiatives in both metropolitan and regional Victoria.

## Road

The long awaited 'missing link' connecting the Greensborough Ring Road with the Eastern Freeway will get a boost, with $100m earmarked for planning and early works.

Another $300m has been earmarked for the Mordialloc Bypass to link the Dingley Bypass with the Mornington Peninsula Freeway. Work on this project is scheduled to commence in 2019 and completion is expected by 2022.

A further $531m has been committed to regional roads, with upgrades planned for the Great Ocean Road, Henty Highway and South Gippsland Highway.

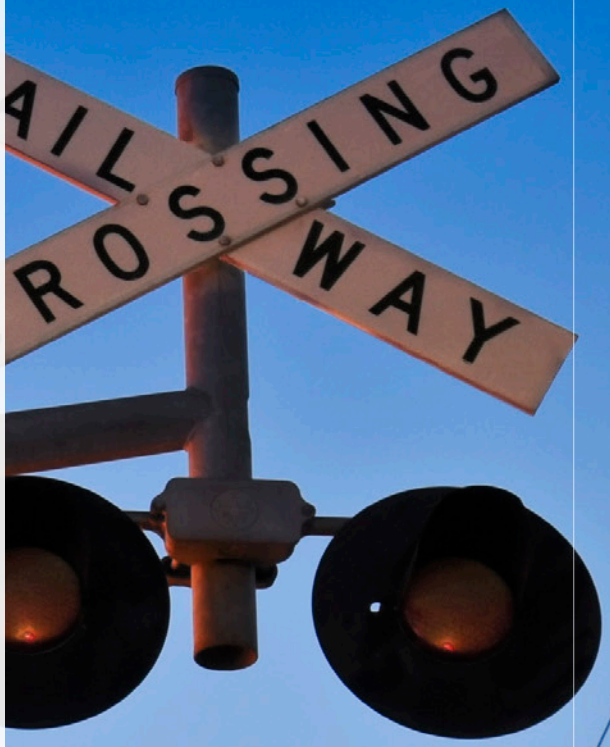
Other smaller initiatives, such as $10m towards the Shepparton bypass, will see the benefits spread more broadly across the state.

## Rail

Road expenditure is almost comparable to rail expenditure, where more than $1.4bn has been allocated for regional rail upgrades. These include a new Surf Coast rail link and a $531m upgrade to the Gippsland line. The Treasurer has confirmed that not all of this expenditure is funded and it will require additional funding from the Federal Government. If federal funding is not forthcoming, some or all of the projects may not go ahead.

An additional $10m has been earmarked for investigations into the Airport Rail Link. After many years of deliberation, it remains to be seen whether this project will see the light of day any time soon.

A commitment has also been made to acquire new trams and to refurbish existing rolling stock.




## *What this means for you*

*Victoria already has a strong construction sector and the government's infrastructure announcements will allow for further growth in construction opportunities.*

Businesses in the construction and building industries, as well as associated service industries, should welcome these ongoing transport infrastructure announcements as they will provide opportunities for growth and jobs for the Victorian economy.

Middle market businesses should be well placed to take advantage of the opportunities arising out of the Budget announcements.

# Education and health – a focus on infrastructure

Following on from strong investment in health and education in last year's Budget, the government has again focused its attention on these areas, investing heavily in infrastructure projects to improve the welfare and prospects of all Victorians.

## Health

The Andrews Government is responding to the continued growth in Victoria's population and its associated strain on our health system. This year's Budget includes a $2.9bn investment in the health sector, with a major focus on the development and upgrade of existing Victorian hospitals – including the Northern, Austin and Royal Melbourne Hospitals. The government has also announced a redevelopment of the existing Footscray Hospital to better service the rapidly growing population in Melbourne's west.

A record $406m investment in mental health services across Victoria has also been announced, building on the significant investment for mental health in last year's Budget.

## Education

Continuing in its efforts to make Victoria the Education State, the government has announced an investment of $1.3bn in education over the next four years.

Again, the construction industry is set to benefit indirectly, with a further $685m invested in the construction of new schools and upgrades to existing schools. With $1.8bn already invested in schools over the last two Budgets, this year's investment will bring the total investment in Victorian school infrastructure to more than $2.5bn.

Melbourne's growth areas will also benefit, with new schools planned for the cities of Ballarat, Cardinia, Casey, Hume, Melton, Mitchell, Whittlesea and Wyndham. Over $269m has been allocated to construct, plan and buy land for new schools in these areas.

Further education initiatives include an $85m dollar project to remove asbestos in Victorian schools, and an $84m investment in IT upgrades in schools across the state.

## *What this means for you*

*While the announcements should directly benefit those in the health and education sectors, we also expect that clients in the building and construction industries will be indirect beneficiaries of the increased education spend.*

Residential developers on the urban fringe of Melbourne should benefit through increased sales, as a result of the development of new schools in areas such as Casey, Hume and Melton.

SAFE PLACE

# Preventing family violence and supporting victims

The Andrews Government has reiterated its commitment to address family violence and provide both preventative measures and support services for those affected.

The government has committed $1.9bn to deliver on its promise to implement every Royal Commission recommendation, as announced in the government's 10-year strategy in November 2016. The underlying focus of the investment is to protect victims and survivors, hold perpetrators to account, and help change community attitudes.

**Key initiatives include:**

- Reforms to the family violence information sharing system
- Reforms to the Court Integrated Services Program (CISP) and CISP Remand Outreach Pilot to increase monitoring, treatment and supervision of offenders on bail to address the underlying causes of offending and reduce reoffenders
- Establishing support and safety hubs in 17 areas to act as access points for victims and provide support services
- A range of prevention measures, including a dedicated prevention agency and continuing to encourage universal attitude and behaviour change
- Strengthening the response of Victoria's legal system to family violence and child protection including a new case management system for courts
- Strengthening support for vulnerable children and providing specialist support for family violence victims
- Providing an additional 110 public housing properties to victim survivors and their children
- Additional funding to public hospitals to build capability to respond to victims
- More support for indigenous Victorians at risk of family violence

## *What this means for you*

*The government's initiatives will be welcomed by those operating in the care services, social housing and building and construction industries, who should look forward to working with the government to implement the proposed initiatives.*

# Summary of other key Budget highlights

## Agricultural sector

The Budget provides support for farmers and primary producers through $86m in expenditure over the next four years for increased biosecurity services, eradication of imported fire ants, and assistance with electronic tagging of sheep and goat livestock. In addition, insurance duty will be abolished for agricultural products insured against damage from flood, fire and other accidents.

## *What this means for you*

*Middle market agriculture businesses may wish to revisit their insurance cover and consider whether the level of cover should be increased to account for the reduction in cost resulting from the abolition of insurance duty for agricultural products.*

# Environmental changes

The Budget commits $300m to invest in cleaner energy, biodiversity and reduction of state-wide emissions. An additional $162m will be allocated to the Environmental Protection Authority (EPA) to increase its investigatory and legal resources.

## *What this means for you*

*For property developers in Victoria, increased resources for the EPA may delay or prohibit development projects due to environmental issues. In addition, development projects near the Yarra River may face higher obstacles given the increased focus to protect the river over the next four years.*

Middle market developers should ensure they satisfy the EPA regulations to reduce the risk of being non-compliant and stalling or potentially terminating their project.

# More support for businesses

The Budget commits $90m for the next two years to attract and assist private sector business to invest in Victoria.

Sectors in the manufacturing, aviation, medical technologies, food and fibre sectors are being prioritised. This initiative has already attracted David Jones and Alibaba to Victoria.

## *What this means for you*

*Middle market businesses should seek opportunities to provide additional goods and services to large organisations increasing their presence in Victoria.*

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