



# Brexit and the property market

A report for NAEA and ARLA

April 2016

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# Key findings

- In June, the UK will hold a referendum on whether or not to remain a member of the European Union. A scenario in which the UK votes to leave the EU (Brexit) would have far-reaching consequences on the country's property market.
- Savills, a real estate services provider, estimates that in 2013/14 68% of buyers in the prime London market were UK nationals. Out of all the prime sales to non-UK nationals in the year to June 2013, 16.5% were to nationals of European countries.
- Not all UK regions would be impacted equally following Brexit. London has by far the highest share of EU nationals and nearly all of the prime investment property is located in the capital.
- Based on the Office for National Statistics' projections, under the low migration scenario (which becomes more likely following Brexit) the population of the UK would be smaller by 1.06 million people in 10 years compared to the principal forecast. Lower immigration would mean less people looking for accommodation which would reduce the demand for housing.
- Brexit would also impact the supply side of the property market. The construction sector is already facing skill shortages and 4.7% of the UK's construction work force was born in another EU country.
- The UK's membership in the EU gives the country status as a 'gateway to Europe'. This has a direct impact on the property market: for commercial property, the substantial presence of foreign firms boosts demand. For residential property, demand is impacted by the large number of foreign staff that relocate to the UK as part of their firms' involvement in the country.
- Should the UK remain in the EU we expect the average UK home to cost £303,000 by 2018. This compares to £290,800 in 2017 and £278,500 in 2016. Under the Brexit scenario we expect the average UK home price to stand at £277,600, £288,900 and £300,800 in 2016, 2017 and 2018 respectively.
- The cause behind the slower rate of growth in the event of a Brexit will be the London market as the capital's safe haven status would be damaged and the decision to relocate by some foreign firms would dampen demand.
- Under the Bremain scenario we expect the average London house price to stand at £536,000, £564,500 and £599,200 in 2016, 2017 and 2018 respectively. Under the Brexit scenario we expect prices of £533,700, £559,300 and £591,700 respectively.
- When we consider these price differences alongside the total number of dwellings in London, the cumulative difference (or hypothetical loss) in property value reaches £8.2 billion in 2016, £18.3 billion in 2017 and £26.5 billion in 2018.
- The impact of Brexit on the rental market would be minimal in the first 2-3 years following the referendum. However, country-wide rents could be impacted more severely in the long term. UK residents born in other EU countries are far more likely to be private renters. Therefore if fewer EU nationals move to the UK in the long term there may be a more noticeable impact on demand levels.

# Importance of EU buyers and renters

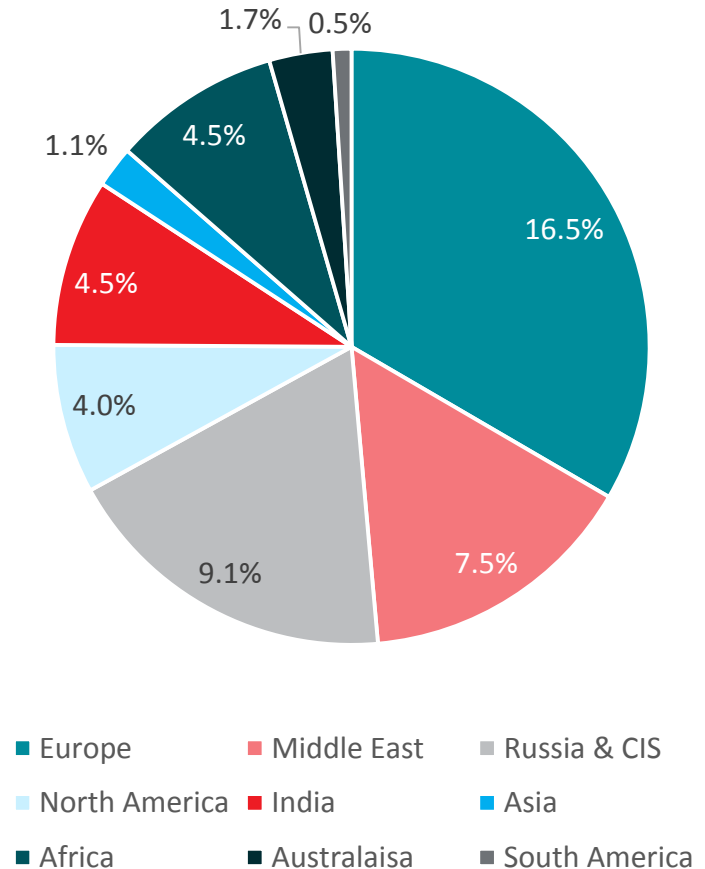
Foreign investment and the property market

Impact of Brexit on property prices and rents

# 1 in 6 foreign buyers of prime property are from Europe

- On June 23, 2016 the UK will hold a referendum on whether or not to remain a member of the European Union. A scenario in which the UK votes to leave the EU (Brexit) would have far-reaching consequences on numerous aspects of the economy, including the property market.
- The long term impacts on the property market should the UK leave the EU depend on a range of factors such as foreign direct investment and the reached labour migration agreements. These longer term impacts are essentially impossible to forecast because so much is still unknown about the UK's future outside of the EU.
- This report focuses on illustrating the current importance of EU membership for the country's property market. We also consider the short term (24 months) effects of Brexit on the property market. Specifically, we consider the increased uncertainty, damage to UK's safe haven status, a potential increase in migration out of the UK and the resulting impact on property prices and rents.
- Savills, a real estate services provider, estimates that in 2013/14 68% of buyers in the prime London market were UK nationals. A further 20% were foreign nationals buying their main residence, while 5% were foreign nationals buying an investment property.
- Out of all the prime sales to non-UK nationals in the year to June 2013, 16.5% were to nationals of European countries.

**Prime London sales to non-UK nationals by world region of buyer's nationality, 12 months to June 2013**

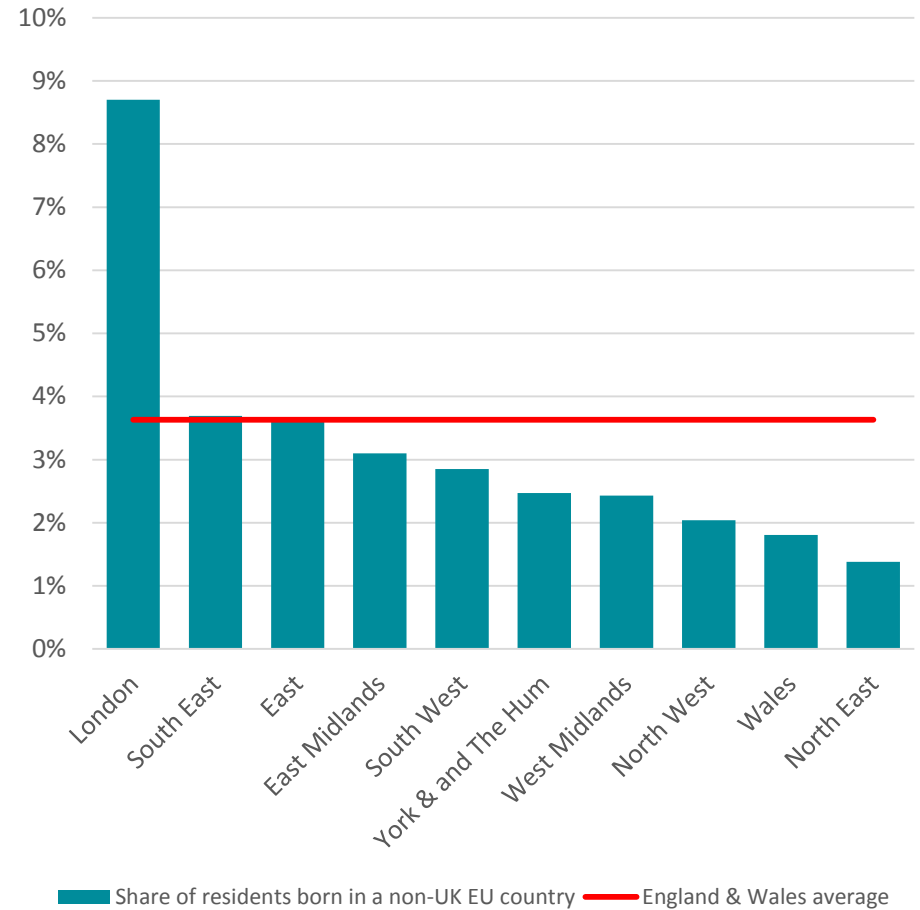


Source: Knight Frank Residential Research

# London has the country's highest share of EU-born residents

- The estimates of how many nationals of other EU countries are living in the UK vary somewhat. The most recent census conducted in 2011 showed that there were 2.68 million people born in other EU countries living in the UK. The ONS' more recent 2014 estimate puts the number at 3.03 million.
- Although there may not be an exact consensus on the number of EU nationals living in the UK, it is certain that EU nationals are not evenly distributed around the country.
- London has by far the highest share of EU nationals. At the time of the 2011 census, 8.7% of the capital's residents were born in other EU countries, compared to a 3.6% country-wide average.
- The only other region with a higher-than-average share of EU born residents is the South East with the East at the average level and all other regions below it.
- This uneven distribution is important to keep in mind as it means that property and rent prices in some parts of the country would be much more impacted than others in the event of a Brexit, given probable changes to net EU migration.

Share of residents born in a non-UK EU country, by region

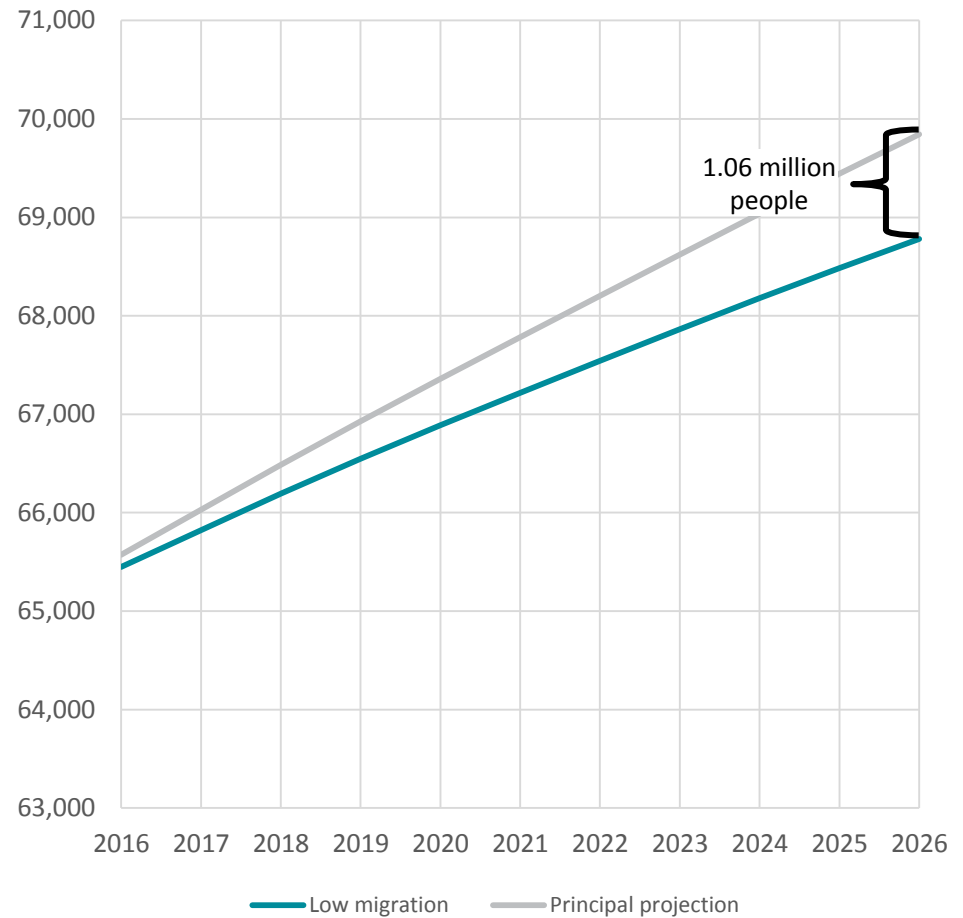


Source: 2011 Census, England & Wales

# Lower immigration would weaken property demand

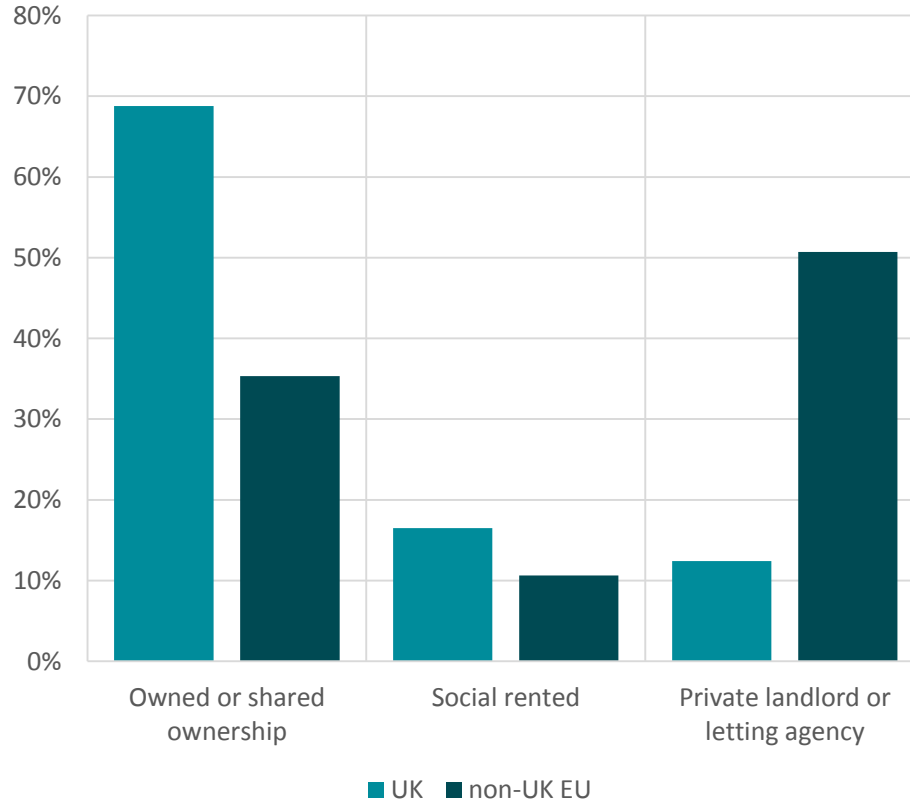
- One of the central issues in the lead-up to the EU membership referendum has been the question of immigration.
- It is still uncertain what shape the UK's immigration policy would take following a Brexit. It is possible that visas or residence permits would be granted to EU nationals currently living in the UK and that an application system would be set up for those wishing to relocate to the country. This may take a form similar to the current visa system for non-UK non-EU citizens.
- It is also possible that following a Brexit vote the UK would maintain the current free movement of people agreement with the EU, but given that a desire to control immigration is one of the key motivating factors for groups supporting the 'out of the EU' campaign this option is less likely.
- Based on the Office for National Statistics' projections, under the low migration scenario the population of the UK would be smaller by 1.06 million people in 10 years compared to the principal forecast.
- Lower immigration would mean less people looking for accommodation which would lessen the demand and, potentially, the upward pressures on housing prices, especially in those regions popular with EU migrants.
- Lower immigration would also impact rental prices. As the graph on the next slide shows UK residents born in other EU countries are far more likely to be private renters. Therefore if fewer EU nationals move to the UK in the long term there may be a noticeable impact on demand levels.

Population projections, thousands of persons, UK



Source: Office for National Statistics

### Housing tenure, by country of birth, England & Wales



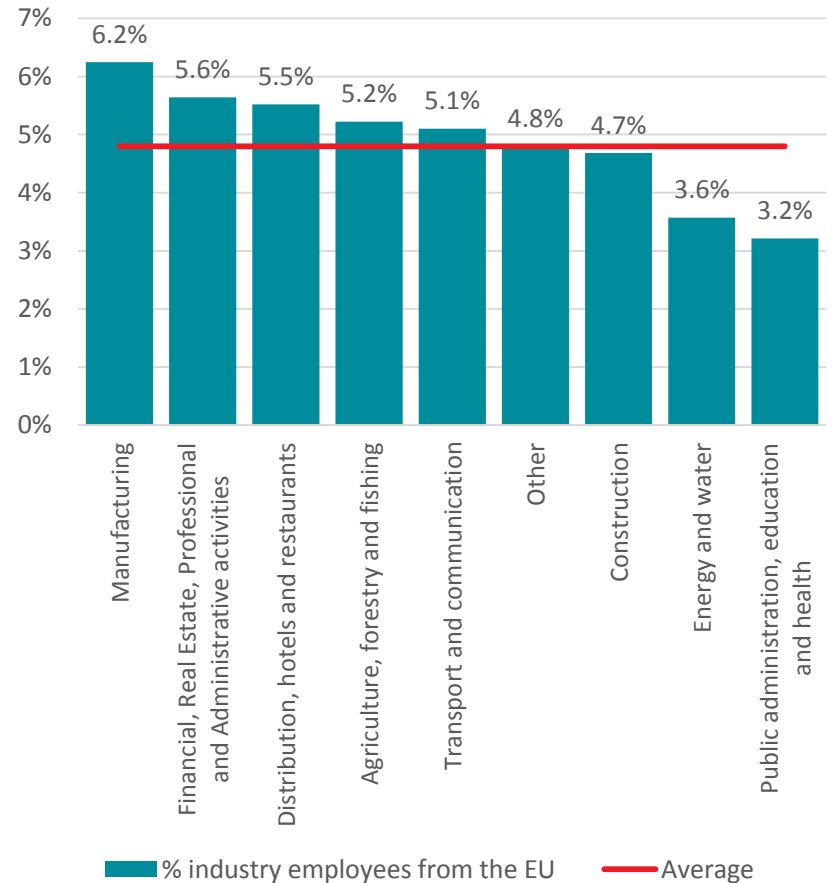
Source: 2011 Census, England & Wales



# 1 in 20 construction workers born in a non-UK EU country

- The UK's EU membership impacts the housing market from the demand side in two primary ways. Firstly, as this report has already discussed EU nationals living in the UK buy and rent properties creating demand. Additionally, as the next section of the report will highlight, the country's EU membership contributes to the country's safe haven status making UK property an attractive investment.
- However, the UK's EU membership also impacts the country's real estate market from the supply point of view.
- As the graph to the right shows, 4.7% of the UK's construction work force was born in another EU country.
- Although this is just below the 4.8% average across all industries it still represents an important part of the workforce, especially in light of the fact that numerous constructions firms and industry bodies have recently reported skill shortages becoming an increasing concern.
- Therefore greater restrictions on foreign workers coming into the UK may compromise the country's ability to build homes.

**Non-UK nationals born in EU countries as share of total work force, by industry, 2011**

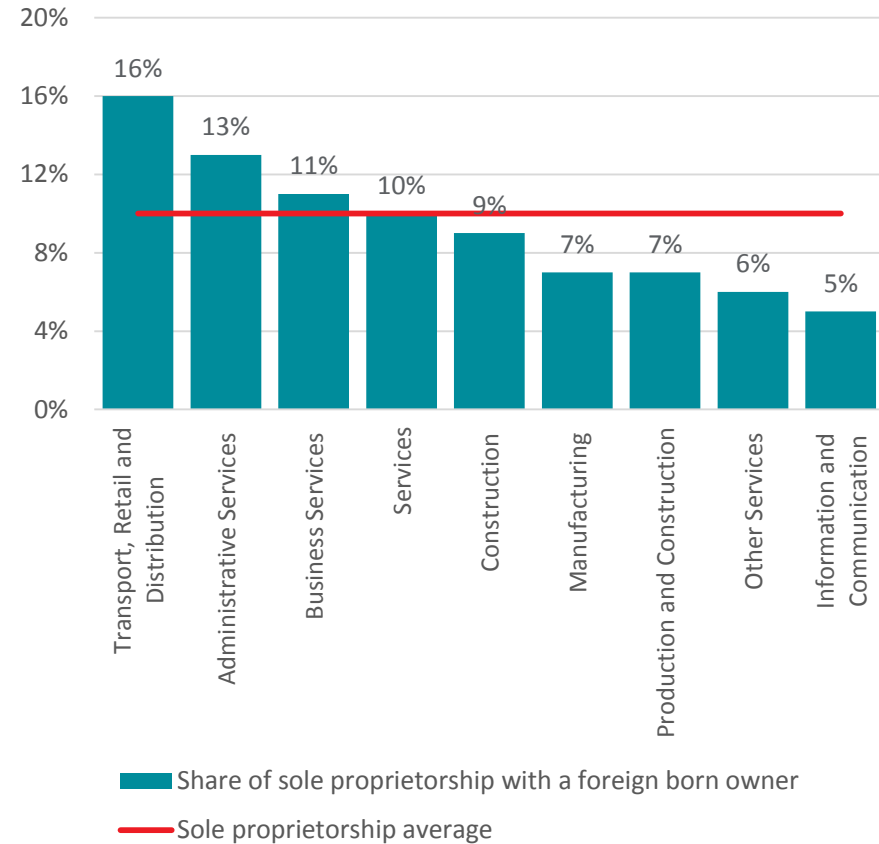


Source: 2011 Census, England & Wales

# Foreign born construction workers help alleviate skill shortages

- To further gauge the importance of EU membership on the construction industry, the figure to the right looks at the share of sole proprietorships that are owned by individuals born outside of the UK.
- In 2014, over 435,000 sole proprietorships in the UK had foreign born owners – this represents 10.0% of the total number of businesses with no employees.
- Of the 435,300 foreign born sole proprietors, an estimated 174,120 were born in EU countries.
- In the construction sector, 9.0% of sole proprietors are born outside of the UK.
- This means that foreign born labour is not only important for larger construction firms, but also that a number of construction professionals working independently move to the UK from the EU.
- Based on apprenticeship data, construction related occupations are becoming a less popular choice for young people in the UK meaning that maintaining an inward flow of foreign talent may help alleviate skill shortages.

**Share of sole proprietorships with a foreign born owner, by sector, 2014**



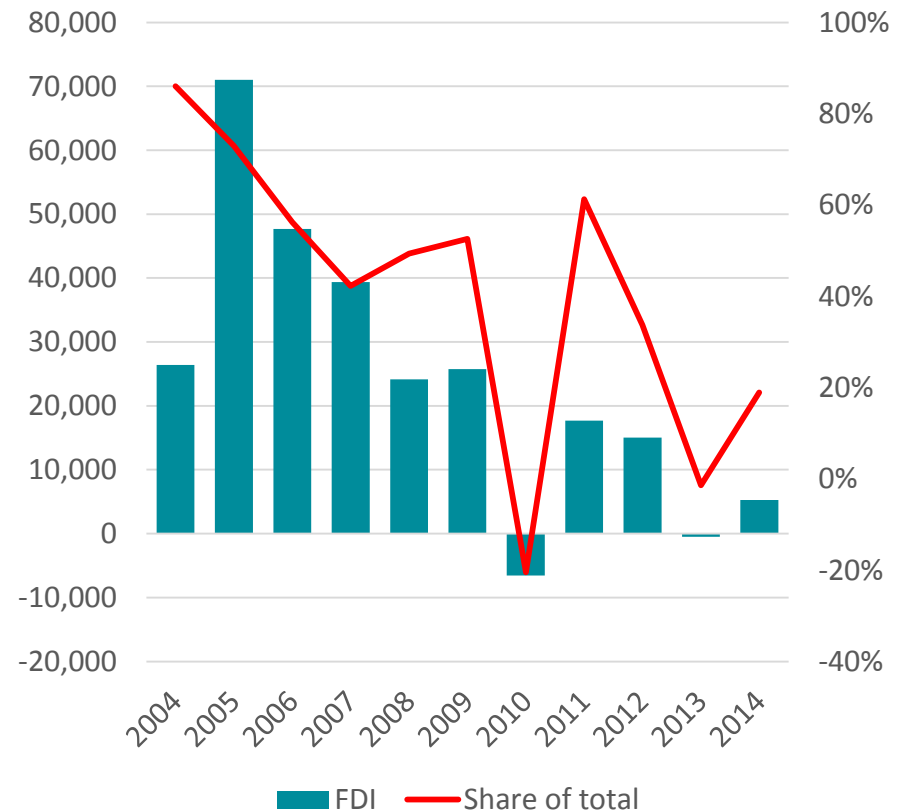
Source: Small Business Survey, Cebr analysis

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# UK's status as 'gateway to Europe' encourages FDI

- A possible area of impact should the UK vote to leave the EU is the flow of foreign direct investment (FDI) into the country. Although the amount and share of FDI flows into the UK from the EU have both declined in recent years, as is shown in the graph, the extent of investment generated by EU membership is not limited to the volume of incoming funds from member states.
- In 2014, the latest year for which official data are available, £5.3bn of FDI came into the UK from EU sources. This represented 19% of the total inflow amount.
- The highest share of FDI in 2014 came from the Americas (60.4%) and Asia (22.6%). However, a certain amount of this investment, even though it comes from outside of Europe, is dependent on EU membership.
- The UK's membership in the EU gives the country status as a 'gateway to Europe'. In other words, many foreign investors looking to establish and/or grow their presence in the UK do so because they want access to the single market. If the country was no longer a part of that single market, a portion of FDI would be redirected toward countries that are.
- This has a direct impact on the property market. For commercial property, the substantial presence of foreign firms boosts demand. For residential property, demand is impacted by the large number of foreign staff that relocate to the UK as part of their firms' involvement in the country.

**Net foreign direct investment flows into the UK from the EU, £ million (LHS) and as share of total foreign direct investment inflows (LHS)**



Source: Office for National Statistics, Cebr analysis

# European real estate firms' supply chains boost UK economy by £13.9 billion

- A drop in FDI could have a direct impact on foreign owned firms, but also an indirect impact on smaller firms that are part of a larger, foreign firm's supply chain.
- When foreign companies set up operations in the UK, a number of supply chain inputs are provided by local companies, for example leasing offices helping the foreign firms' employees find housing.
- The existence of these supply chains creates a multiplier effect as economic activity created at the top of the chain trickles down across a number of firms.
- In order to estimate the magnitude of the supply chain impact, the table to the right looks at the level of supply chain and production spending that is generated by non-UK European owned firms in each industry group. The contribution is defined in terms of intermediate consumption i.e. spending on goods and services used as part of the supply chain and production process.
- In 2013, the latest year for which data are available, non-UK European owned firms in the real estate industry were responsible for £13.9 billion of intermediate consumption – 4.2% of the total.
- Following a Brexit not only would this investment be at jeopardy, but a portion of the intermediate consumption by non-European firms would come into question as well given that some of the foreign UK-based firms are in the country because of its access to the single market.
- It is however important to keep in mind that even if the referendum results in the UK leaving the EU, it is possible that the country would maintain its access to the single market and thus avoid an adverse impact on FDI.

## Firm spending on inputs by non-UK European owned firms, £bn, 2013

Industry group	Intermediate consumption by European owned firms, £bn
Agriculture	5.0
Other services	7.5
Construction	8.1
Information and communication	10.6
<b>Real estate</b>	<b>13.9</b>
Financial and insurance	19.0
Professional and support activities	28.1
Government, health and education	44.8
Distribution, transport, hotels and restaurants	64.4
Production	127.9

Source: Annual Business Survey, Office for National Statistics, Cebr analysis

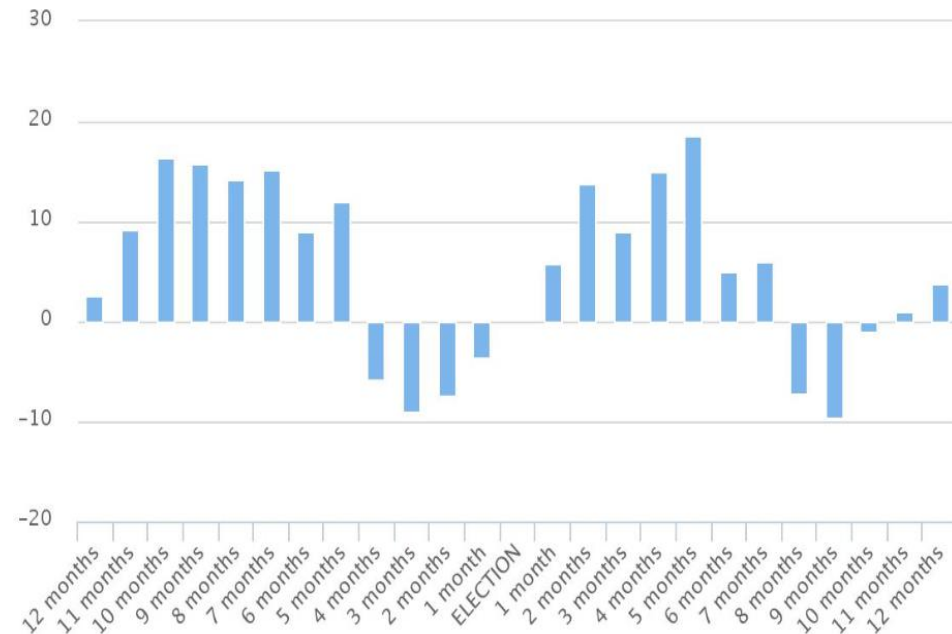
NB The data in the table refers to the European geographic area, most, but not all, of which is comprised of EU countries

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# Brexit uncertainty to dampen price and transaction growth

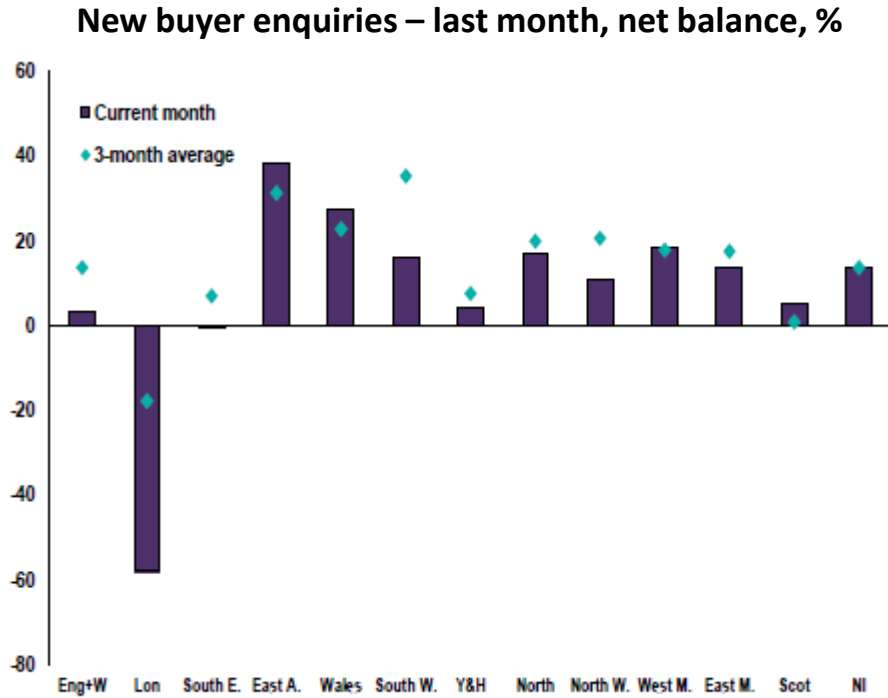
- Almost any major source of political or economic uncertainty has the potential to dampen housing market sentiment as buyers postpone or give up on purchases until the source of uncertainty passes.
- As the graph on the right shows, the period leading up to an election (or in this case a referendum) is usually marked by a decline in transactions.
- Evidence of this is already visible in the Royal Institution of Chartered Surveyors (RICS) data presented on the following slide.
- If the UK was to leave the EU in an unprecedented move, it would take some time to clarify the country's migration laws, international trade agreements as well as other aspects of the economic landscape. This would lead to transaction number and price declines, common in periods of uncertainty.
- The impact on prices and transaction in this instance may differ to the one usually associated with a general election. This is because the period of uncertainty extends not only to the date of the referendum, but may, in the event of an 'out' vote, last for much longer. Additionally, while election uncertainty usually impacts the entire country, Brexit property uncertainty is largely concentrated in London.

**Home sales around a general election, % change in transaction levels compared to time of the vote**



Source: Jefferies

# London buyers postponing purchases in lead up to referendum



Source: RICS

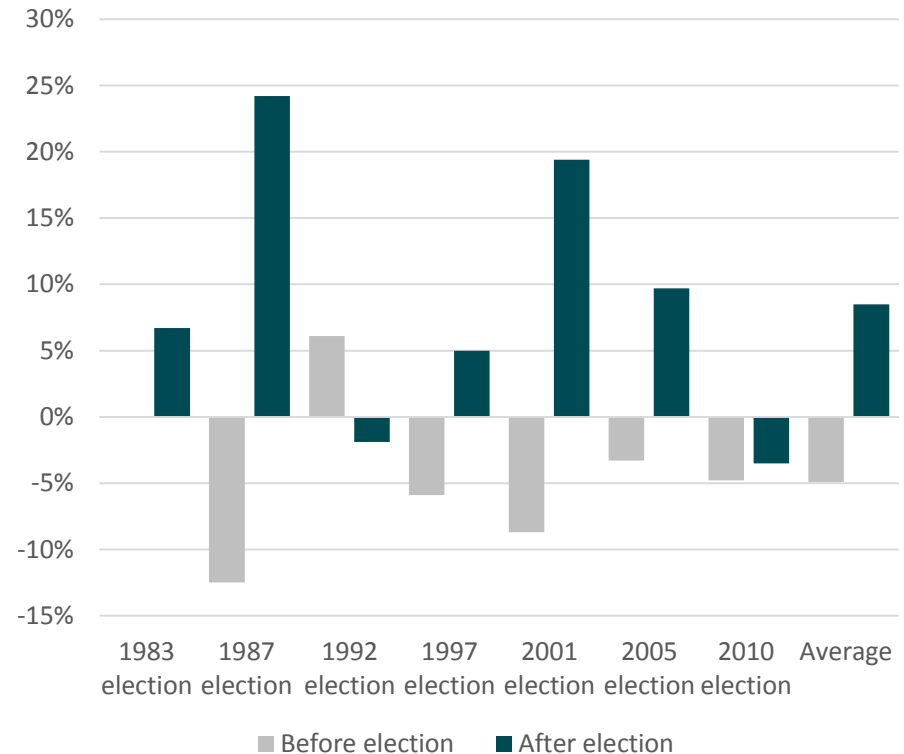
NB Brexit uncertainty is not the only factor impact buyer enquiries in London. Changes to Buy-to-Let taxation are also playing a role.



# London's safe haven status at risk

- Uncertainty has a similar impact on prices as it does on transaction numbers – not entirely surprising as the two are somewhat related.
- Those sellers that for any reason cannot be flexible and must sell their property during a period of uncertainty will face the challenges associated with fewer buyers in the market and may need to lower their asking price to make up for the risks the buyer is assuming because they are buying at an uncertain time.
- Based on surveyor comments presented in the RICS March 2016 UK Residential Market Survey, a number of industry professionals are already noticing a reluctance to complete transactions among prospective buyers as many take a wait-and-see approach.
- The impact of the market uncertainty is especially pronounced in the London market as property in the capital has often been considered a safe haven investment by investors and London may lose that status if it enters an extensive period of figuring out its economic and political standing post-EU membership.

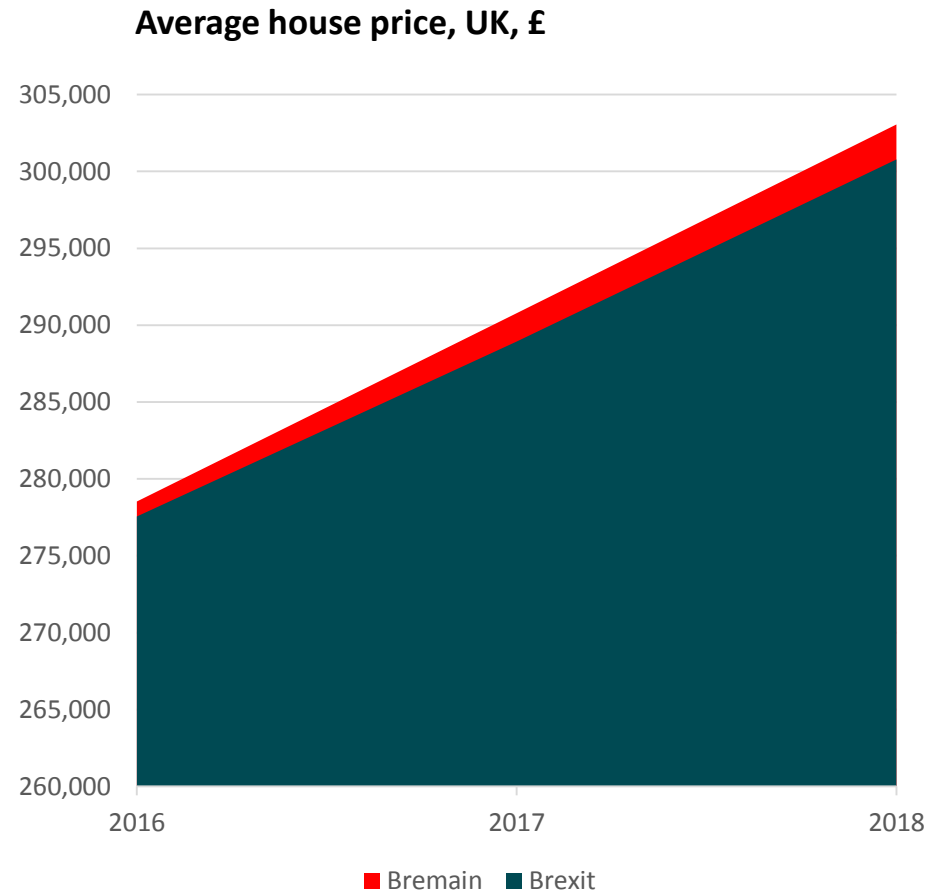
**House price growth 12 months before and after a general election, UK**



Source: Jefferies

# By 2018, Brexit would reduce the average UK house price by £2,300 and the average London house price by £7,500

- By 2018 we expect the average UK home to cost £303,000. This compares to £290,800 in 2017 and £278,500 in 2016. This forecast is made under the assumption that at the June referendum, the UK votes to remain in the EU. In the graph to the right this is referred to as the 'Bremain' scenario.
- However, should the UK instead vote to leave the EU (the 'Brexit' scenario) we expect the average UK home price to stand at £277,600, £288,900 and £300,800 in 2016, 2017 and 2018 respectively.
- The cause behind the slower rate of growth in the event of a Brexit will be the London market. London property price growth would slow down in the years following a Brexit for a number of reasons, primarily:
  - International investors would no longer consider London property a safe haven investment
  - Foreign companies with European headquarters in London may choose to relocate, reducing demand for both commercial and residential properties
- Under the Bremain scenario we expect the average London house price to stand at £536,000, £564,500 and £599,200 in 2016, 2017 and 2018 respectively. Under the Brexit scenario we expect prices of £533,700, £559,300 and £591,700 respectively.



Source: Office for National Statistics, Cebr analysis

# In the short term, London property market faces greatest Brexit related risks

- The factors that would hinder house price growth in London following a Brexit do not apply to other regions in the UK. Therefore, we expect property prices in other regions to remain largely unaffected in the 2016-2018 period.
- A country-wide impact on home prices and rents may materialise in the longer term. As explained earlier in the report, a Brexit vote would probably translate into lower immigration levels down the line. This may moderate property demand and impact price growth in that sense. However, it is highly unlikely that EU nationals currently living in the UK would be expected to leave if the UK was no longer a member state.
- Therefore, we do not expect the population level to shift drastically enough in the 2016-2018 period to impact housing demand.

## Average house price, UK, year-on-year growth

	UK		
	Bremain	Brexit	Percentage point difference
2016	4.9%	4.5%	0.4%
2017	4.4%	4.1%	0.3%
2018	4.2%	4.1%	0.1%

## Average house price, London, year-on-year growth

	London		
	Bremain	Brexit	Percentage point difference
2016	5.8%	5.3%	0.5%
2017	5.3%	4.8%	0.5%
2018	6.2%	5.8%	0.4%

Source: Office for National Statistics, Cebr analysis

# A weaker pound to make sterling-priced assets attractive for foreign investors

- One of the reasons we expect the impact on prices to be smaller in 2018 than in 2016 and 2017 is the currency effect.
- In the first quarter of 2016, sterling has notably weakened against major currencies. One of the reasons for this move has been the pending referendum.
- Numerous banks, including Goldman Sachs and Citi, have forecast that an 'out' vote could weaken the sterling by as much as 20%.
- A weaker pound means that goods, including property, priced in sterling would become relatively cheaper for foreign buyers.
- Therefore in the medium term, London property may see a rebound in foreign investment.
- The extent of the rebound, however, is difficult to estimate as it is highly dependent on the progress the UK makes in international negotiations following a Brexit.

Foreign exchange spot rates, GBP per EUR and GBP per USD

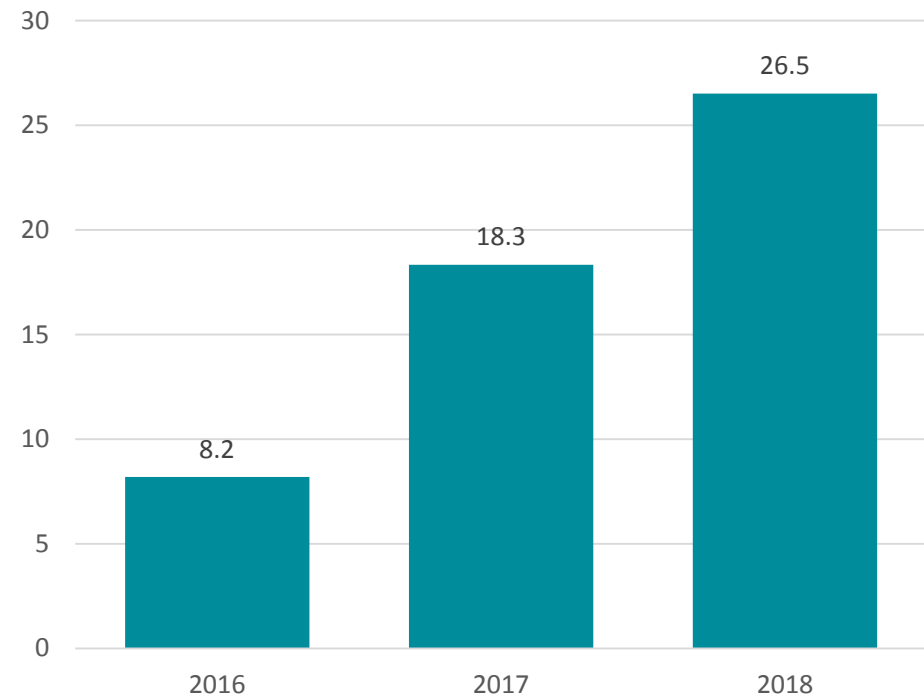


Source: Macrobond, Bank of England

# Cumulative property value loss following a Brexit to surpass £26 billion in 2018

- Under the Bremain scenario we expect the average London house price to stand at £536,000, £564,500 and £599,200 in 2016, 2017 and 2018 respectively. Under the Brexit scenario we expect prices of £533,700, £559,300 and £591,700 respectively.
- When we consider these price differences alongside the total number of dwellings in London, the cumulative difference (or hypothetical loss) in property value reaches £8.2 billion in 2016, £18.3 billion in 2017 and £26.5 billion in 2018.
- Weaker house price growth can have far reaching economic implications. For example, homeowners may feel less 'wealthy' or financially confident and choose to spend less, which would damage the overall level of consumer spending.
- On the other hand, prospective buyers struggling to afford a home may welcome slower price growth. However, even this group may choose to hold off on purchases until they consider that the market is starting to pick up again.

**Cumulative loss in London property value resulting from a Brexit, £bn**

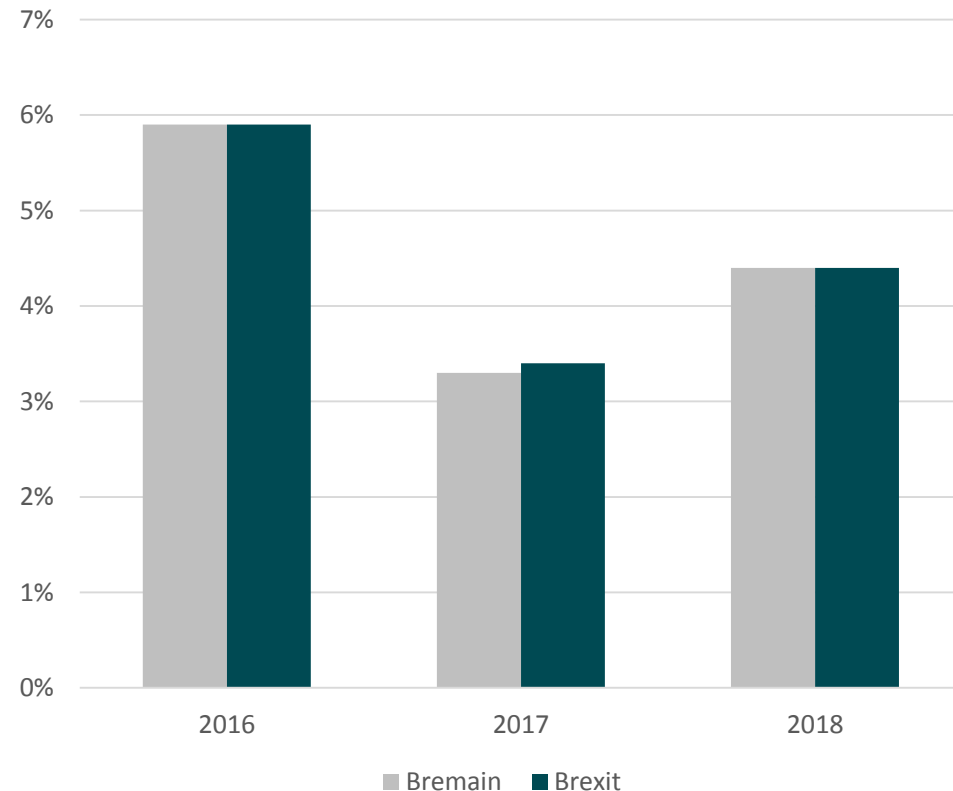


Source: Office for National Statistics, Cebr analysis

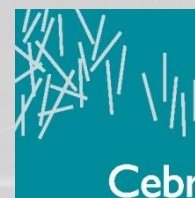
# Short term Brexit impact on rents would be minimal

- The impact of Brexit on the rental market would be minimal in the first 2-3 years following the referendum.
- Rental prices are primarily determined by the supply of and demand for rental property and the impact of Brexit on both would be insignificant in the short term.
- In contrast to the impact on house prices, the short term effect of Brexit on rents may be a positive one. If the UK government allocates a transitional period during which EU nationals can still freely relocate to the UK there may be an uptick in migration as those individuals that were already considering the relocation decide to move while they can still do so without restrictions.
- Under the Brexit scenario we only expect London rents to be impacted in the 2016-2018 period and only very slightly. If the UK remains an EU member state, we expect year-on-year growth in the private rental market 5.9% in 2016, 3.3% in 2017 and 4.4% in 2018. In the case of a Brexit we expect 5.9%, 3.4% and 4.4% respectively.
- However, the impact on rents in the long term may be a negative one. UK residents born in other EU countries are far more likely to be private renters. Therefore if fewer EU nationals move to the UK in the long term, rental property demand may weaken.

Private rents, London, year-on-year growth



Source: Office for National Statistics, Cebr analysis



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