# Brexit and its impact on the UK Property Market


**The impact of the EU leaving the UK is difficult to ascertain with precision given that there is no historic precedent.** The Bank of England's report on EU membership from October 2015 summarises a number of estimates of the net impact of EU membership on the UK economy over various time periods and suggests that it is between -4.5% to +20% of annual GDP. However, there is no conclusive evidence to suggest that EU membership has actually contributed to the growth of the UK economy. Since the UK became a member of the EU in 1973, its economy grew by an average of 2.2% p.a. This compares with 2.4% p.a. over the same time period from 1930s until the end of 1973. **Therefore, there is no clear argument that the UK's membership has actually boosted its economic growth.** Although we believe that there will be a significant impact on the UK economy in the short-term largely due to uncertainty, we do not believe that Brexit will be responsible for the deterioration in the long-term economic prospects more than, for example, stagnation in productivity. Having said that, in the short and medium-term, Brexit will most likely impact investors' confidence, credit provision, and the strength of sterling.

**The economy is most likely to experience short-term volatility.** However, it is still well positioned in the longer-term as it beats other developed economies in almost every category according to the World Economic Forum's Global Competitiveness Index 2015. The UK is ahead of the other advanced economies in infrastructure, business sophistication, technology, finance, etc. - all apart from macroeconomic environment where the ranking is currently lowered as a result of the UK's sizeable budget deficit.

**We believe that a Brexit vote would result in the following effects, the majority of which will be temporary:**

- **Both sterling and the euro will fall in value relative to the dollar.** In order to define the scale and magnitude of the impact on sterling, a potential precedent is the abolition of the Exchange Rate Mechanism in 1992. As a result, the value of sterling fell by 14% against the dollar and a movement of similar magnitude is possible.
- **Gilt yields will rise as a result of the exchange rate uncertainty.** In the more remote scenario that the UK economy is downgraded, this will results in gilt yields rising further and putting upward pressure on asset yields.
- **Impact on trade is ambiguous.** Much will depend on the terms of the divorce from the EU. A fall in the sterling exchange rate would reduce the UK's purchasing power and reduce imports, but benefit exports at the same time. However, recent evidence suggests that the link between the value of the currency and exports has weakened as a result of companies prioritising more stable market share. Moreover, over a third of UK exports are dependent on the volatility in the oil prices (machinery, oil, and vehicles) and the uncertainty is further exacerbated by the EU (53.6%) and Asia (22.5%) being the main UK trading partners. On a positive note, an overall increase in the customs tariff for UK exports to the EU could be offset by the fall in the exchange rate to increase the competitiveness of UK exports.
- **Inflation will rise.** It is currently well below MPC targets of 2%, but a Brexit would import cost-push inflation as a result of a sterling devaluation.
- **Credit spreads to rise.** The uncertainty would drive a rise in LIBOR.
- **Base rate will stay low.** It will be impacted by the rise in uncertainty and the next rate movement may be down. Conversely, if the depreciation of sterling is significant, there may be a need to raise interest rates to protect sterling. In this scenario, the outcome is dependent on the strength of the economy and the outlook for the exchange rate.
- **Migration numbers will decline once the exit is complete.** As only about a third of immigration is from the EU, we believe that impact will not be significant. There may benefits in that migration policy could focus on non-EU migration which could boost growth potential in the economy.
- **Investment may be highly volatile.** The result of uncertainty and lower short-term confidence in the UK economy. Foreign Direct investment is likely to fall until the exit process is complete.
- **Equities are not likely to be significantly impacted.** We believe that the UK equity market will be volatile. However, given that a c.60% share of profits for FTSE 100 constituents is derived from exposure outside the UK and EU, we do not believe that there will be long-term impact.
- **Eurozone Integration.** A Brexit will provide the impetus for Eurozone countries to address some of the fundamental problems of the single currency in its current form.

**We believe that the impact of Brexit will be short-lived with the economic growth recovering towards the end of 2017.** In terms of the longer horizon, the breakdown of the impact of Brexit on different components of GDP results in our view being broadly neutral on the long-term impact.

**The implications for the UK Property Market are modest for subsectors not exposed to international demand.** Different sources estimate varying degrees of impact on the UK property market. Some sources suggest that capital falls are likely to be in the range of 8% p.a. in the next two years. We believe that **property markets exposed to either international investment, overseas occupational demand or occupiers 'passporting' financial services in the EU are expected to be hit the most in the short-term.**

- At the forefront of the markets negatively impacted are London markets, particularly West End and City offices. Here Brexit is likely to result in a capital value fall (an outward yield movement of c.50-70bps is likely) as well as weakened occupational demand (we estimate -10%).
- Against this background, Central London retail looks better positioned in the short-term as lower sterling should cushion capital falls on the back of stronger retail sales and rental values resulting from elevated numbers of overseas shoppers.
- London residential, and industrial with a potential to be converted into residential, may also benefit from lower sterling translating into stronger overseas demand. However, lower migration levels will reduce demand and price growth in the long run.
- The commercial property markets outside of London are predominantly driven by domestic investor and occupier demand and therefore the impact of Brexit is expected to be muted.
- Regional industrial is not likely to benefit significantly from stronger exports. The most recent evidence suggests that currency/exports relationship is not as strong as it once was. Nowadays companies are more focused on maintaining stable market share and therefore are more likely to take a hit in their profits rating then export significantly more.

**Our longer-term Brexit forecasts point to a recovery of both economic growth and property market values following the uncertainty period following a vote to exit. In particular, if a UK vote to exit improves integration in the Eurozone, and its economic prospects, then there may be additional long-term upside in the Brexit scenario.**

**Figure 1.** DTZ Investors Brexit Scenario Commercial Property Market Forecasts

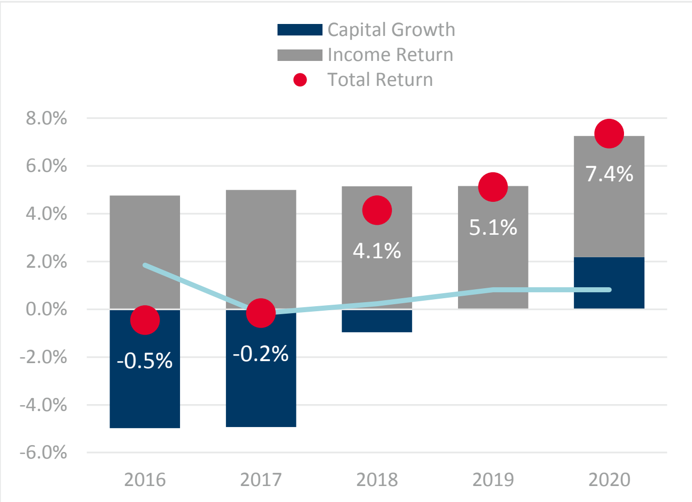


**Figure 2.** Forecast Brexit Impact on Commercial Property Market Capital Values relative to the DTZ Investors Remain Scenario 2016-2020


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