

ANALYSIS

A New Year and a New Deal With Europe: What Does It Mean for Real Estate?

Boris Johnson's Trade Deal With the EU Re-Imagines the UK's Role in the World



European flags fly in front of the European Commission headquarters in Brussels. (iStock)

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The EU-UK Trade and Cooperation Agreement, announced just in time for Christmas Day, covers a collective market

worth \$905bn as well as more than 1,200 pages of reading, but what does it have to say about UK real estate?

The agreement, reached on Christmas Eve after four years of turbulent political negotiations, has been widely welcomed in that it has avoided a much-feared "cliff-face" plunge into a "no deal" on 1 January, ensuring in particular that the UK and EU can continue to trade without taxes being bolted onto goods.

But it has raised clear concerns, too, not least in the area of services, and financial services in particular, where little detail has emerged other than confirmation that a memorandum of understanding is to be agreed in March. The Labour Party has called it a "thin deal" that does little to protect jobs in an economy heavily weighted towards the services sector.

What it does mean is that the UK needs to urgently get to grips with where it sees its place in the world, how it is to be governed internally and what its ambitions are for trade and its industries such as financial services and manufacturing.

The agreement's impact on the UK is clearly set to be significant — it is both the largest bilateral trade agreement in history and the first modern trade deal to terminate a trading partnership, creating significant barriers between the two markets.

But what will that impact be and how long will it take before we understand how it is being felt? The agreement covers vital ingredients to the UK's ongoing success, from goods and services trade to investment chapters, data provisions and, of course, fish.

The construction industry for one is at first glance upbeat about the fact that there has been a deal at all, given the threat of tariffs and quotas has been avoided, guaranteeing continuity in costs and availability of products and materials.

Construction Leadership Council's Brexit working group chair, James Butcher, said the mutual co-operation in respect of reducing technical trade barriers and co-operation at the border will "also undoubtedly help to avoid some of the risks of delay and disruption".

"What this means is that we will not see the inflationary shock of tariff and quota introductions or the expected currency depreciation associated with a no-deal. This deal delivers certainty at a time when it is needed most and represents a good day for British construction," he said.

The agreement also secures a continuation of rules of origin where bilateral recognition of assembly means UK inputs and processing into EU products and materials will be recognised.

The National Federation of Builders says this will encourage trade and ensure complex product supply chains would not become "burdensome or costly through technical and regulatory barriers".

But real estate is only mentioned once in the course of the giant agreement, and that is in passing relation to public procurement. Blink and you will miss it.

It says the agreement ensures that the UK can maintain a separate and independent public procurement regime and will enable the government to enact reform of the system.

The rules are based on the WTO Government Procurement Agreement, or GPA, with some precedented additions for covered procurement, including the use of electronic means in procurement, electronic publication of notices, environmental, social and labour considerations, and domestic review procedures.

The UK and EU have also agreed it says an extension of market access coverage beyond the GPA, which includes the gas and heat distribution sector; private utilities that act as a monopoly; and a range of additional services in the hospitality, telecoms, real estate, education and other business sectors.

And that is the sole mention of real estate.

Where the Brexit agreement will have clear impact for us all including in the real estate sector is on the UK's economic performance.

Boris Johnson and his government see the agreement as essential to securing the UK's democratic sovereignty and in doing so being able to take charge of its own destiny. This in particular means enabling the government to focus on "levelling up" the country as well as "spreading opportunity" via targeted investment in developing UK innovation and by securing separate competitive trade deals.

Writing in the Sunday Telegraph over the Christmas period, Johnson said the deal would provide new legislative and regulatory freedoms to "deliver for people who felt left behind". Crucial will be how the UK decides to diverge from

EU Standards, in a host of areas such as animal welfare, data and chemicals.

Despite this argument, there is consensus from economists that the UK economy is in for another tough year in 2021, with Brexit not helping an already tough situation.

The CBI thinks the economy will repair this year from the Covid pandemic but a fifth year of weak business investment will delay a full recovery until the end of 2022.

Goldman Sachs, admittedly against consensus, is predicting a 7% rebound for the UK economy in 2021 after upgrading forecasts for UK gross domestic product growth in 2021 and 2022.

In a prescient report on the deal written shortly before agreement was reached, CBRE writes that it is expecting the economy to take a hit but believes that has been to a large extent priced into real estate already in the UK. And it believes the real estate sector can be critical in repositioning the UK economy as it diverges from Continental Europe.

"All other things being equal, the UK's exit from the EU risks being net negative for UK real estate overall (and we think this risk is largely already reflected in prices). This is because of lower economic growth from additional trade barriers.

"However, all other things are not equal. In the short to medium term, the UK is likely to be tied to the EU's way of doing things because of its decision to import all of EU law into UK law until such time as it decides to diverge.

Divergence will be slow and piecemeal — and so will the real estate consequences.

"Longer term, the UK's success depends on improving the productivity of its economy outside the EU, and the opportunities it takes to increase competitive advantage. Real estate decision makers will need to be part of that dynamic."

Where there remains much concern for real estate practitioners, particularly those focused on the City of London office market, is financial services, and to a wider degree services, a significant part of the UK economy.

Johnson writing in the Telegraph admitted the deal "perhaps does not go as far as we would like" on financial services.

John Forbes, an expert on tax and financial regulations at Forbes Consulting, described the prime minister's claim that it was a great deal for financial services as "particularly ludicrous".

He said: "The Trade Agreement with the European Union is incredibly flimsy on financial services which is mainly covered in a half page side agreement that says that a Memorandum of Understanding will be agreed by March.

"There will be some form of cooperation and a route to possible equivalence to be covered in a Memorandum of Understanding to be agreed by March. So we are in the dark but have jointly agreed we can light a candle."

The UK has of course now lost access to the financial services single market and passporting from 1 January, and there

remain concerns about the impact of this on the competitiveness of the sector.

Forbes said the development of a memorandum by March and agreeing an approach to determining financial services equivalence is a "very long way off the certainty for which the industry hoped".

He said: "A key concern for the industry has been the delegation of portfolio management under the Alternative Investment Fund Managers Directive (AIFMD). The EU had sought to include a 'technical headnote' granting it the ability to limit the provision of certain services on prudential grounds, including the delegation of portfolio management activity. After lobbying by the Investment Association of senior Number 10 officials, this text was removed from the final version."

But Forbes said the UK is now in a much weaker negotiating position post-deal, so it can be expected that this may resurface in the memorandum and equivalence debates. "We also share the Investment Association view that this may also feature in changes to the AIFMD. The French financial services regulator, the AMF, specifically raised this as its preferred course of action in comments just before Christmas."

Forbes said investment managers will also need to consider the implications of other parts of the deal, too, in particular the general provisions on "services, the sharing of data, the movement of people and the recognition (or rather lack of) for professional qualifications".

CBRE thinks it "very likely" that a financial services equivalence deal will materialise shortly.

The firm said this does not mean that all risks that could arise with a declining UK financial services footprint have dissipated because "equivalence is not available in all financial services sub-sectors, and it is not as comprehensive as staying in the EU".

Nevertheless, it does mean that there will be no "cliff edge" effect causing international financial services firms as a whole to suddenly find that the UK is an unattractive base.

For this reason, the firm continues to think that predictions of tens of thousands of financial services job relocations as a result of Brexit are "overblown".

"It will take many years for the relationship to evolve to a new equilibrium, and as with any other long term change, the real estate footprint consequences remain rather diffuse and distant — if indeed they are of any significance at all."

In fact, for CBRE, the pandemic has pushed to the forefront a host of issues for real estate that are simply of more pressing concern than the impacts of Brexit, which will take years to play out.

"Other far-reaching structural changes in UK real estate, many (but not all) driven by COVID-19, are now much more important for decision makers to focus on.

"These include major changes in retail, a reappraisal of the purpose of the office, and major government intervention or reforms in rent collection, planning, and business rates."

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