



# EU Referendum

Impacts for land, property  
and construction



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## Foreword

**The question of the UK's relationship with Europe and the development of the European Union is a multi-faceted and multi-generational one. The pressure on politicians and parliamentarians to consider the UK/EU relationship has grown over the last five years.**

A Conservative Party win in the 2015 General Election triggered their manifesto commitment to hold a referendum, asking “Should the United Kingdom remain a member of the European Union or leave the European Union?”, and the Prime Minister seeking a renegotiated reform package ahead of this vote.

This referendum could result in major geo-political and economic consequences, through what is arguably the biggest choice facing the UK for 40 years.

The impact of the referendum process, and the Prime Minister’s renegotiated package, is such that should the UK vote to remain we will be dealing with a ‘new normal’ in terms of this contested relationship.

Given the role that land, property and construction – and investment in, and occupation of, real estate – play in the economy, RICS has worked with members and stakeholders to consider the differential impacts of the two possible outcomes from the referendum choice on the property sectors.

Our Royal Charter requires us to serve the public interest by engaging with government and parliament, to provide critical insights based on the knowledge of our chartered members. We are politically neutral but not policy neutral. This means that we will never steer public opinion but will always speak up when policy proposals will impact on property.

We are seeking to provide a concise critique to assist property professionals come to a view on this major matter. This paper will look at the impacts for investment, development and occupation, and for the construction, commercial, housing and rural sectors. We offer this assessment of differential impact, but will not take the analysis to the next stage of a ‘remain or leave’ conclusion.



Table 1 – Assessment of major macro issues

|  | Remain  | Leave   |
|--|---|---|
| <b>GDP and output<sup>1</sup></b>            | Buoyed by consumer spending, the IMF expects Britain to be the second fastest growing economy in the G7 industrial nations this year, behind the US <sup>2</sup> .  | If Britain left the EU, it would win back its net contribution to the EU's budget, which the Treasury estimates will be 0.5% of GDP per year between 2014 and 2020.   |
|  | IMF said that after growing 2.2% in 2015, the UK economy is now expected to expand by only 1.9% in 2016, down from a forecast of 2.2% made by the Fund in January. That compares with 2.0% growth predicted for 2016 by the government's independent forecasters, the Office for Budget Responsibility (OBR). | UK GDP could be 2.2% lower in 2030 if Britain leaves the EU and fails to strike a deal with the EU or reverts into protectionism. In a best case scenario, under which the UK manages to enter into liberal trade arrangements with the EU and the rest of the world, whilst pursuing large-scale deregulation at home, Britain could be better off by 1.6% of GDP in 2030. |
| <b>Foreign direct investment<sup>3</sup></b> | The EU was the source of 46% of the stock of foreign direct investment (FDI) in the UK in 2013. This dependence has fallen somewhat in recent years, with the EU share down from 53% in 2009, but remains significant.  | UK has many advantages that would be unaffected by Brexit such as language, light regulation and deep capital markets.  |
|  | Britain continues to host half of all European headquarters of non-EU firms, with the UK hosting more HQs than Germany, France, Switzerland and the Netherlands put together.   | The risk that the UK is less attractive as a gateway to Europe, as a base for corporate HQs and as a location for investment from Europe, is offset by the international funds – such as Saudi and Dubai based sovereign wealth funds – for whom the UK remains attractive and safe opportunity.  |
| <b>Trade<sup>4</sup></b>                     | Britain continues to avoid 4% exporter tariffs, important as 45% of our exports go to other EU members and we obtain better trade terms due to EU's size.   | Value of UK exports to the EU is growing but percentage share of UK exports going to the EU is declining as we increase our trade with countries outside EU.  |
|  | UK has deeply negative trade deficit (-£62bn in 2014) with the EU, meaning we import more than we export; in contracts we have a trade surplus with non-EU countries. UK manufacturing in particular is trade deficit with EU.  | Britain can negotiate a new trade deal with the EU without the encumbrance of compliance to EU law, and seek its own trade deals with China, India and America.   |
| <b>EU budget</b>                             | Britain pays the EU £340 a year per household compared with an estimated £3,000 yearly benefit of membership.   | Britain can stop sending £350m to Brussels every week (some £18bn a year) and use this money domestically. Net cost of membership is however estimated at £7bn, after taking into account a rebate secured by Thatcher and EU payments to the UK.   |



|                               | Remain  | Leave  |
|-------------------------------|---|--|
| <b>Regulation<sup>5</sup></b> | Most EU regulation collapses 28 national standards into one common standard, making simpler law across all nations. In the EU, Britain can negotiate on regulation and BIS estimates costs at £8.6-9.4bn. | Leaving returns control over legislation and returns sovereignty to UK Parliament; burden of regulation would be removed from UK businesses, particularly SMEs.              |
| <b>Immigration</b>            | Britain continues to benefit from the free movement of labour within EU and countries that trade with the EU continue to have higher immigration levels than Britain.                                     | Britain can change the expensive and malfunctioning system that offers an open door to EU migrants and blocks other non-EU migrants that could contribute to the UK economy. |

1 'What if? ... the consequences, challenges and opportunities facing the UK outside the EU', Open Europe, March 2015

2 IMF World Economic Outlook (WEO): Too Slow for Too Long, April 2016

3 'Brexit: the impact on the UK and the EU', Global Counsel, June 2015

4 'Brexit: The EU Referendum and its impact on UK commercial property', Colliers, March 2016

5 'Brexit: Big risk, little reward – The UK Referendum on Europe', BlackRock Investment Institute, February 2016

**Additional sources:** Open Europe, CBI, CBRE, House of Commons Library Research, Financial Times

**Table 2 – Brexit survey results from other organisations**

| Organisation           | Remain or benefit | Undecided/Don't know | Leave or EU is negative |
|------------------------|-------------------|----------------------|-------------------------|
| <b>CBI 2016</b>        | 80%               | 15%                  | 5%                      |
| <b>TechUK 2016</b>     | 70%               | 15%                  | 15%                     |
| <b>SMMT 2016</b>       | 77%               | 14%                  | 9%                      |
| <b>EEF 2016</b>        | 61%               | 24%                  | 5%                      |
| <b>BCC 2016</b>        | 60%               | 9%                   | 30%                     |
| <b>Ipsos Mori 2016</b> | 83%               | 2%                   | 12%                     |
| <b>ADS 2016</b>        | 70%               | 20%                  | 10%                     |
| <b>IoD 2015</b>        | 65%               | 1%                   | 22%                     |
| <b>FSB 2015</b>        | 47%               | 11%                  | 41%                     |

**Source:** CBI, *Two Futures: What the EU Referendum means for the UK's Prosperity*, April 2016



# The role of property in the economy

The “single market” experience for the UK since joining the European Economic Community in 1973 has, by and large, been positive. Enhanced product market competition has led to a decrease in the mark-up ratio in manufacturing from 38% to 28%<sup>6</sup>, price dispersion has fallen significantly, and a rise in business innovation has lifted aggregate productivity and real wages. While any assessment of Brexit will be fraught with assumptions and unknowns, it is worth noting that the potential cost of leaving the EU is not necessarily the same as the benefits derived from Britain’s involvement in the past. The economic and trading linkages established after nearly half a century are unlikely to simply vanish, whatever the outcome of the referendum.

Uncertainty will be the key economic transmission channel for either referendum outcome. According to Ernst & Young’s 2015 UK Attractiveness Survey<sup>7</sup>, 72% of investors cite access to the European single market as important to the UK’s attractiveness. Until the outcome of the referendum is known, 31% of investors will either freeze or reduce investment. If capital flows were to become more volatile or experience a sudden stop, the financing of the UK’s twin deficits would become less of a worry and more of a problem. Weaker business and consumer confidence would lead to reduced domestic investment with markets demanding a higher risk premium for UK assets. Moreover, a credit rating downgrade for the UK would trigger a sharp depreciation of the pound, raising inflation through higher import prices and squeezing real household incomes. Weaker domestic demand, currently the backbone of the UK’s economic recovery since the global financial crisis, would shift the gears of prospective economic growth.

In the event of a vote to leave, the UK would have at least two years to redefine its relationship with the EU. The alternatives fall under five broad categories:

1. join the European Economic Area (EEA), e.g. Norway
2. form a bilateral agreement, e.g. Switzerland
3. customs union, e.g. Turkey
4. free trade agreement, e.g. South Africa
5. default to most favoured nation terms under the World Trade Organisation.

Whatever the outcome, it is in the EU’s interest to discourage the recent uptrend of using the referendum mechanism amongst its members to decide on EU policies whenever domestic policies conflict. By taking a hard line with the UK, the EU could underscore that the costs and benefits associated with membership are a collective arrangement whereby the sum is greater than the parts.

The EU is an important trading partner of the UK accounting for 53% of its imports and 45% of its exports. In recent years, the UK’s current account deficit has been fuelled by resilient domestic demand and weak EU domestic demand. The composition of this trade balance is likely to inform any renegotiated relationship as the UK runs a deficit in goods but a surplus in services, although most of the latter is with non-EU countries. In other words, while the EU may be willing to grant the UK unrestricted access to the single market in goods, it would require far greater concessions in services.

<sup>6</sup> *Has the EU’s Single Market Programme Fostered Competition? Testing for a Decrease in Mark-up Ratios in EU Industries*, Harald Badinger, April 2007

<sup>7</sup> Ernst and Young, UK Attractiveness Survey 2015

Financial and insurance services account for 7% of GDP in the UK (3Q 2015) compared to 3% to 4% in Germany or France. Companies based in the UK seeking to do business in the EU will need to comply with EU regulations, but in the event of a Brexit will no longer have any say in how those regulations are developed. Due to high levels of industry regulation in the financial industry, non-tariff barriers to trade and regulations could be particularly onerous. According to an analysis of UK Government impact assessments, Open Europe estimates that the 100 most burdensome EU-derived regulations costs the UK economy £33bn a year<sup>8</sup>, which contrasts with the £59bn in annual benefits the government claims is derived from those regulations. According to the OECD, the UK is amongst the least regulated from a product market perspective, second only to the Netherlands<sup>9</sup>.

The ease of visa-free recruitment across the EU is another important reason why businesses choose to invest in the UK. According to a 2013 Ipsos MORI survey of financial and professional services firms in the UK, 38% of respondents would relocate at least a portion of their headcount if the UK were to leave the European single market<sup>10</sup>. In fact, access to EU migrants has improved the flexibility of the UK labour market, thereby lowering the sensitivity of British workers to business cycles. Research from the Centre for Economic Performance (CEPR) shows that counties in the UK with the largest increase in immigrants have experienced neither larger nor smaller increases in UK-born unemployment; the impact of immigration on wages was negligible as well<sup>11</sup>. Moreover, the demographics of migrants have proven to be highly complementary to the domestic workforce, with younger, skilled EU migrants bridging critical skills gaps and contributing to the UK budget in the process. In its analysis of social housing in the UK, CEPR found that two-thirds of the drop in availability to British citizens was due to a decline in the total stock of social housing rather than the rise in immigration.

Ultimately, the referendum is a risk event for both the UK and Europe. Recent geopolitical events and cross-border terrorism have heightened concerns related to immigration and national security. Left unchecked, this can fuel the appeal of regressive, populist and extremist policies on both sides of the Channel. Moreover, the UK should not assume that its pre-eminence as a global financial centre will be left unchallenged. In the World Economic Forum's latest Global Competitiveness Report, the UK placed tenth in global competitiveness, outranked by Switzerland, Germany and the Netherlands in the top five<sup>12</sup> – a striking indicator for consideration.

<sup>8</sup> Open Europe, *The Top 100 costliest EU-derived regulations in force in the UK*, March 2015

<sup>9</sup> Koske, I. et al. (2015), "The 2013 update of the OECD's database on product market regulation: Policy insights for OECD and non-OECD countries", OECD Economics Department Working Papers, No. 1200, OECD Publishing

<sup>10</sup> Ipsos MORI, *EU Single Market Membership Survey*, October 2013

<sup>11</sup> Jonathan Wadsworth, *Immigration and the UK Labour Market*, 2015

<sup>12</sup> World Economic Forum, *The Global Competitiveness Report 2015-2016*, 2016

## Uncertainty, risk and investment

From the outset, RICS called for the referendum to be called as quickly as feasible to avoid any prolonged uncertainty potentially damaging the recovering economy.

The nature of investment and speculative property development requires stability, clarity and certainty. These factors ensure that investment in property happens, build projects start, and that occupiers commit to locations.

RICS members felt that a climate of risk began when the Prime Minister first verbally committed to a referendum in 2014; a sentiment that was nourished by the Conservative Manifesto pledge in 2015. This has been seen through our own market surveys<sup>13</sup> but also those of individual firms and researchers, such as a CBI/CBRE London Business Survey, where 80% of 206 surveyed businesses rated it one of their 'top three concerns'<sup>14</sup>.

The concern is generated by a series of unknowns for decision-makers:

- Risk generated by the debate in the lead up to the June referendum<sup>15</sup>
- Uncertainty over the referendum outcome<sup>16</sup>
- Uncertainty over the process for exit
- Uncertainty over the renegotiated package if the UK remain in the EU
- Uncertainty over the exit negotiation period and potential trade deals

Anecdotally, this uncertainty has already had an impact on decisions in property markets and heightened the perception of risk attached to the UK. Investors are hesitating, occupiers re-planning their footprints, and building pipelines are slowing<sup>17</sup>.

As Christine Lagarde of the IMF said: 'Uncertainty is bad in and of itself. No economic player likes uncertainty. They don't invest, they don't hire, they don't make decisions in times of uncertainty'<sup>18</sup>.

In our property practitioner survey of March 2016, around 30% had noted a negative impact on property transactions mirroring Ms Lagarde's outlook.

The impact of this referendum has been likened to the uncertainty and risk created in domestic and FDI investments markets by General Elections, and by the nearest comparator we have the Scottish Independence referendum of September 2014. However, the impact of the EU referendum is greater than those, as it fits with such a potentially large geo-political and economic shift.<sup>19</sup>

While investor and occupier confidence were affected by polling results in Scotland, just as we are seeing in the UK now, property markets readjusted quickly following the 'no' vote. RICS members expect the same resurgence across the UK if the decision is to remain.

Over the last quarter of 2015 and into 2016 it was evident that investment in property was slowing. Uncertainty being one of the main drivers behind this and particularly relevant to decisions about long term investment in real estate.

<sup>13</sup> Sentiment surveys undertaken across our members, on residential, construction, commercial and rural sectors; these have proven to be leading indicators for the property industry in recent years: <http://www.rics.org/uk/knowledge/market-analysis>

<sup>14</sup> CBI/CBRE London Business Survey - February 2016

<sup>15</sup> Implications of a UK Withdrawal from the EU: A Discussion Paper', Investment Property Forum (IPF) Research Programme 2011-2015, published April 2015

<sup>16</sup> Deloitte survey of 120 CFOs in Britain's FTSE 350 quoted in 'Brexit jitters deal blow to investment', Emily Cadman, Financial Times 4 April 2015 <sup>16</sup> 'UK construction activity hits 9-month low', Financial Times 2 Feb 2016, quoting Markit/CIPS survey of purchasing managers

<sup>17</sup> 'UK construction activity hits 9-month low', Financial Times 2 Feb 2016, quoting Markit/CIPS survey of purchasing managers

<sup>18</sup> Christine Lagarde interview with *CNNMoney* on Wednesday 24 February 2016

<sup>19</sup> Brexit Britain looks less attractive for investors', David Smith, Economic Outlook, Sunday Times 3 April 2016

In March 2016, the KPMG poll of 25 global real estate investors, with assets under management of over \$400bn, found that two thirds believed a Brexit would result in less inward investment into UK property and property companies<sup>20</sup>. Their consensus was that an initial period of uncertainty could potentially be more immediately damaging to the UK real estate market than the stable post-Brexit world.

Wider fears that overseas investors would no longer see the UK as an attractive place to invest if we lost our access to the single market have merit, but access to Europe is only one reason why investors opt to come to the UK, often with a focus on London. The legal system, the language, professional property standards and the ease of doing business are also important and these are not a function of EU membership, which we have explored in a previous RICS paper<sup>21</sup>.

Therefore FDI could slump in the short-medium term if the UK left the EU but recover given the attractiveness of the UK; this is closely linked to most property purchases by overseas buyers being for investment, not operational purposes.

UK based real estate investors have a broader interest in the UK market, so risks that might affect the overall health of the economy and the level of economic activity (including occupier demand), are more relevant to them.

Investment and occupier decision making are intimately linked, both driving overall economic activity. If there were an adverse effect from a UK exit, lower GDP and employment would mean lower demand for office space, less assets developed and less opportunities to invest.

Regardless of the outcome, the UK property market could see a flurry of activity: occupancy and purchase transactions could complete; just as much as the same deals could drop out – returning these properties to the market.

<sup>20</sup> 'Global investors believe Brexit would result in less investment into UK property', *KPMG survey of 25 global real estate investors*, 4 April 2016 [investors surveyed have properties located in the UK within their real estate investment portfolios and the total worth of their global real estate investment portfolios equals over \$400bn]

<sup>21</sup> 'Corporate Real Estate: Investment and Global Cities', RICS 19 November 2012

# Property sectors

## 1. Commercial

### Office

Opposing statements on their future UK-based operations have emerged from a number of large, predominately financial firms, and RICS practitioners have cited some international clients preparing contingency plans to shift their headquarters in the event of Brexit – harming occupancy rates, particularly in London.

International firms based in the UK occupy large swathes of real estate, with their operations looking for inward investment opportunities. The majority of RICS member firms' Brexit reports reiterate negative connotations for office occupancy should international firms relocate to the EU. Whilst Capital Economics have suggested an increase in vacancy rates and a dampening of the Central London premium, a Brexit could ease pressure on office space demand.<sup>22</sup> However, less UK-focussed operations by international firms could impact on investment and new development.<sup>23</sup>

Likely beneficiaries of a Brexit are Paris, Frankfurt and Dublin; the latter being the only major city in the EU that has English as its first language – this will have a pull for some international firms, particularly those from the USA<sup>24</sup>. That said, the UK would still have significant quantity of quality office space, and a large pool of highly-educated office staff, which these other cities, at least in the immediacy, may not be able offer<sup>25</sup>.

Despite the aforementioned Brexit cancellation clause in contract agreements, UK occupation and investment rates have not frozen, suggesting appetite for investment and occupation, be it subdued. That can either be interpreted as discarding a Brexit impact as nominal, or that the UK's economy will return to normal within a fixed time period (less than the length of the lease under negotiation), indicating confidence in the UK economy's resilience.

We should note that occupier agreements are designed to withstand market volatility, with average contracts for office space lasting seven years. Many office occupants will be tied in for the assumed period of uncertainty should UK vote to leave i.e. that caused by the two year exit negotiations.

London is likely to remain a magnet for investment, but it is harder to anticipate how other major cities and the devolved nations will be affected. Scotland's pre-referendum slow-down in commercial activity still saw degrees of investor appetite and occupation, and witnessed a bounce-back from held back investment and occupation decisions. We cannot second-guess if the entire UK, on a region by region basis, will all experience this bounce-back simultaneously after Brexit.

### Retail

Confidence in the economic outlook is fundamental to UK consumers' spending decisions, so the uncertainty in the run up to the polling day is more important for retail in the short term, and could soften sales. The view that some international retailers may see this short term disruption as a deterrent has been offset by the success and expansion of German discounting chains in the UK, whose growth is likely to continue irrespective of any result<sup>26</sup>.

<sup>22</sup> Capital Economics, *The economic impact of 'Brexit': A report by Capital Economics for Woodford Investment Management*, February 2016

<sup>23</sup> How big a threat is Brexit to UK property markets?: Roger Bootle & Ed Stansfield, UK Commercial Property Focus, Capital Economics 30 September 2015

<sup>24</sup> HSBC ready to move 1000 bankers to Paris on Brexit, Bloomberg cited in 'Heading for the Exit: the property market impacts of the UK referendum on EU membership, CBRE February 2016

<sup>25</sup> Savills: *The EU Referendum; Implications for commercial, rural and residential property markets* 2016. Brexit would hurt the City's export value and everybody would suffer', Philip Aldrick, The Times 27 February 2016

<sup>26</sup> Carter Jonas, *Brexit: issues for UK property*, 2016

Brexit will raise a bigger question over whether existing or potential pan-European retailers would continue to view UK as a prime location for their headquarters. Like financial services and its demand for office space, this could mean a rebalancing of footprint for existing businesses.

In the medium term some retail commentators have argued that employment costs would fall due to either the Prime Minister's renegotiation package, and its effect on the application of future EU legislation in UK labour markets; or in the event of the UK leaving the EU, the lifting of existing requirements and compliance across UK retail.<sup>27</sup>

Whilst retail related logistics are likely to be unaffected by Brexit, given the continued growth of 'clicks vs bricks' and e-commerce, retailers and industrial occupiers face the more direct constraint of labour shortages – particularly in lorry drivers<sup>28</sup>. If the free movement of labour within the Common Market is removed, this is either amongst the skill sets which a new Government must, and could, target through unrestricted migration policy; or employers will need to balance good local labour profiles with drawing on capacity from their wider EU operations.

## Industrial

Manufacturing has continued to steadily grow, albeit from a low base, during the last Parliament.<sup>29</sup> A number of policies have been put in place in the UK to incentivise business investment, and in particular capital allowances for investment in plant and machinery. These improvements are put at risk by the referendum.

Major manufacturers have been attracted to the UK over successive decades because of our mix of economic and labour market policies, the transparency of regulation, incentives like Enterprise Zones – crucially, all within the Common Market. Given the timelines these businesses work to, leaving the EU would not mean short to medium term cessation of production. Views have been mixed with some saying they would look to leave the UK, consider a significant scaling down of their UK operations, or remain in the UK regardless<sup>30</sup>.

Brexit could see an increase in tariffs for exporters and impact on costs for the industrial sector, in the medium to longer term. Many industrial occupants are tied into contracts of 15-25 years, so will be looking at UK's recovery from instability in the long term. Post-Brexit trade negotiations will be key as industrial occupiers wait to assess what can be achieved with the EU and also if this has benefits for their business through access to new world markets.

Similarly, the chairman of JCB – a large construction equipment firm – does not believe a Brexit would have a negative effect on the UK economy; suggesting with the UK could continue "on our own – peacefully and sensibly".<sup>31</sup>

## 2. Land

The most significant debate taking place within the farming and land management sector revolves around access to Common Agricultural Policy (CAP) payments. British farmers receive annually €3.1bn in direct support from CAP, with 60% of our food exports going to, and 70% of food imports coming from, the EU.

<sup>27</sup> Labour regulations in the UK, via the EU are often cited as onerous but the OECD's assessment finds them to be comparatively favourable: Koske, I. et al. [2015], "The 2013 update of the OECD's database on product market regulation: Policy insights for OECD and non-OECD countries", OECD Economics Department Working Papers, No. 1200, OECD Publishing

<sup>28</sup> JLL, *The Sky's No Limit: what does property have in store for the property markets?*, 2016

<sup>29</sup> Bank of England, Agents' summary of business conditions, July 2015

<sup>30</sup> 'Toyota pledges to stay in UK even if country takes Brexit', Robin Harding, Kana Inagaki and Kunio Saijo, *Financial Times*, 11 January 2016

<sup>31</sup> Lord Bamford speaking on BBC Midlands Today, 18 May 2015

Data from the Department for Environment, Farming and Rural Affairs (DEFRA) suggests that 55% of UK farming income comes from CAP<sup>32</sup>, with almost 70% of all English land in linked agri-environment schemes and further funds benefiting rural communities through the Rural Development Plan for England (RDPE). Upland areas which are less agriculturally productive, but often of high landscape quality, are deemed 'Less Favoured Areas' and receive further income to ensure that they remain managed.

Following a vote to remain this sector will still face the current challenge of competitive commodity prices. Coupled with the prospect of rising interest rates in 2017 farm incomes will continue to be under pressure. The sector will continue to see EU led CAP reform process every six to seven years with shifting policy priorities for agricultural subsidy.

Defra's most recent Farm Business Income Survey 2014-15 found average farm income across all types to be £39,700, of which £28,000 is direct support and agri-environment payments. This means that 70% of farm profitability is dependent on EU support.

Farmers will likely lose access to the EU single market and CAP following Brexit, which will impact farm incomes and profitability. Access to the single market and new global markets would inevitably be determined by renegotiations. The EU Commissioner for Agriculture has suggested that the EU has a contract to support UK farmers, via CAP, until 2020 and the end of the Multi-Annual Financial Framework<sup>33</sup>. UK Land and farming businesses would, however, still experience restructuring in the short to medium term.

It could also lead to a decrease in land values in the longer term, as the subsidy regime was withdrawn and no replacement support mechanism introduced<sup>34</sup>, though 70% of our survey respondents felt that land would remain a strong investment opportunity. Ministers have suggested continued support, be it lacking detail; only UKIP<sup>35</sup> have suggested a replacement to CAP – established from retrieved EU payments. Our members are not convinced that a post-Brexit government would match this level of subsidy.

Conservative led Governments have committed to making UK farming more globally competitive and lowering its dependence on CAP. Given the importance of the rural vote to this party, it's likely that some form of transitional arrangement – and future scheme – would be put in place, but it would not be to the scale or same priorities as the existing CAP in the UK.

## Forestry

Quite uniquely, forestry has benefitted from the uncertainty and the consequential weakening of the GBP. The second half of 2015 saw a strong GBP performance against the Euro, and this impacted on the competitiveness of UK domestic supplies due the better prices of imported timber.

Continued uncertainty from a Brexit will not be conducive to an immediate revival of the GBP, so we could see resurgence in the domestic timber market – on the proviso there is a demand from the end-users like the construction sector. Relieved from EU legislative compliance and stringent materials access ruling, UK public sector contracts could place a preference upon the use of UK timber – ensuring demand is maintained. All this could lead to UK timber being an enticing external investment option for those looking into the UK – maintaining jobs, output and value.

Conversely, continued uncertainty and a reduction in grant support after Brexit could lead to a continued reduction in new woodland planting with associated impacts on the nursery and contracting sectors.

<sup>32</sup> In 2010-11, while about 15% of farms in the UK had negative incomes even with the direct payments, this position worsened to nearly 60% if the payment was removed. roljik, H.C.J., de Bont, C.J.A.M., Blokland, P.W. and Soboh, R.A.M.E., Farm Viability in the European Union: Assessment of the impact of changes in farm payments, LEI report 2010-11

<sup>33</sup> 'The EU Referendum: implications for commercial, rural and residential property markets', Savills, March 2016

<sup>34</sup> 'English farmland prices hit by Brexit fears', James Pickford, Financial Times 8th April 2016; and Knight Frank Farmland Index Q1 2016

<sup>35</sup> George Eustice MP, Farming Minister on behalf of Vote Leave, has said repatriated CAP funds could reward higher welfare standards for livestock but not outlined an alternative scheme: 'If pigs could vote...a better life for pigs outside the EU', The Times, 5 March 2016

Our members indicated that wider forestry, including major landed estates, is not, in itself, self-sufficient, with the majority of their forestry clients receiving direct grants from the EU, as well as owning agricultural land (thus in receipt of EU subsidies to provide income). Indeed, forestry sectors across the UK – through their region-specific Rural Development Programmes – will be in receipt of over £640m for 2014-2020.<sup>36</sup> A move away from subsidy reliance could make the forestry industry more self-reliant and resilient in the medium to long term.

### 3. Residential

Our monthly Residential Market Surveys indicate a chronic shortage of housing across the UK. The long-standing, disparity between supply and demand is a major factor in increased house prices and rents in key locations (such as London and the south east).

Like other sectors we have considered, residential investment transactions in the residential sector have slowed. It has also limited house buying transactions across the house price spectrum, but this is outcome is not unexpected. Before any national poll there is usually a slowing of residential transactions; potential home buyers generally delay their decisions to purchase a home and investors stall on completing financial commitments.

After an election vote we typically see the residential sector recover and ‘bounce back’ as stability and confidence returns. However, the outcome of Brexit could provide an alternate effect. The ‘no’ result of the Scottish referendum saw a housing transactions recover in the immediacy, as highlighted by Knight Frank<sup>37</sup>, and we would expect the UK to follow suit should the electorate vote to remain an EU member.

Should the UK opt for a Brexit, we could assume that uncertainty could linger whilst the UK Government negotiates new trade deals and relationships with the EU and third countries.<sup>38</sup>

The lower to middle priced property market is, in the main, directed by domestic participants so the uncertainty has had less impact on demand and house prices at this end of the market when compared to the higher end.

A significant number of higher end properties – particularly those in London and the south east – are purchased by EU and non-EU individuals. Brexit could see less demand for higher end properties as highly paid executives could follow their headquarters to mainland Europe; relieving pressure in demand for higher-end residential areas. We can, therefore, suggest house prices could decrease in the immediate to short term.

According to Savills, there was over \$6.5bn of investment in the UK student accommodation sector in the first three quarters of 2015<sup>39</sup> – a very significant figure. Changing enrolment rules for higher education institutions after Brexit could deter international students – thus affecting demand for student accommodation and PRS accommodation.

### 4. Construction

In 2014, the UK construction industry directly employed 2.1m people and contributed £103bn to the UK economy. This equated to 6.3% of all UK jobs, and 6.5% of total economic output<sup>40</sup>.

The potential stalling of UK-bound investment from external groups has been felt; uncertainty has put a stopper on some investment decisions, and this has negatively affected the construction sector. However, investor confidence is not the only element of the debate that could affect construction.

<sup>36</sup> EuropaEU, Rural Development Programme fact sheets: for England, Wales, Northern Ireland and Scotland

<sup>37</sup> Knight Frank, *The EU and the UK Housing Market*, 2016

<sup>38</sup> The Bank of England has already indicated that it has undertaken contingency planning for economic support in the event of a Brexit vote, including the announcement of three additional indexed long term repo operations (ILTRs): Treasury Select Committee Hearing – The economic and financial costs and benefits of UK’s EU membership: Mark Carney and Jon Cunliffe

<sup>39</sup> Savills, *Spotlight: World Student Housing 2015/16*, 2016

<sup>40</sup> House of Commons Construction Industry Research Briefing, October 2015

## Infrastructure

As an EU member state, the UK has access to significant funding streams, such as the European Investment Bank (EIB) and European Investment Fund (EIF). EIB investment in the UK reached €7.8bn in 2015 – this equates to the Bank's largest engagement in the country to date – with the majority of the funding feeding into infrastructure projects covering: energy, transport, communications and water<sup>41</sup>.

Key projects financed by the EIB include London's transport (£1bn 35-year loan) and the electricity transmission network in the north of Scotland (£500m). These are significant sums of money that have driven infrastructure forward in the UK. As an EU member state, the UK is fully eligible for bank financing operations.

The EIF provides financial support to assist EU and Accession countries develop and support SME lending. EIF's contribution to UK enterprises reached €655.8m in 2015<sup>42</sup>. Whilst not as substantial as the EIB, access to this funding is beneficial to smaller firms – not just in construction.

A loss of both funding streams could have a significant impact on project delivery and start-ups and across the UK, so would need to be replaced in some capacity.

## Imports and Exports

China is the only non-EU state in the top five UK import markets, and EU imports accounted for 59% of total construction material imports – electrical wires, sawn wood (> 6mm thick), and lamps and fittings being the top three imports<sup>43</sup>.

A Brexit, and the loss of free movement of goods, coupled with the potential introduction of tariffs, could go either way in terms of impact. It could either push construction sector firms to look inward and purchase domestic materials, benefitting local enterprise; or it could increase the cost of production through imported materials.

Looking to exports, the free movement of goods benefits UK exporters selling their product(s) to EU member states when compared to non-EU states (without a pre-existing trade agreement in place).

EU regulations stipulate central rules for marketing construction products within the EU. In the event of Brexit, these regulations, whilst not applying to the UK, would still have to be followed when exporting to an EU state. Unless renegotiated, the UK would need to comply with regulations but with no voice to shape.

On the flip side, the UK would be able to develop and negotiate its own trade agreements with the EU and other large importing countries, such as China and the USA. However, these trade negotiations could take years to finalise.

## Labour

RICS' most recent Construction Market Survey indicated that in general, across the UK, workloads are going up, but the availability of skilled workers is decreasing.

To tackle the skills shortages, developers and construction firms have been looking to skilled workers from other EU member states to fill the gap; construction within London, in particular, has become almost reliant on importing skilled labour. Any changes to the free movement of labour could have a negative impact. If immigration is limited, particularly for skilled workers, the UK will witness higher project expenditures where labour demand outstrips supply.

Alternatively, those in favour of Brexit argue that a UK-set migration system could allow the UK to pinpoint the skilled workers it requires. However, with quantity of programmes and projects, the UK may not have an adequate level of investment and development that would necessitate a high(er) number of construction staff.

<sup>41</sup> EIB in the United Kingdom

<sup>42</sup> EIF in United Kingdom

<sup>43</sup> Department for Business Innovation and Skills, Monthly Statistics of Building Materials and Components, February 2015

## Procurement

The UK's membership of the EU has seen the procurement regime move from unregulated tendering processes to a stringent and obligatory framework of directives and regulations. This framework exists to inhibit bribery and corruption, and increase competition through the provision of best value for money. However, some argue this comes at a cost.

Under the EU procurement directives, all EU firms can bid for EU member state public procurement contracts free from discrimination ie. member states cannot reject a bid on the basis of the firm's country of origin. Obligated to promote the free movement of goods and services member states cannot "buy national" nor have a preference for "indigenous" companies.

A Brexit could allow UK public procurement to stipulate the use of "UK firms and materials only", thus being a tool to support UK-based and enterprises.

## VAT

It is EU statute that member states impose a minimum of 15% VAT on the consumption of goods and services, with potential reduced rates on certain items (minimum of 5%). UK reduced rates relating to the built environment include 5% VAT on residential energy, insulation and renovations, and 0% VAT for new building construction.

RICS has historically been in favour of a VAT cut for home refurbishment works. VAT acts as a disincentive for works to be considered, with a cut aiding local SMEs and the wider UK economy: a VAT cut to 5% would have created over 95,000 additional jobs in the construction sector and provided at £15.1bn stimulus to the UK economy between 2015 and 2020<sup>44</sup>.

A post-Brexit Government could alter VAT arrangements to encourage purchase and investment – from a small to large scale – in specific goods and services.

44 Experian, *An estimate of the effects of a reduction in the rate of VAT on housing renovation and repair work: 2015 to 2020*

## Comparative benefits

| Sector                                  | Remain  | Leave   |
|---|---|---|
| <b>GDP</b>                              | Free movement of capital allows, and encourages, investment in UK's land and property market.   | UK's economic performance is established and resilient – beyond single market access – GDP will recover.                |
| <b>Trade agreements (import/export)</b> | Access to the single market and EU trade agreements with third countries beneficial to UK based firms – any post-Brexit deal will not match current benefits. | UK will have authority to renegotiate own trade agreements with EU and third countries – with UK interests at the fore. |
| <b>Migration: skills and employment</b> | Free movement of people provides skilled labour force and high quality talent pool.   | UK-set migration policy can target specific individuals with required skills sets.                                      |
| <b>Commercial – office</b>              | Multinational UK based headquarters occupy large offices, ensuring continued investment and development, and employment.                                      | UK set trade agreements could entice international firms for continued sector confidence.                               |
| <b>Commercial – retail</b>              | Withdrawal from EU will see loss of retail headquarters (loss of jobs) and increased vacancy rates.   | UK residents' purchasing power still driver for external interest in UK retail sector.                                  |
| <b>Commercial – industrial</b>          | Tariff-free exporting assists manufacturing sector and the continued use of industrial property.  | Removed from EU 'red tape' and regulation, industry capacity will grow.   |
| <b>Rural</b>                            | CAP and access to single market imperative for vibrant farming sector and rural property market.  | Free from paying "EU contributions", UK can provide replacement for CAP through domestic support.                       |
| <b>Residential</b>                      | EU nationals purchase higher-end properties ensuring continued activity at this end.  | Reduction of migration could cool demand on supply and housing benefits.  |
| <b>Infrastructure</b>                   | Loss of access to European funding (EIF/EIB) could dampen infrastructure investment and delivery.   | Monies saved from EU contribution can be steered into infrastructure development.                                       |
| <b>VAT</b>                              | UK has negotiated appropriate reduced rates.  | UK will be unrestricted in setting applicable VAT rates.  |
| <b>Procurement</b>                      | As part of the EU, the UK enjoys competitive procurement and tendering processes – ensuring high quality bids and lower costs.                                | Current framework does not allow UK to preference indigenous firms.   |

## Summary: Implications of potential scenarios

Having considered the differential impacts of the remain or leave scenarios across the property sectors, there are implications that could arise from the vote on 23 June that property professionals should be considering.

We outline these below, and whilst speculative, they explore what land, property and construction need to contemplate as the period of uncertainty post-vote crystallises. As stated in our opening remarks, such an important geo-political event will not mean 'business as usual' – and this scenario planning should help readers develop their business strategies from 2017 through to 2020.<sup>45 46</sup>

**Neverendum** – an unclear, marginal or low turnout vote – on either side – won't answer the question that the Prime Minister, campaigns and nation has set out to settle. As seen in Scotland, either could lead to a political climate of instability where further referendums are proposed and are regularly part of domestic political negotiation. Such a situation could continue the uncertainty seen in markets and contribute to investors' overall assessment of risk in the UK.<sup>47</sup>

Under the Prime Minister's renegotiation package, which will see repatriation of powers, if any EU measure is deemed a transfer of sovereign powers under criteria laid down in the UK's 2011 European Union Act, this will trigger another referendum about whether the United Kingdom should adopt it. The additional power doesn't need to be the result of a treaty change; it can be the result of Qualified Majority Voting in the European Council or the accidental by-product of legislation.

**New normal** – Remain doesn't mean business as usual, the Prime Minister's reform package still alters our relationship, particularly free movement of people, and knock-on renegotiation by other Member States (such as the Czechs). The package puts in place an 'emergency break' on significant movements of migrants into the UK, ensures protections for The City from EU regulations, limits discrimination for UK being outside the Eurozone, and ever-closer Union will not apply to the UK.

The reform package has limited direct impact on property sectors, but as it effects migration and financial services, it invokes relevance and alters the UK/EU relationship. Commentators have pointed out that the Prime Minister's reform package, the re-imposition of domestic borders in Europe in response to pressure from migrants, and security measures through recent terrorist attacks, mean that the free movement of people in the Common Market and through the passport-less Schengen Agreement is now inevitably fractured.

**Secondary separation** – Scottish and Welsh leaders have been clear that an English-led Brexit, would lead to national pursuits of EU reunion. This implies the breakup of the UK state, given that our devolutionary settlement (even if grasping towards proto federalism) would not be significant enough to cope with UK nations in different macro jurisdictions, and the return of hard borders for some parts of the UK. Northern Ireland would find itself with a new international land border with the Republic of Ireland and the Eurozone. Such a situation would greatly complicate Brexit negotiations and potentially weaken the 'remainder UK' bargaining power.

The continuing process of devolution raises further issues for the campaigns for independence in Scotland Wales; not least radical plans for more tax powers at Holyrood, and demands from other parts of the UK for a different distribution of funds.

<sup>45</sup> 'Three futures for a Britain outside the EU', Chris Giles, Financial Times 23 February 2016

<sup>46</sup> Economic research groups assessment of impact of Brexit, Centre for Economic Performance LSE, CBI / PwC and Oxford Economics, discussed in 'Damage Limitation: alternative models weigh trade costs of exiting EU', Chris Giles, Financial Times 22 March 2016

<sup>47</sup> Friends, foes and critics lend Cameron their ears: Stay or go, what happens next', Alex Barker, Stefan Wagstyl & Henry Foy, Financial Times 20 February 2016

The devolved election results will be scrutinised post 5 May for what they mean for the EU referendum vote and will potentially sharpen the mandate of devolved leaders.<sup>48</sup>

**Long goodbye** – The period for Brexit negotiations has been posited as being two years. That discounts, however, how long it might take to hammer out a new status or trade relationship with the EU, and new trade deals with other world nations.<sup>49</sup> Canada's trade deal with the EU took seven years to negotiate for instance. The UK is the second largest economy in the EU, and the second largest consumer, so it's highly likely that EU member states will still want a strong trading relationship even if barriers do go up. However, it is fair to assume that the market access that the UK currently enjoys i.e. no tariffs, will not be as comfortable as it is presently, and access to the Common Market will come with obligations to adopt certain areas of legislation.<sup>50</sup>

### An EFTA member in the EEA?

Should the UK vote to leave the EU, it could agree to become a member of the European Free Trade Association (EFTA) and remain within the European Economic Area (EEA). It is difficult to assess how this option would impact on the land and built environments. This is because members of the EEA still have access to the EU's internal market, but have to adopt most EU legislation – but, significantly, not fisheries and agriculture. It is likely that the built environment would still have incoming investment, but how the land market and rural sector react will depend on the future monetary policy i.e. CAP replacement and investment.<sup>51</sup>

### In the EFTA or go it alone?

While Switzerland is a member of the EFTA it is not a member of the EU or EEA. This removes its commitment to EU legislation, instead opting for bilateral agreements on specific issues e.g. procurement. In this instance the UK will have to negotiate a similar package – though renegotiating trade agreements could take years to establish.<sup>52</sup>

### Make like Turkey?

The UK could, given its strength as an economy, seek to hammer out a customs union with the EU, or attempt to seek a deep and comprehensive free trade agreement.<sup>53</sup> Both situations would still mean that we rely on normal World Trade Organisation rules for access to the EU market and for trading relationships with other world nations.

### Splendid isolation?

The option preferred by most Eurosceptics would be to negotiate a special deal for Britain alone that retains free trade with the EU but avoids the disadvantages of other models, possibly even compliance with EU regulation. This could be the hardest or even impossible to negotiate in an atmosphere post-Brexit that is unlikely to be a warm one.

48 Regulatory difference and divergence can be expected to continue under devolution and accelerate in a Brexit situation, as shown under CAP structures now: 'BREXIT & Agriculture', Farmer Scientist Network, Yorkshire Agricultural Society

49 Divorce will show breaking up is hard to do', Alex Barker, Financial Times 27 February 2016

50 The concept of 'No Brexit, Good Brexit and Bad Brexit' as discussed in 'Brexit: issues for UK property', Carter Jonas 2016

51 Overlapping relationships between countries in Europe, cited in 'Heading for the Exit: the property market impacts of the UK referendum on EU membership, CBRE February 2016

52 Swiss style bilateral accords as discussed 'EU Referendum 2016 – 113 Days', Strutt & Parker

53 Brexit: Big risk, little reward – The UK Referendum on Europe." BlackRock Investment Institute, February 2016





| Remain   |  |   |  |   |
|--|--|---|--|---|
| <ul style="list-style-type: none"> <li>The prospect of the referendum has increased uncertainty</li> <li>Investment decisions put on hold until after result</li> <li>Delay in investment decision having slight impact on new development</li> <li>Occupation decisions stall – some contracts include leave ‘get-out’ clause.</li> </ul> | <ul style="list-style-type: none"> <li>UK’s ‘new package’ – no substantial impact on land and property markets</li> <li>Uncertainty begins to alleviate</li> <li>Most pre-referendum investments concluded – post-result “bounce-back” witnessed</li> <li>Delayed developments commence</li> <li>Occupation agreements concluded.</li> </ul> | <ul style="list-style-type: none"> <li>Uncertainty and risk back to pre-referendum announcement levels</li> <li>Investment, development and occupation grow as GBP strength against the Euro recovers</li> <li>Bounce-back has positive effect on occupation rates, resulting in an increased interest in development.</li> </ul> | <ul style="list-style-type: none"> <li>“New” EU relationship – engineered through renegotiation package – well underway</li> <li>Employment costs fall as result of ‘new’ relationship</li> <li>Other EU countries negotiate new package/hold poll on membership?</li> </ul> | <ul style="list-style-type: none"> <li>Other EU countries negotiate new package/hold poll on membership?</li> </ul> |

| Leave  |  |  |   |   |
|--|--|--|---|---|
| <ul style="list-style-type: none"> <li>The prospect of the referendum has increased uncertainty</li> <li>Investment decisions put on hold until after result</li> <li>Delay in investment decision having slight impact on new development</li> <li>Occupation decisions stall – some contracts include leave ‘get-out’ clause.</li> </ul> | <ul style="list-style-type: none"> <li>Preparation for exit strategy begins, but uncertainty continues due to fragmented UK political and constitutional framework</li> <li>UK Government considers future relationship with EU (EAA, EFTA or neither)</li> <li>Devolved nations seek clarity on post-Brexit negotiations – possible triggering of <i>indyref2</i></li> <li>Some commercial tenancy contracts cancelled due to ‘get-out’ clause</li> <li>Global companies consider contingency plans.</li> </ul> | <ul style="list-style-type: none"> <li>UK formally leaves the EU after two years of negotiation</li> <li>UK Government working through trade renegotiations with TCs</li> <li>Uncertainty still evident due to unknown relationships</li> <li>Short term expansions of firms put on hold</li> <li>Without confirmed replacement for CAP (Direct Payments cease in 2020), land values diminish</li> <li>Replacement for CAP considered by UK Government.</li> </ul> | <ul style="list-style-type: none"> <li>Uncertainty alleviation evident</li> <li>UK finalising trade relationships with third countries</li> <li>Office and retail assess cost of UK operations as tariffs and access to single market weakened, and occupancy contracts [average 7.2 years] reach conclusion</li> <li>Whilst UK sees dip in occupation from third countries, UK beginning to be seen as viable investment option for overseas investors.</li> </ul> | <ul style="list-style-type: none"> <li>UK regarded as viable investment arena for overseas investors economy and property markets stabilise</li> <li>As contracts reach conclusions (after 15-25 years), industrial firms and large retail units assess cost of UK operations as export tariffs and access to single market weaker than when UK was EU member.</li> </ul> |





## Confidence through professional standards

RICS promotes and enforces the highest professional qualifications and standards in the development and management of land, real estate, construction and infrastructure. Our name promises the consistent delivery of standards – bringing confidence to the markets we serve.

We accredit 118,000 professionals and any individual or firm registered with RICS is subject to our quality assurance. Their expertise covers property, asset valuation and real estate management; the costing and leadership of construction projects; the development of infrastructure; and the management of natural resources, such as mining, farms and woodland. From environmental assessments and building controls to negotiating land rights in an emerging economy; if our members are involved the same professional standards and ethics apply.

We believe that standards underpin effective markets. With up to seventy per cent of the world's wealth bound up in land and real estate, our sector is vital to economic development, helping to support stable, sustainable investment and growth around the globe.

With offices covering the major political and financial centres of the world, our market presence means we are ideally placed to influence policy and embed professional standards. We work at a cross-governmental level, delivering international standards that will support a safe and vibrant marketplace in land, real estate, construction and infrastructure, for the benefit of all.

We are proud of our reputation and we guard it fiercely, so clients who work with an RICS professional can have confidence in the quality and ethics of the services they receive.

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