BREXIT: INDIRECT IMPLICATIONS FOR DEVELOPMENT AND PLANNING

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Legal Briefings – By **Matthew White**

The real estate sector as a whole is in a strong position to cope with such short-term volatility.

There are many briefings on what Brexit means for real estate and I don't intend to repeat them in this article. There are only so many ways of saying that the outlook remains uncertain and some transactions are likely to be put on hold until the situation becomes clearer.

Instead, I want to consider some of the indirect implications of the leave vote. I have spent the last week talking to clients and contacts about their concerns, many of which are less obvious than the headlines would suggest. It would be unfair to identify whom I have spoken to, but equally I cannot claim all the credit for these thoughts either.

1. THE DISTRACTION EFFECT

In my view, this is the number one impact of Brexit: it will dominate the political agenda for at least the next two years and crowd out almost everything else. The legislative timetable will be put under enormous strain, leaving little time for other important matters to receive due attention (many of which had already been delayed in the run-up to the referendum). With the UK having very few expert trade negotiators, the civil service will also be under considerable pressure.

For example, the Community Infrastructure Levy Review Panel's report is due to be published before the summer recess. That may still happen, but there is little prospect of a Government response to their proposals this year. Securing the necessary Parliamentary time to bring forward much-needed but complex reforms to the CIL system looks like a lost cause.

The Government's response to the Airports Commission has, unsurprisingly, now been delayed until a new Prime Minister has been chosen. That is bad news for Heathrow and potentially good news for Gatwick. But even if an announcement is made, adopting a National Policy Statement on Aviation seems unlikely in the near future. Committing to an application for a development consent order for a new runway without an NPS in place would be a bold move for investors.

Other infrastructure projects may also suffer from this factor. HS2 is probably far enough through the Parliamentary process to survive unscathed, but smaller road and rail projects – including Crossrail 2 – may be placed under renewed scrutiny. New European funding towards infrastructure projects is almost certainly not going to be available.

2. WHAT HOUSING CRISIS?

The share prices of housebuilders have been hard hit by Brexit and many have announced that they are putting new projects on hold. But the demand for homes has not suddenly evaporated – the housing crisis still exists and the housing delivery pipeline remains significantly below objectively assessed need across most of the south-east. This is largely due to the inherent demographics of Britain rather than our immigration policies. There will not be a mass exodus of people from the country, nor of Britons returning to the UK from Europe for that matter. Current housing projections are unlikely to change dramatically unless the country enters a full-blown recession.

But this does not stop the uncertainty being used as a weapon to try to prevent development from taking place. At planning inquiries into housing schemes, expect Brexit to be raised by objectors as a spurious reason why housing demand has been overestimated and why viability appraisals cannot be relied upon.

David Cameron and George Osborne made housing their number one policy objective. Their target of delivering 200,000 new Starter Homes in this Parliament is now likely to be quietly forgotten by the new leader. It is possible that the whole initiative will be shelved, with policy reverting to traditional affordable housing products instead. The affordable housing expectations of local planning authorities and the Mayor of London should become more realistic, particularly if housing deliveries continue to decline.

If there is a reduction in building new homes for sale, private rented sector demand might increase proportionately. Build to rent projects could therefore see a further boost.

3. WANTED: BRICKLAYERS

The planning system is frequently and unfairly blamed for the failure to deliver housing. A much greater constraint holding back housing supply is a shortage of skilled construction workers. There are a finite number of bricklayers and other tradesmen in this country, considerably fewer than the number needed by the construction industry working at full capacity.

This shortage has, to some extent, been made up by skilled migrant workers from eastern Europe. Whilst it will be years before immigration rules change – and even then the changes may not affect entry restrictions for skilled workers – in the short term there could be a reduction in workers wanting to come to the UK because of concerns about their longer term status. This issue will be exacerbated if anti-immigration tensions increase on the back of the referendum result.

Construction supply chain issues are therefore likely to be a major concern for developers looking further ahead.

4. RAW MATERIALS

The UK development industry imports a large proportion of raw construction materials from Europe. The depreciation of sterling has increased the price of these imports, pushing up construction costs significantly.

Who bears this price risk for existing contracts will depend on the form of procurement and pricing structure that has been adopted. Even if the risk rests with the contractor, developers and funders may be wary of the prospect of a contractor going under if they are made to bear the full extent of price increases. It is therefore possible that variations will be raised regardless of the underlying contractual situation. Retaining a team and completing the build would be infinitely preferable to insolvencies and the resulting exercise of step-in rights in the current economic climate.

For contracts that have not yet been entered into, currency risk and hedging will be an issue that deserves particular attention during negotiations.

5. BARGAIN BASEMENT

Market sentiment on the ground has not moved as dramatically as the headlines in the trade press would have you believe. Yes, some deals are on hold – but few have actually been pulled. Investment decisions are certainly difficult at the moment, but development is a longer term game and developers have learnt not to respond to short-term shocks. Real estate as a whole remains a fast growing sector over the medium and long term.

Where deals do fall over, there will be opportunities for investors and developers sitting on cash or with access to funding to pick up significant bargains. The prospective loss of "passporting" rules for banks puts new office floorspace in the financial industry at greater risk than for other tenants. Occupiers are undoubtedly reviewing their options at the moment. The office market has greater diversity than financial services alone, however, and any reduction in bank demand is likely to be offset by an upturn in other sectors such as professional services.

Furthermore, for investors into the country, and particularly from outside Europe, the softening of the pound makes the UK look more attractive and presents new buying opportunities.

6. ULTERIOR MOTIVES

We can expect the referendum result to be exploited for the purpose of achieving other political objectives.

The Mayor of London, Sadiq Khan, has already said that London should "take back control" of its own destiny following the strong remain vote in the capital. He has suggested that London should have more autonomy, including tax-raising powers and greater control over public services, in order to protect London's economy, jobs and prosperity. Revenues from stamp duty, business rates and vehicle excise duty could be used to address air pollution and deliver new infrastructure, but would be likely to be offset by a reduction in central government grant.

The Mayor has also called for a revaluation of council tax rates, as well as more control over business and skills, housing and planning, transport (including suburban rail services in London), health and policing and criminal justice.

The new Deputy Mayor for planning, regeneration and skills, Jules Pipe, said that London needs more power over its own destiny "to help cope with the fallout of leaving the EU".

The Mayor of London currently has control of 7% of London taxes, compared to 50% in New York and 70% in Tokyo. He is using Brexit uncertainty to give weight and urgency to his arguments to move towards a more international model of city governance, but stopping short of Singaporean-style city state independence.

7. ANTICIPATORY NON-COMPLIANCE

Much has already been written about the prospect of environmental and procurement regulations being breached in anticipation of their abolition when we finally exit the EU. Non-compliance would be a mistake however. Existing regulations are binding under UK law unless and until they are repealed by Parliament. Breach of environmental regulations would in many cases be a criminal offence. Breach of procurement or state aid requirements could potentially lead to transactions being unwound. Developers should therefore treat all existing regulatory requirements as binding for the foreseeable future.

Many regulations are, in any event, likely to remain in force following an exit from the EU – because they are regarded as beneficial to the UK (many environmental protections, for example), because they are necessary in order to enable us to export our goods and services to the EU, or because they derive from obligations beyond EU membership (such as under the UN Aarhus Convention or the European Convention on Human Rights – it is not widely known that the jurisdiction of the European Court of Human Rights operates independently of EU membership).

What is clear, however, is that during Brexit negotiations, we will have no influence over how these regulations might change. So we will potentially be subject to future regulations which we have not been able to input into. Emerging regulations such as new rules on environmental impact assessment will therefore still need to be tracked closely.

If and when regulations do change, it will be a slow and incremental process to introduce more flexibility, rather than any bonfire of red tape.

8. WHAT NEXT?

The unpredictability of the current political and economic climate means that predictions about what will happen over the next week, let alone the next 2-3 years, would be foolish. The real estate sector as a whole is nevertheless in a strong position to cope with such short-term volatility.

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KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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