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Brexit
What could it mean?

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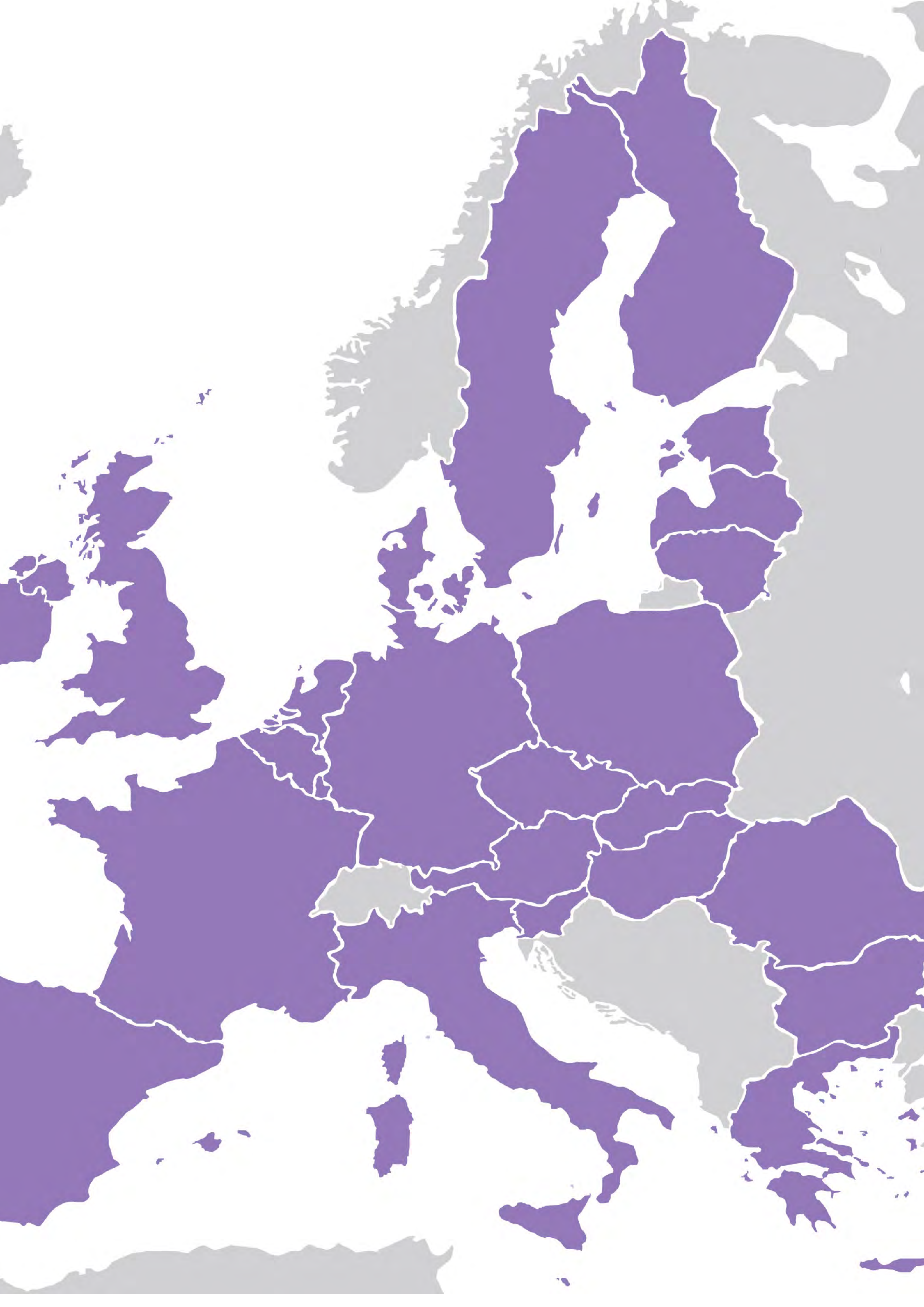


What *could* it mean?

“Before we move forward, we should recall the origins of the union, its historical basis as both a common market and a structure to help prevent future conflict in Europe.”

Sir Evelyn de Rothschild

In or Out? The papers are full of it, and the Press coverage will only get more intense as the referendum looms closer. The air is full of rhetoric, but not much in the way of a calm and impartial review of facts. Even the mere mention of prudence seems to prompt accusations of scaremongering – one need only look at the reaction to Mark Carney’s announced contingency plans for a Brexit to understand that.

Both Brexiters and Stayers are equally prone to jumping on the other side’s statements with charges of alarmist or over-optimistic bombast. Views are certainly polarised, and the general public are starved of some predicted realities ahead of a binary decision on 23 June – one that could have dramatic implications for the UK in many ways.

Sir Evelyn de Rothchild recently said: “Before we move forward, we should recall the origins of the union, its historical basis as both a common market and a structure to help prevent future conflict in Europe”. Whilst he might have used this to reinforce his firm ‘stay’ stance, it is a useful reminder that we ought to consider why we joined the EU, what it provides for us, why it frustrates us and – most importantly of all – what might happen should we decide say goodbye to it.

In this short paper, we attempt to do just that, concisely, and in a way that uses the facts as much as possible.

From a business perspective in the property and construction sector, we believe that a vote to leave the EU would cause a number of adverse effects, many of which would be aggravated by the sheer uncertainty created.

Our view is based upon a consideration of the potential impacts of a Brexit on our industry.
In summary:

- Uncertainty would prevail.
- Much needed labour would be harder to come by.
- Foreign investment could waiver at least in the short term.
- London’s status as a financial centre could be compromised.
- Investment in national infrastructure could be hindered.
- Trade across borders would be more difficult.
- Sterling could decline further, making imports more expensive.
- Interest rates could be pushed up, affecting mortgage affordability and house sales.

The European Union

The problem with trying to work out what a Leave vote would mean for construction, or the UK as a whole, is that no one has left the EU before. Here, we look at what the EU actually means and what a vote to leave could possibly mean for construction.

What is the EU?

The European Union, in its current state, was formed in 1993 but can trace its roots back to the European Coal and Steel Community (ECSC) and the European Economic Community in the 1950s. It is a single market in which no tariffs are imposed on trade between member states and non-tariff barriers (such as quotas, paperwork and differing regulations) are minimised. Members also benefit from trade agreements made by the EU Council – which is currently in the process of setting up the world's largest free trade area with the US. Through the EU, Britain has preferential access to 53 markets.

The UK joined the bloc in 1973 (known then as the European Economic Community or EEC) after being blocked twice by the then President of France, Charles de Gaulle. The UK had a referendum on its EEC membership in 1975 and voted to stay in under newly negotiated terms.

The EU is the world's largest single market, with 28 members and a population of 500 million consumers. It is also works to transparent rules and regulations. Its exports reach 80 countries and it accounts for 16% of global imports and exports; it is first in the world for international investments (both inbound and outbound).

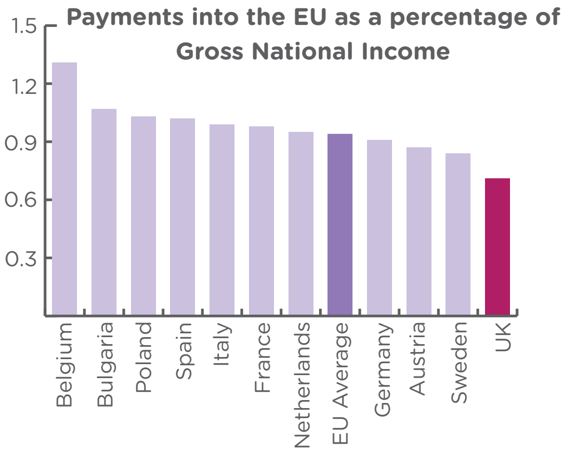
What does the UK contribute?

The UK's annual budget for EU payments is summarised in the table below, however this doesn't take into account any private sector receipts such as investment into universities (like EU bursaries) which is a significant figure (in 2013 this was £1.4bn).

	£ million	
	2014	2015
Gross payments	18,777	17,779
Rebate	-4,416	-4,861
Public sector receipts	-4,576	-4,445
Net contributions	9,785	8,473

Source: European Commission, EU Budget 2014 Financial Report

Whilst the UK is a major contributor to the EU budget, it pays less than all other countries in its peer group. As a percentage of gross national income, the largest net contributors are Germany, Sweden and the Netherlands. The UK, along with Austria, Belgium, Denmark and France are all net contributors but to a lesser extent.



Source: European Commission, EU Budget 2014 Financial Report

Exports

The EU is a less important market for the UK than it has been in previous years, with exports to members falling. However it is still a significant partner: 44% of UK goods go to the EU but the UK imports just 10% of goods from the EU. Should the UK leave the EU, exports from the UK to the EU would be subject to a tariff and new trade negotiations would need to be drawn up on a country by country basis.

Since all of the UK's trade has been through the EU, Whitehall has not employed a trade negotiator since 1973. Non-member states can have access to the single market, but through many bi-lateral trade agreements (Switzerland, for example has 100). The process of setting up a trade deal is also notoriously long, with the recent deal between Canada and the EU taking seven years.

The European Union (cont.)

Negotiating trade deals without the EU could be difficult. The US has indicated that other trade deals with single countries will likely wait until it has concluded its trade deal with the EU - the economic incentive is to conclude larger deals first.

Politics

The European Union is committed to an "ever closer union among the peoples of Europe", however some members, such as the Dutch government, have expressed concerns over this. In David Cameron's negotiations with the EU, the UK's rights as a country outside of the Euro area were protected and Britain will not be expected to participate in measures for the Eurozone such as bailouts.

For UK politics, a vote to leave would undermine key figures in the Conservative party, and the government itself.

Immigration

A lot of the EU rhetoric is focussed on immigration figures, and there are a lot of different numbers from various sources; even figures from the Office for National Statistics have recently been called into question. For the sake of clarity here, we have used figures from a single source.

According to the Migration Observatory at Oxford University, the UK is home to 3 million people from the EU and 8.3 million foreign-born people in total. Currently 1.2 million British people live in the EU.

One of the 'four freedoms' at the heart of membership of the EU is the free movement of people across borders. In 2014 617,000 people immigrated to the UK, 41% of whom were from the EU.

Regulation

According to the OECD, the levels of regulation in the UK are the lowest amongst EU members and we are less regulated than many developed, liberal economies in the English speaking world. EU membership does not require strict homogenisation of standards across the whole bloc but the adoption of minimum standards which can then be built upon at a national level.

Foreign Direct Investment (FDI)

Between 2005 and 2014, the EU accounted for 44% of the FDI flows into the UK. Britain is by far the largest recipient of FDI in the EU. A large amount of this FDI comes from the US, though this may be because it is a very open, well capitalised economy where everyone speaks English, rather than simply due to its EU membership.

Having said that, this investment is largely guided by market size and the EU supports this by creating a larger market size.

The services market is the largest attractor of foreign investment and the integration of this market between EU members is still a work in progress. Yet there are studies showing that being part of the single market has boosted investment into UK services as investors seek a base to use as a point of access into the single market.

The City of London

The single market has been of great benefit to the City of London, establishing it as an international financial hub. In 2014, banks based in the UK presided over a quarter of all EU banking assets.

The UK has a favourable business environment with the lowest levels of corporation tax in Europe (also the joint lowest in the G20 alongside Russia, Saudi Arabia and Turkey). Combined with this, the UK is well connected to the rest of Europe, has four of the top ten universities in the world and is supported by a legal system which is renowned for its ability to handle commercial disputes. Settling in the UK as a base for European business makes clear commercial sense.

Brain freeze

One large benefit of EU integration is the availability of a large population from which to select a workforce and this is particularly apparent in specialist industries. Recently Prof Stephen Hawking deemed it a "disaster for UK science" if Britain decided to leave the bloc, as the EU is responsible for a large proportion of science funding and the ease of relocating professionals around the EU makes collaboration much easer.

The impact of Brexit on property and construction

Should the country vote to leave the EU on 23rd June, it will have important and far-reaching consequences. It is difficult to assess all probabilities with any certainty, but here we try to outline its potential impacts.

Uncertainty and demand

The immediate impact of the EU referendum - no matter what the outcome -is the degree of uncertainty it has already caused.

There is increasing anecdotal evidence of investment and project decisions being delayed until after the vote, and this uncertainty will undoubtedly intensify should the population vote to leave. Inward investment is bound to be adversely affected, at least in the short to medium term, as financiers try to understand what it means for the UK politically and economically

Any political destabilisation will dent confidence and can only be bad for the construction industry in the short term.

The most fundamental uncertainty should we vote to leave, would be the future make up of trade agreements and associations (see box on the right).

Construction workforce

Currently the UK construction industry is reliant on migrant workers to fill the gap created by our skills crisis. A report by KPMG and the British Chamber of Commerce in November 2014 stated "access to migrant workers is vital for filling the immediate skills gap in the sector" especially as "20% more workers will be required" to fulfil pipeline demands. And this ignores the need to replace those leaving the industry as a recent survey by the Chartered Institute of Building showed that 38% of workers in the sector are over the age of 50.

A restriction on migrant workforces could heavily impact the construction industry by increasing costs as demand out-paces supply. Long-term, this could benefit the UK in time, forcing apprenticeships and vocational courses to be given equal status alongside university courses as an option for school-leavers - but that is some time away.

Post-Brexit uncertainty: possible options for UK trade

- Trade under World Trade Organisation rules
- The Swiss Option
- Achieve a 'special status' within the EU as a half member
- Negotiation of a customised relationship
- Join the EU customs union (similar to Turkey)
- Create a new Free Trade Agreement
- Join the European Economic Area (The Norwegian Option)

Many of these options still require the imposition of the Four Freedoms. Some, such as a 'special status' are regarded as highly unlikely by other members of the EU as it would cause a logistical headache for all other 27 members, including the rewriting of existing treaties.

Every alternative to being an active member of the EU would involve the UK having a say in how new regulations for the single market are written.

In all of these cases, the UK would need to negotiate its own deals, something that it has not had to do since the early 70's and would create a legal headache for UK legislators.

City of London status

One of the key advantages of EU membership is the ability for finance businesses to 'passport' around the EU: a firm which meets certain conditions, is able to carry out activities across the trading bloc without further review or the imposition of further requirements by the host country, Combined with favourable regulatory and tax environments, many foreign banks chosen have their European headquarters in London. Mark Boleat, policy chairman at the City of London Corporation commented that if the UK were to leave,

The impact of Brexit on property and construction (cont.)

"then London's position as a leading financial centre would remain but without doubt there would be an impact on our relative size and the jobs we support".

This could affect London's economy which is of ever increasing significance (its GDP is larger than Sweden or Poland), and integral to UK PLC.

London is also home to Europe's Silicon Valley, with strength in design, media and professional services. Could these lucrative industries be affected by a Brexit?

Perhaps it's not a question of whether banks or other institutions would still operate in London, but whether large headquarters or expansions to existing presence would take place in London or whether they would redirect investment elsewhere.

UK PLC

The government is intent on following its 'devolution revolution' course. This will require significant investment, as outlined in last week's Budget, and is further predicated on foreign funding to certain infrastructure and commercial developments. A Brexit could make foreign investment less certain, putting the speed and scope of projects supporting the Northern Powerhouse and other regional endeavours in some doubt.

Material supplies

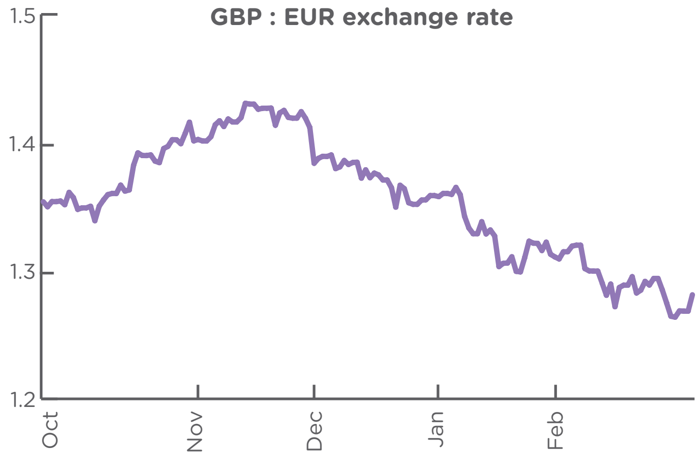
Goods and services bought by the construction industry from Europe may be affected by new trade agreements entered into with EU states or other countries. Goods could become more expensive as they are subject to increased import duties.

> **What does the industry think?**
>
> Many large construction firms work across Europe because of the ease of working across borders therefore many have come out in support of staying in the EU. In a survey by Building magazine, nearly 60% of the industry want to remain in the EU, 30% want to leave and almost 10% are undecided.

Sterling

Sterling's fall since November 2015 has already been exacerbated by worries of a Brexit. Goldman Sachs predicts that a vote to leave would further devalue our currency by up to 20%.

This would make inputs from the continent more expensive and significantly affect the price of key elements such as façades, lifts and MEP plant.



Interest rates.

If the pound sinks against global currencies, the Bank of England may chose to put up interest rates principally to encourage foreign investment into the country. This could affect home owners adversely as mortgages become less affordable and repayments on existing loans are increased.

alinea consulting LLP was formed in 2013 by six partners who know each other very well and represent the very best of the cost consulting profession. We have since grown to over 70 people. We work across a variety of sectors and possess a wealth of experience and complementary skills - but, most importantly, we share a desire to offer a better service to clients and a strong set of values that underpin everything we do.

Excellence | clever solutions from innovative thinking and smart systems

Teamwork | the best people working together, and with our clients

Trust | through an evident integrity and an eagerness to exceed expectations

Applying learning from both live projects and research studies, and feeding them into each other, is how we try to ensure that our clients and their teams get the best possible service from us. This is why we have been committed to research from the day we launched.

Whilst data and information are the lifeblood of our business, we understand that they alone do not represent knowledge – which requires analysis, insight and questioning. For these reasons we involve everyone at alinea, and we share our desire to innovate across borders: of discipline, geography and perspective. That way, we can learn from each other.

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