Brexit

Key issues for Real Estate

1 February 2020

Background

On 31 January 2020 (at midnight CET, 11pm UK time, **exit day**), the UK ceased to be a member state of the EU, and the European Communities Act 1972 – the statutory basis for giving effect to EU law in the UK – was repealed. This is a profound change, but its immediate impact on UK law and regulation is limited in two important ways.

- Under the UK-EU agreement on the UK's withdrawal from the EU (the **Withdrawal Agreement**), virtually the whole of EU law remains "applicable to and in the UK" from exit day until at least 31 December 2020. The Withdrawal Agreement calls this the "transition period". Here, we call it the "**implementation period**", following terminology used in the European Union (Withdrawal Agreement) Act 2020 (the Act **2020**). The 2020 Act implements the Withdrawal Agreement into UK domestic law.

- Under the European Union (Withdrawal) Act 2018 (the **2018 Act**), all the EU law that applies in and to the UK immediately before the end of the implementation period (a substantial proportion of all UK regulation) will continue in force as UK domestic law (with some modifications) unless and until it is replaced or amended by new UK legislation. Under powers contained in the 2018 Act, the UK government has already issued a large number of statutory instruments to amend that "on-shored" body of law, and make it fit for purpose as domestic UK legislation in a post-Brexit environment. These statutory instruments are due to come into force at the end of the implementation period.

The Withdrawal Agreement provides for the implementation period to end on 31 December 2020, unless the UK and EU agree, by 1 July 2020, that it should be extended for a further one or two years. The UK government has indicated that it does not wish to seek such an extension, and the 2020 Act states that the implementation period ends on 31 December 2020.

Deal or no deal?

The implementation period gives the UK and EU a time-limited opportunity to negotiate, against a stable background, the terms of their future relations in respect of trade and the other areas that are currently regulated by EU law. At the end of the implementation period, any given area of UK-EU relations either will or will not be regulated by a new UK-EU agreement (a **future relationship agreement**).

When the Withdrawal Agreement was being negotiated, "deal or no deal?" was used to refer to the fact that, at the point when the UK ceased to be an EU member state, there would either be no agreement on the terms of the UK's withdrawal (and so, effectively, a legal vacuum in UK-EU relations), or the UK would enter a transition period in which, for the duration of that period, the status quo would be largely preserved. At the end of the implementation period, it is possible that the UK and EU will have reached agreement on all the aspects of their future relations that will be governed by future relationship agreements, or none of them, but it is also quite likely that they will have reached agreement on some, but not on others, so that the question "deal or no deal?" can only be answered for each individual topic or sector. Indeed, in some areas it may take time before it is clear whether the UK and EU will seek to reach a bilateral agreement at all, rather than, for example, simply relying on the provisions of existing multilateral instruments like the WTO rules.

It will therefore necessarily take time for clarity on any possible "deal" outcomes to emerge. The shape of "no deal" outcomes is more predictable, but here too there is some uncertainty, since an agreement reached in one area may have effects that spill over into areas that are not explicitly addressed by it.

Brexit and real estate: commercial rather than legal

The key impact of Brexit on UK real estate has been and will continue to be commercial rather than legal. The laws underpinning property ownership, letting and conveyancing in England, Wales and Scotland are largely domestic in origin. As such they are relatively unaffected by (a) withdrawal from the EU and (b) the question of whether any future relationship agreement is agreed with the EU.

In contrast, the property market is not insulated from Europe (or indeed the rest of the world) and is susceptible to political changes both here and abroad. It does not generally respond well to uncertainty. The 2016 EU referendum result and subsequent political wrangling did have an impact on confidence within the UK property market although some sectors, notably logistics, showed great resilience and have continued to perform well. The greater political certainty brought by the recent Conservative election victory has instilled a sense of optimism in the market for 2020 with some predicting a Brexit bounce.

Accompanying that optimism will be ongoing questions about pricing, funding, occupational requirements and liquidity.

Pricing

The economic and political uncertainty brought about by the 2016 EU referendum result made it difficult to price UK commercial property accurately. At the same time, the fall in sterling presented currency play opportunities that some overseas investors found hard to resist. Now that we have entered the implementation period, there is a feeling that Brexit has been priced into the market and there are indications that sterling is on the ascent. Buyers, particularly those from overseas, will want to time purchases before prices and sterling peak, while sellers will be looking to maximise whatever bounce Brexit generates. All parties will need to remain vigilant as the market will remain sensitive to political developments both at home and abroad.

Funding

The problem for lenders over the last 12 months or so has been in sourcing new transactions as a direct result of the more limited activity across the real estate market and, in addition, sponsors being reluctant to refinance away from their existing funding partners due to a general desire for stability.

Lenders are already seeing a spike in activity post the 2019 General Election. Part of this will be deals that were effectively put on hold in the run-up to the election; part will be a reflection of the growing optimism in the market and increase in deal flow in 2020. Even so, borrowers still need to present the right deals with the right credentials as lenders continue to maintain sensible lending criteria.

Impact on occupational trends

While there have been some exits from the UK market due to Brexit, it has not been the exodus that many had predicted. Brexit has clearly been and will continue to be one of the factors being taken into account in commercial decisions to take on, retain or dispose of premises but it has not been and will not necessarily be the main driving force. Instead demographic and behavioural trends (such as housing shortages, internet shopping and flexible working) have had a much more pronounced impact, particularly in areas such as residential, logistics and retail.

Last year there was one significant Brexit legal development relating to occupiers. In *Canary Wharf Limited v. European Medicines Agency* the High Court ruled that the EMA's lease of premises in London would not be frustrated (i.e. brought to an early end) by Brexit and the EMA's consequential relocation to Amsterdam. This has provided comfort to the market that Brexit cannot easily, if at all, be used by occupiers to terminate their letting arrangements.

Liquidity

We expect increased liquidity in 2020 as the market reacts positively to recent developments. The lack of supply within the market last year should ease as confidence returns.

Conclusion

As we enter the implementation period, UK real estate is feeling more buoyant. There is still the possibility of further disruption from Brexit as the UK negotiates the details of its future relationship with the EU. However, the outlook is more confident and positive than it was a year ago. Instead, we expect to see other issues grow in importance, for example the industry's role in tackling climate change, calls for another Scottish independence referendum, concerns about where we are in the current property cycle and disruption from socio-economic trends impacting on the way in which property is used. What we can take away from the last few years is that, even in the face of significant headwinds, there are always sectors of the market that are resilient and, for the savvy, opportunities to be had.

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