BREXIT

ISSUES FOR UK PROPERTY

Carter Jonas

WITH THE REFERENDUM ON THE UK'S MEMBERSHIP OF THE EUROPEAN UNION DUE BY THE END OF 2017, THE DEBATE ABOUT WHETHER WE SHOULD BE IN OR OUT IS HEATING UP. THERE IS A LIMITED AMOUNT OF EVIDENCE-BASED ANALYSIS ON THE POTENTIAL IMPACT OF A BREXIT AND STILL CONSIDERABLE DISAGREEMENT ABOUT THE MERITS OF STAYING IN OR LEAVING THE EU.

Indeed, as at January 2016, opinion polls and press coverage suggest that both ordinary voters and the business community remain sharply divided, although events such as the recent attacks in Paris may exert undue influence on voters.

The referendum is, arguably, the biggest choice facing the UK for forty years – since the 1975 referendum on remaining in the old European Economic Community. The economy and property sector are likely to be affected by the pre-vote uncertainty, as was the case in the run-up to the Scottish referendum in 2014 when there was a marked "wait-and-see" approach to decision-making. Clearly, a much greater impact will be seen in the event of vote to leave.

The think tank Open Europe has analysed how a Brexit would impact on eight of the UK's main exporting sectors, which together account for 53% of the UK's global exports and 47% of its exports to the EU.

While it believes that the UK would probably be able to negotiate preferential trade deals for the five goods sectors, securing good access for services (in which it has a surplus with the EU) would be more difficult. Access might also come with conditions attached.

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> **THE REFERENDUM IS, ARGUABLY, THE BIGGEST CHOICE FACING THE UK FOR FORTY YEARS**

In the event of a Brexit, Open Europe believes that all exporting sectors would be vulnerable to initial disruption, mainly through higher tariffs. Foreign Direct Investment (FDI) – of which 45% is in financial services - could also be affected.

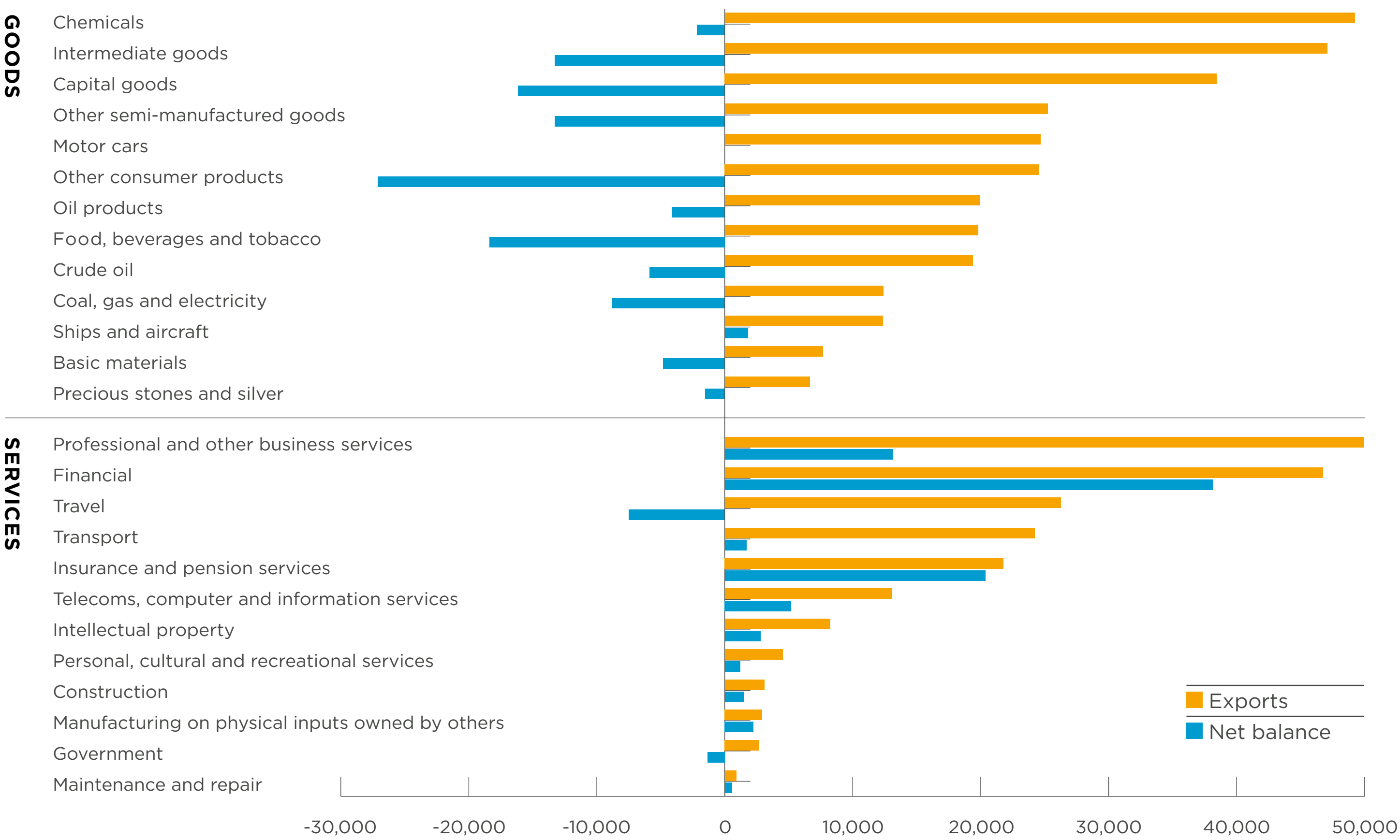
Figure 1
Initial impact of Brexit?

Source: Open Europe

	Sector	Exported to EU	Trade **deficit** /surplus with EU	Potential barriers to EU markets	Risk of disruption	Chances of similar EU access	Possible conditions attached
GOODS	Cars	35.0%	-£13.95bn	10% tariff	High	High	Basic standards
	Chemicals	56.6%	-£7.82bn	4.6% tariff	High	Medium to High	Adhering to EU's regulatory standards
	Aerospace	44.6%	£2.56bn	Zero tariffs	High	High	Basic standards
	Machinery	30.7%	-£5.47bn	1.7% to 4.5% tariffs	Medium	High	Basic standards
	Food, Beverages & Tobacco	60.5%	-£16.56bn	Average tariffs over 20% and higher	High	Medium to High	Keep external tariff with rules on foreign content
SERVICES	Financial Services	41.4%	£16.06bn	Various EU market access regulations	High	Low	Equivalent regulation; possibly still with patchy access
	Insurance	18.4%	£3.85bn	Various EU market access regulations	Medium	Medium	Equivalent regulation; possibly still with patchy access
	Professional Services	29.8%	-£1.92bn	Primarily national market access regulations	Medium	Medium	Mutual recognition, free movement of professionals

Figure 2
UK global exports and trade balances by sector in 2013 (£ million)

Source: ONS/Open Europe



CARTER JONAS CLIENT POLL

As part of our contribution to the debate, Carter Jonas has conducted a short poll of leading property figures to gauge the level of concern about a potential Brexit, in addition to other major challenges facing the industry.

We have also summarised the sort of environment we expect to see during the campaign, as well as an analysis of the key issues and risks facing the main property sectors in the event of a "Bad Brexit".

Our survey comprised four questions and a sample size of 69, drawn from a range of industry players operating across a number of sectors (including residential and commercial).

> **"A CLEAR MAJORITY BELIEVE THAT A BREXIT WOULD HAVE A NEGATIVE IMPACT**

While the campaign is still at its early stages, the poll shows that a clear majority believe that a Brexit would have a negative impact on the UK property sector, both from an investment and occupier perspective.

However, only a handful of respondents would consider relocating to another EU country in the event of a vote to leave.

Moreover, while a possible Brexit is a major concern for UK property professionals, there are also a range of other issues which are uppermost in the minds of people in the industry. The housing shortage, the likelihood of higher interest rates and rising construction costs - not to mention the skills shortage - are also seen as major challenges for the industry over the next couple of years.

Figure 3
How do you think a Brexit would impact on investment in UK property?

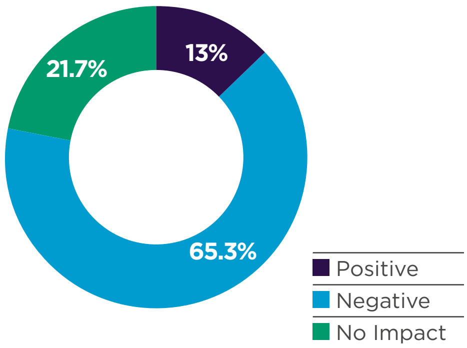


Figure 4
How do you think a Brexit would impact on the UK occupational market?

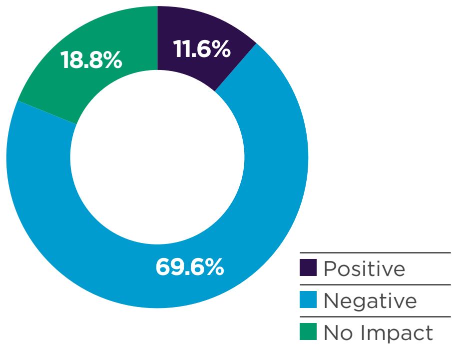


Figure 5
If there is a vote to leave the EU, would your business consider relocating to another EU country?

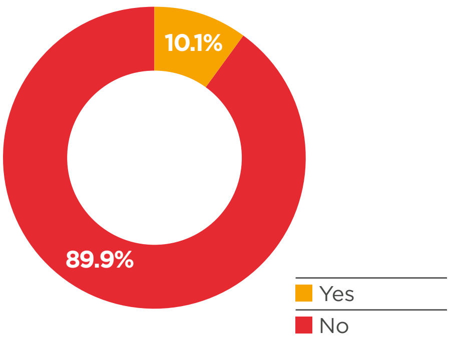
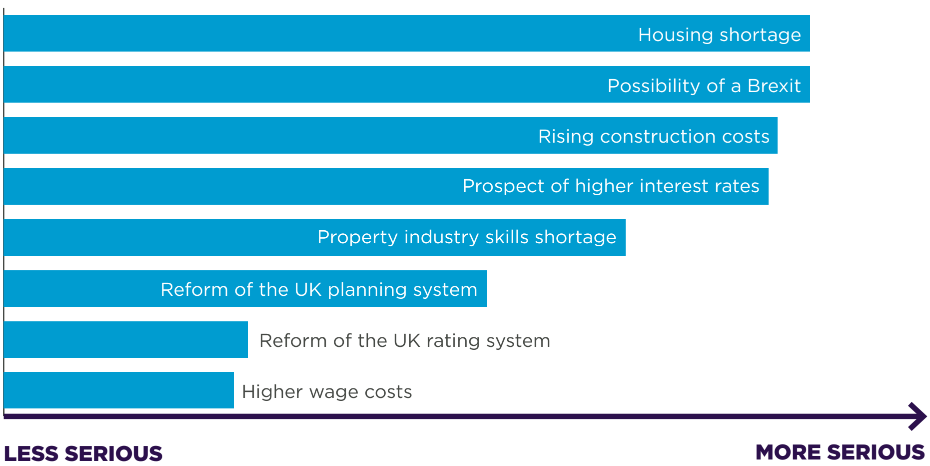


Figure 6
What do you think will be the main challenges facing the UK property industry over the next two years? (higher score means more serious challenge)



WHAT DO WE EXPECT IN THE RUN-UP TO THE REFERENDUM ON EU MEMBERSHIP?

Expect lots of noise between now and the referendum which must be held by the end of 2017 – and afterwards if there is a vote to leave the EU.

Unlike the Scottish independence referendum in 2014, UK businesses will be more vocal during a highly polarised debate.

Many companies will start making plans for an "out" vote and, potentially, go public with these.

Uncertainty among businesses will result in delayed decision-making by some occupiers and investors, both domestic and international.

Key economic and property data such as survey-based indicators, take-up and investment volumes, will probably soften in the months before the vote.

However, this may present opportunities, such as "mispriced" investments or the ability to take "cheap" space.

If there is a vote to stay in, we would expect a bounce in economic and property market activity, following the uncertainty of the referendum campaign - a swift return to "business as usual".

IN OUR VIEW, THERE ARE THREE MAIN POSSIBLE SCENARIOS:

RESULT: "NO BREXIT"

Economic and property market uncertainty before the referendum, but swift return to "business as usual" thereafter.

RESULT: "GOOD BREXIT"

UK votes to leave but negotiates a beneficial agreement allowing full access to the single market.

Impact: Post-referendum uncertainty while a deal is negotiated, which will probably take around two years

RESULT: "BAD BREXIT"

UK votes to leave but fails to negotiate a beneficial agreement.

Impact: Prolonged period of uncertainty while businesses and investors realign themselves with the new economic and trading realities.

HOW WILL A VOTE TO LEAVE THE EU IMPACT ON THE UK PROPERTY MARKET?

If there is an "out" vote, there is likely to be a 1-2 year period of negotiation with the EU and other countries while trade deals are agreed. In the short term, this would generate more uncertainty in the property market, potentially with an immediate impact on Sterling and the bond and equities markets. In the longer term, it could lead to more significant challenges – depending on the nature of the deal struck with the EU. A Brexit may also have implications for the relationship between Scotland and the rest of the UK.

> **"EXPECT LOTS OF NOISE BETWEEN NOW AND THE REFERENDUM**

If we vote to leave the EU, our central assumption (and belief) is that the UK would be able to negotiate a mutually beneficial trade agreement, along with a similar level of market access enjoyed by full EU members.

However, in the event of a Brexit and a relatively disadvantageous agreement with the EU, there would be a more adverse impact on the economy and property market. Based on a "Bad Brexit" scenario, we have summarised the key issues and risks for each of the main property sectors overleaf.

"BAD BREXIT" SCENARIO: KEY ISSUES & RISKS BY SECTOR

RETAIL

UK retail property may suffer from reduced demand and uncertainty in the wider economy, while some international retailers using the UK as a bridgehead to Europe may be deterred – at least in the short term. Likewise, pan-European retailers may opt for France or Germany as a first port of call or for their HQs.

However, the size, strength and sophistication of the UK retail sector should ensure retailer demand over the longer term, along with continued innovation in new formats and investor interest. This has been demonstrated by the rapid expansion of the German discounters, whose growth is likely to continue regardless of the EU referendum result.

Retail-related logistics is likely to be relatively unaffected by a Brexit, particularly given the continuing growth of e-commerce.

OFFICE

Depending on the nature of the new UK-EU agreement, some global and pan-European firms providing business and financial services may consider relocating to other EU countries. The main reason is that non-EU banks would probably no longer be free to set up a London subsidiary and passport into the wider EU. For example, many Swiss banks have an HQ in London as Switzerland is not part of the EU or European Economic Area and does not have such a comprehensive agreement with the EU on financial services as it does on goods. This could have a significant impact on the London office market (notably the City), albeit the effect elsewhere would be less pronounced. Much would depend on the ability of UK-based firms to "passport" into the rest of the EU under the new agreement, but the strength of some of the UK's banks and professional services firms could be undermined.

However, while cities such as Dublin, Frankfurt and Paris might benefit from a scaling down of banking operations in the UK, none of these cities offers the same critical mass or talent pool as London. In addition, much of the debate around the impact of a Brexit on the City tends to ignore the fact that emerging markets in Latin America and the Far East offer better growth prospects for financial services than the EU. It is worthwhile remembering that London is a global – not just a European - financial centre.

INDUSTRIAL

A "Bad Brexit" could lead to weaker demand for logistics, while significant exporters of goods such as car manufacturers may relocate factories outside the UK. Even if the UK succeeds in negotiating a beneficial trade deal with the EU, exporters will still need to contend with administrative procedures at EU borders.

The car industry is particularly reliant on a pan-European supply chain, with data from Open Europe suggesting that only 37% of the value of the supply chain which goes into a UK car actually originates here. Factory closures would also affect high value R&D in the automotive sector and smaller businesses in the wider supply chain, which could have a disproportionate effect on the Midlands and the North East.

However, the UK has a significant deficit with the EU in terms of car imports (note German car exports to the UK, for example) and is an important market for cars in its own right, so fears about car manufacturers relocating to the Continent may be overblown. The overall tone emanating from UK-based manufacturers is that, while they have a preference for staying in the EU, they will continue to produce cars in the UK regardless of the vote because of the quality and efficiency of their facilities here.

RESIDENTIAL

Demand for housing may weaken, notably for high-end residential in London and the South East, as more skilled workers and executives choose to relocate to mainland Europe.

A "Bad Brexit" might deter international students ("talent"), thereby reducing demand for high quality, purpose-built student accommodation. This would be exacerbated if the government also adopts a more anti-immigration stance. The biggest impact would most likely be felt in London and Manchester (Imperial College and Manchester universities both attract over 11,000 international students), while other key university towns, such as Oxford, York, Cambridge and Bath might also be affected.

The mainstream residential market would experience less of a direct impact, although it may be affected by the wider economic consequences of a "Bad Brexit". However, on the upside, a potential weakening of Sterling would boost the purchasing power of foreign buyers.

RURAL

Regarding the EU debate, the most significant issues for the rural sector relate to workforce availability and financial support from the government. Any kind of Brexit would raise concerns over the Basic Payment Scheme and the annual £3bn of CAP support for many businesses, while major exporters of food, drink and animal feeds would be worried about future access to the single market. In fact, recent data from Defra suggests that 55% of UK farming income comes from CAP payments.

A tighter stance by the UK on immigration from the EU might also impact on the agricultural sector's ability to recruit cost-effective workers. However, a potential upside of a Brexit for UK agriculture might be looser regulation in areas such as organic farming, pesticides and greenhouse gas emissions, not to mention greater control over its fisheries policy.

"THE UK CAN HOLD ITS OWN AS A LARGE AND GROWING MARKET OF OVER 60 MILLION PEOPLE

CONCLUSIONS

In the short term, the run-up to the referendum will lead to significant uncertainty and many businesses and investors will delay decision-making. A Brexit would merely prolong this and it would clearly be in the interests of the UK and the EU to reach a mutually beneficial agreement.

However, in the longer term, whether we are inside or outside the EU, we believe that "fundamentals" would continue to drive the economy and the property market. The UK can hold its own as a large and growing market of over 60 million people and, in the event of a Brexit, it would probably receive beneficial trade and market access terms with the EU, as well as other expanding economies around the world.

Moreover, the UK would remain a very attractive place to do business in its own right. It is worth noting its consistently high scores in surveys on transparency and the ability to do business. The UK property sector is one of the most mature and sophisticated in the world, offering easy access, high liquidity and a wide range of market opportunities.

As our client survey demonstrates, a potential Brexit is just one of numerous risks facing the UK property market in the coming years. There are other "home-grown" issues such as skills shortages, a lack of good quality housing and the likelihood of rising interest rates – all of which are major challenges that need to be addressed urgently.

36 OFFICES ACROSS THE COUNTRY, INCLUDING 12 IN CENTRAL LONDON

Bangor	Leeds
Basingstoke	Marlborough
Bath	Newbury
Boroughbridge	Newbury - Sutton Griffin
Bury St Edmunds	Northampton
Cambridge South	Oxford
Cambridge North	Peterborough
Cambridge Central	Shrewsbury
Cambridge - Sawston	Suffolk
Edinburgh	Wells
Harrogate	Winchester
Kendal	York

National HQ One Chapel Place	Hyde Park & Bayswater
Barnes	Knightsbridge & Chelsea
Barnes Village	Marylebone & Regent's Park
Fulham Bishops Park	Mayfair & St James's
Fulham Parsons Green	Wandsworth Common
Holland Park & Notting Hill	Waterloo

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