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EU Referendum Briefing: what could a Brexit mean for Housing?

Introduction

With just under a month to go until the referendum, we are entering the final phase of what has been one of the most emotive political campaigns in living memory.

This short paper takes a look at the potential implications of a Brexit on the Housing Sector. It is of course all speculative, as there is no precedent for such an event.

What happens after a vote to leave?

A vote to leave the EU on 23 June would be only the start and not the end of a complex and protracted process. The **rules for leaving** the EU are set out in **Article 50** of the Treaty on European Union, which is the only lawful process of exiting. Article 50 triggers a staged withdrawal process, starting with the European Commission (the EU's executive body which will act as the EUs negotiator) seeking approval by consensus of the European Council (the body made up of the heads of members states, setting the EU's overall direction and priorities), and finally the European Parliament.

There is a **two-year deadline** on negotiating the withdrawal agreement, with an extension requiring the agreement of the 27 remaining EU member states. If no agreement is reached within this timeframe (and in the absence of an extension), the UK would leave with no immediate replacement agreed. This means that the UK would lose protection under the EU for the rights of UK business to trade on a preferential basis with Europe / the EUs free trade partners; and UK citizens to live and work in Europe / UK travellers to move about freely in Europe.

It is important to notice that regular **EU decision-making** would continue during negotiations, albeit without any UK involvement. However, the UK would be bound by any **new EU legislation** up to the moment it leaves.

What are the more 'practical' implications of a Brexit on Housing?

In the event of a Brexit, Parliament will determine which **EU regulations** will be **retained, revised or repealed**. UK law which currently 'transposes' EU rules and gives them legal effect is likely (initially at least) to remain, i.e. energy, employment, tax, and health and safety. Equally, we won't see a wholesale repeal of legal instruments relating to EU rules adopted during over 40 years of EU membership[1], due to administrative and resource implications and the recognition that some of it is actually positive and desirable.

The **OJEU public procurement** procedure is a good example. Whilst the EU Procurement Directives would cease to apply in the case of a Brexit, it is unlikely that the rules would change since they have been transposed into UK law in the form of the Public Contracts Regulation 2015. If the Government negotiates a new deal excluding OJEU, the UK will have to establish its own public procurement regime. Since policy is often modelled on previous incarnations, or similar ones adopted in other countries, we could see a regime emerging akin to the OJEU procedure.

Data protection is also an area which we can expect a similar outcome. Given that the restrictions placed on EU-based businesses by EU law for transferring personal data outside of the European Economic Area (EAA), it is likely that the UK will have to comply (or implement similar rules) with EU data protection law.

Whilst there is **no clarity** as to what would happen to EU citizen already living and working in the UK, as well as UK citizens living in the EU, it is unlikely that their status would change. Brexit campaigners maintain that no EU citizens residing legally in the UK would have to leave in the case of a Brexit. The expected **economic slowdown** in the case of a Brexit could **impact on employment levels**, putting further pressure on already stretched household budgets and in turn impact on rent arrear levels. Additional welfare **spending restrictions** could therefore be on the cards, such as further housing benefit cuts which could affect our revenue stream.

The spectre of **higher interest rates** after a leave vote, coupled with more limited mortgage availability could lead to a **reduction in demand** for homeownership. With grant funding heavily geared towards LCHO.

[1] The UK statute book includes one-sixth of EU-related law. In additions there are 12,295 EU regulations with direct effect.

What might be the impact of a Brexit on investment?

A large number of economic commentators, as well as institutions such as the IMF and OECD have warned of the **economic impact** of a Brexit. The latest Treasury assessment of the short-term impact of Brexit also paints a gloomy picture (for an overview see table overleaf). For the Bank of England a sharp **depreciation of sterling** is a likely scenario, with the UK being "… viewed as a bigger risk to overseas investors, who would immediately increase the premium they charge for lending to UK businesses and households." There is also the prospect of financial markets becoming **less liquid** as investors seek safer places for their money. Hence, we can expect some impact on the **cost and availability of finance**.

Table 1 – Immediate impact of a vote to leave the EU

	Shock scenario[a]	Severe shock scenario[a]
GDP	-3.6%	-6.0%
CPI inflation rate (percentage points)	+2.3	+2.7
Unemployment rate (percentage points)	+1.6	+2.4
Unemployment (level)	+520,000	+820,000
Average real wages	-2.8%	-4.0%
House prices	-10%	-18%
Sterling exchange rate index	-12%	-15%
Public sector net borrowing (£ billion)[b]	+£24 billion	+£39 billion

[a] Peak impact over two years. Unemployment level rounded to the nearest 10,000. [b] Fiscal year 2017-18.

Note: % difference from base level unless specified otherwise

Source: HM Treasury

In the event of a Brexit, the sector would **lose access to EU funding** focused on energy efficiency and social inclusion, such a **European Regional Development Fund** (ERDF) and **European Social Fund** (ESF).. Such funds would simply not be available in the future.

Also the **European Investment Bank (EIB)** highlighted that its UK activities could be at risk in the event of a Brexit. Only earlier this month it has signed a deal to lend £1bn which will result in 20,000 new homes. However, the EIB made it clear that the more than £2bn of existing social housing loans would not be at risk of a **'call in'** should there be a leave vote.

Leaving the EU means that the UK would no longer be bound by **'state aid rules'** which prohibit government grants and subsidies. So, we might see new Government grant funding regimes emerging. Social housing grant is currently not affected by EU state aid rules. This could however change under new trade deals which would have to be negotiated. Indeed, WTO agreements and others prohibit government grant and subsidies without exception.

Would we be able to maintain house building levels?

With the potential of an increase in borrowing cost, as well as the potential prohibition of state grant and subsidy following a new international trade deal, we could well see a knock-on effect on housing delivery. Of particular concern will be a deepening of the construction skills shortage which the UK currently faces. EU migrants make a vital contribution to the construction sector (the proportion working in the construction sector rose from 3.65 to just over 7 per cent between 2007 and 2014). Removing the right of EU citizens to settle freely in the UK could therefore exacerbate the skills shortage and hence impact on house building targets. Also a recent study has highlighted the potential impact of a visa regime for EU workers and the challenges this would bring for UK businesses. It showed that three-quarters of EU citizens working in the UK would not meet current visa requirements for non-EU overseas workers in the case of a Brexit.

The prospect of currency devaluation could further **increase the cost** of **imported** construction materials, which the UK is heavily reliant on.

How might a Brexit affect the housing market?

Brexit could result in 1 million fewer migrants than projected by 2026, leading to a fall in housing demand and a dampening of prices. According to the National Association of Estate Agents and the Association of Residential Letting Agents it would also affect rental prices as demand lessens from EU migrants, who are more likely to live in the PRS. However, a demand shock could see buy-to-let landlords exist the market on masse, countering any price effects.

Market commentators predict an immediate **weakening of house prices**, followed by a longer-term fall in demand as the country's status as a financial hub is questioned. Rating agency Fitch forecasts house prices to fall by as much as a quarter, with the Treasury anticipating a fall of between 10 and 18 per cent. Obviously this would be good news for FTB. However, Bank of England Governor Mark Carney said that even if rates were to be cut further, we might not see a corresponding drop in mortgage cost, as banks would be looking for an greater risk premium in the light of their funding costs increasing. The results could be even higher mortgage costs for householders.

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