Brexit: the UK referendum on EU membership

Risks, possible outcomes and potential real estate market impacts

Focused on the future of real estate
Brexit: what’s known

- On 21 February David Cameron, the UK Prime Minister, announced that a referendum on EU membership will be held on 23 June

- In the event of a ‘no’ vote, the UK government would have to apply to leave the EU in accordance with Article 50 of the Treaty of the European Union. This gives the UK and the EU two years from the date of the application to negotiate an exit deal

- To investors, a crucial aspect of these negotiations would be the degree of access the UK retains to EU markets, and what trade agreements and treaties can be negotiated with non-EU countries

- A number of risks for investors have emerged following the referendum announcement:
  - Uncertainty over the referendum outcome
  - Uncertainty over the process for exit
  - Uncertainty over the substantive effects of exit

- The Conservatives: the Conservative government will campaign to remain in the EU, but cabinet members are permitted to support either side. Conservative Mayor of London, Boris Johnson, together with a materially significant number of Conservative MPs, are campaigning to leave the EU

- UKIP, DUP, and the rest: The seeds of the referendum were sowed by the formation of UKIP in the nearly nineties. UKIP and the DUP are the only notable political parties officially campaigning for exit. The Liberal Democrats and Labour both support remaining in the EU
## Upsides and downsides

Sources of possible gains and losses from Brexit

<table>
<thead>
<tr>
<th>Possible gains</th>
<th>Possible losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less regulation</td>
<td>Possible tariffs on exports to the European Union</td>
</tr>
<tr>
<td>Savings on European Union contributions</td>
<td>Loss of access to the single market</td>
</tr>
<tr>
<td>Ability to strike new trade deals</td>
<td>Damage to the City</td>
</tr>
<tr>
<td>Skills-based migration policy</td>
<td>Drop in investment caused by uncertainty</td>
</tr>
</tbody>
</table>

*Source: Capital Economics, AEW Europe*
The Cameron deal: useful, but not decisive

Concessions David Cameron was able to secure from the EU prior to the referendum announcement:

- The UK’s “Special Status”
- The new unilateral “safeguard”
- Detachment from “ever closer union”
- Migrant benefits “emergency brake”
## Prior form

### Outcome of other comparable UK referendums

<table>
<thead>
<tr>
<th>Question</th>
<th>Yes</th>
<th>No</th>
<th>Turnout</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975: UK to stay in the European Community?</td>
<td>67%</td>
<td>33%</td>
<td>65%</td>
</tr>
<tr>
<td>2014: Scotland to become independent?</td>
<td>45%</td>
<td>55%</td>
<td>85%</td>
</tr>
</tbody>
</table>

*Source: BBC*
Too close to call?

Should the UK remain in the EU? (Poll of polls, as at 09 March, 2016)

Source: What UK Thinks
The ‘undecided’ – kingmakers?

Opinion polls on Brexit

Source: Financial Times EU referendum poll of polls

*Dots denote individual polls; lines show 10-poll moving average*
Geography matters

Lead of ‘Yes’ over ‘No’ among the regions

Source: The Daily Telegraph
Size matters

Divergence of opinion between businesses and the public  (January, 2016)

Source: LSR, YouGov
Have the pollsters got it wrong?

How the bookmakers see it: best odds

<table>
<thead>
<tr>
<th></th>
<th>1 December 2015</th>
<th>24 February 2016</th>
<th>9 March 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Remain</strong></td>
<td>8/15 65% probability</td>
<td>2/5 71% probability</td>
<td>1/3 75% probability</td>
</tr>
<tr>
<td><strong>Leave</strong></td>
<td>7/4 36% probability</td>
<td>9/4 31% probability</td>
<td>12/5 29% probability</td>
</tr>
</tbody>
</table>

Source: oddschecker.com  * Use of best odds from a variety of bookmakers means that probabilities do not add up to 100%
Sterling first to suffer

EUR per GBP, EUR per USD and GBP per USD

Source: Macrobond
Government bond yields still at very low levels

Selected two year government bond redemption yields

Referendum called – 21 Feb 2016

Source: Macrobond
Government bond yields still at very low levels

Selected five year government bond redemption yields

Source: Macrobond
Government bond yields still at very low levels

Selected 10 year government bond redemption yields

Source: Macrobond

Referendum called - 21 Feb 2016
Anyone’s guess?

Estimates of the impact of Brexit on the British economy (% GDP)

High growth scenario, Central scenario, Low growth scenario
Not just ‘In’ or ‘Out’ - other possible eventualities... Overlapping European relationships

Source: CBRE
### No free lunch

**Trade options: access or control - the trade-offs**

<table>
<thead>
<tr>
<th></th>
<th>Tariffs on Goods</th>
<th>Full access to single market</th>
<th>Influence over EU Regulations</th>
<th>Control of EU migration</th>
<th>Contributions to EU Budget</th>
<th>Independent Trade Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>EEA (e.g. Norway)</strong></td>
<td>No</td>
<td>Yes</td>
<td>Consultation, but No Voting rights</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Bilateral Agreements</strong></td>
<td>No</td>
<td>No - Services excluded</td>
<td>No</td>
<td>No - but subject to Swiss Referendum</td>
<td>Yes - but a little smaller</td>
<td>No</td>
</tr>
<tr>
<td>(eg Switzerland)</td>
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</tr>
<tr>
<td><strong>FTA (e.g. Canada, South Africa)</strong></td>
<td>No</td>
<td>No - Services excluded</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes - but subject to EU norms to access single market</td>
</tr>
<tr>
<td></td>
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</tr>
<tr>
<td><strong>Customs Union (e.g. Turkey)</strong></td>
<td>No</td>
<td>No - Services excluded</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes - but subject to EU norms to access single market</td>
</tr>
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<td></td>
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<tr>
<td>WTO / Most Favoured Nation</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

*Source: PMA, AEW Europe*
EU is a big market for the UK

British financial services exports by destination (% share of total 2013)

Source: World Trade Organization, Capital Economics
The imbalance that’s a source of concern

British financial services trade with the EU (GBP billions)

Source: Thomson Datastream, Capital Economics
## Upsides and downsides

Main concerns of the financial services industry about leaving and staying in the EU

<table>
<thead>
<tr>
<th>What are your main concerns for the future of the City if the UK decides to leave the EU?</th>
<th>What are your main concerns for the future of the City if the UK decides to remain part of the EU?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss of business to EU financial centres</td>
<td>Over regulation</td>
</tr>
<tr>
<td>Decline in international stature</td>
<td>EU becoming increasingly uncompetitive</td>
</tr>
<tr>
<td>Loss of influence on international policy</td>
<td>Declining influence of EU</td>
</tr>
</tbody>
</table>

*Source: Survey of the Financial Services Sector’s Views on Britain and the EU, CSFI, April 2015*
Perceptions over time

Property investor views on impact of exit on UK real estate investment (2014-2016)

Source: CBRE. The question asked was “How would it affect the attractiveness of property investment if the UK were to leave the EU” (2014: 385 respondents; 2015: 280 respondents; 2016: 191 respondents)
How important is EU investment?

Foreign direct investment inflows into the UK (nominal, GBP billions)

Source: Office for National Statistics, Capital Economics
UK investment activity now much higher than pre-GFC

UK commercial real estate investment volumes (GBP billions)

Source: RCA
Construction starts peaked?

City office starts (millions sq ft)

Source: PMA
2015 development in short supply

City office development pipeline

Source: CBRE
Vacancy rate at lowest level since 2000

City office take-up and vacancy rates

Source: PMA

Take-up (LHS)  Vacancy rate (RHS)

Source: PMA
Financial services of lessening importance?

% of London office-based jobs by sub-sector (latest = Q2 2015)

Source: Office for National Statistics, Capital Economics
London offices forecast to suffer most

Brexit impact: capital values (base = 100)

Source: PMA
Other sectors and markets do better

Brexit scenario: capital values (base = 100)

Source: PMA
Appendix
Research & Strategy platform

- 16 Research & Strategy professionals globally
  - 6 based in London and Paris

- London/Paris team provides seamless applied research support to Investment, Portfolio and Asset Management teams:
  - Production of proprietary Pan-European property market analysis, with a particular focus on core European and CEE markets covering logistics, retail, office and alternative sectors
  - Investment strategy formation
  - Investment underwriting
  - Input into the business planning and asset management processes
  - Regular publication writing
  - Global macroeconomic analysis with a particular focus on property market and investment strategy implications

- Research & Strategy produces regular and special topic research for internal and external clients on a weekly, quarterly and annual basis:
  - Real Estate Weekly Monitoring Page
  - European Real Estate Quarterly
  - Quarterly client market reports
  - Ad-hoc special topics and articles for the property press
Research & Strategy platform

- We gather economic, financial and property markets intelligence from a wide variety of resources both internal and external

- Our main inputs include:
  - Macroeconomic:
    - Independent analysis and reporting challenging prevalent consensus views
    - Global, regional, country-level, city-level, and sub-city level data including independent forecasts
  - Real estate:
    - Independent and property consultants’ commentary and analysis at market and sub-market level
    - Detailed fundamental data and independent forecasts at country, market and sub-market levels
    - Investment volume data and analysis
  - Capital markets:
    - Relative and absolute pricing of other asset classes
    - Real estate market implications

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Data and intelligence sources

Macroeconomics
- Natixis
- Lombard Street Research
- Oxford Economics
- Capital Economics
- Economist Intelligence Unit
- Consensus Economics
- Société Générale
- Variant Perception

Real estate
- Property Market Analysis
- Property consultants’ data, commentary and analysis
- Annual valuation reports
- Investment Property Databank
- Investment Property Forum
- Society of Property Researchers

Financial markets
- Bloomberg
- Macrobond
- Decision Economics
- The Economist
- The Financial Times
- Natixis Capital Markets
- Reuters Breaking Views
Migration matters

Net migration to the United Kingdom, thousands per annum

Source: Office for National Statistics, Capital Economics
Germany’s size matters

Exports of goods by destination (% of total 2014)

Source: Thomson Datastream, Capital Economics
EU less important over time

European Union most-favoured nation average tariff on manufactured goods (%)
The cost of access

Exports of goods and services to the EU (% of UK total)

Source: Office for National Statistics, Capital Economics
Focused on the future of real estate