# Brexit and the Property Market Impacts and Predictions for 2021

Residential Estates

In 2020, we covered a broad range of topics – the coronavirus pandemic, Stamp Duty, interest rates, legislation and many others – but we wrote very little about one of the biggest economic stories in decades. Brexit – Britain's departure from the European Union – has been looming over us for years, so perhaps we ought to explain our apparent silence.

One reason is that the issue was so highly politicised and divisive. It was difficult to write anything without causing offence to one camp or another. More importantly, the negotiations themselves took so long that, for literally years, it was almost impossible to make any definitive statements. Everything associated with Brexit had to be couched in terms of 'claims' and conjecture rather than being delivered as hard and verifiable fact. Indeed, for a long time, the only certainty about Brexit was the uncertainty it was causing. The two words 'Brexit uncertainty' often appear hyphenated in newspaper and magazine articles, creating a shorthand term to cover a host of unknowns.

Happily, many of those unknowns have now been put to rest. Like it or loathe it, an agreement has now been reached, and the terms of the country's future relationship with Europe have been set out in black and white.

For business, this is welcome news. Uncertainty is the enemy of investment, and if you're a multinational employer thinking about a major new construction project or creating hundreds of new jobs, it's far better to do that when you have a clear view of the economic landscape in front of you.

These things are important to property investors, too, because the health of the economy has such a pronounced effect on investment returns. In this article, we'll consider some of the most important consequences of the newly signed Brexit agreement, and what they mean for the UK residential property market.

## Property and the UK Economy

Money drives all economies. It's a basic measure of demand and national productivity, and the less of it there is in circulation, the slower the economy tends to move.

House prices, like all prices, are the result of the market finding a balance between supply and demand. Supply is determined by factors such as existing housing stock, the rates of house-building and residential property conversions. It's widely accepted that there is a significant national shortfall in supply, which means that a relatively large number of people are chasing a relatively small number of properties. That gives rise to price competition amongst buyers and tenants, which tends to drive values upward.

There are exceptions, of course, and 2020 was one of them. Conventional wisdom would have said that at a time when millions of people were living on furlough or losing part-time jobs, average incomes would fall, and that house prices would fall with them. That clearly didn't happen – Nationwide estimates that prices rose by over 7% over the course of the year. But that could be ascribed to exceptional circumstances: an increasing desire to move and find more living space during the pandemic; pent-up demand after the lockdown; and – perhaps most significantly – the Stamp Duty holiday.

Under more usual conditions, falling incomes tend to slow price growth, whereas economic growth and rising living standards tend to support a more rewarding property investment market. That's one reason why Brexit is an important factor in the housing market. Many economists and commentators have associated Brexit with the threat of economic contraction. They have argued that by moving away from its closest and largest trading partner, and by presenting businesses with more hurdles and administrative costs, Britain could see comparatively slow economic growth in the years ahead.

Importantly, these aren't predictions made by people with an obvious political agenda. In December, for example, the BBC's Reality Check correspondent Chris Morris wrote: "This is not a normal trade agreement. Trade deals are designed to make trade easier and cheaper, by bringing countries closer together. This one is pushing the two sides further apart. It ends frictionless trade between the UK and its largest trading partner, creating extra costs." He also noted that any new deals signed by the UK "will not replace trade that will be lost with the EU."

In a similar vein, the Government's own Office for Budget Responsibility (OBR) estimated that over the next 15 years, the UK economy will be 4% smaller than it would have been if it had remained in the EU. However, that's considerably better than its forecast for a no-deal outcome, which it believes would have been 2% worse still.

Of course, we must also recognise that the OBR's figure of 4% is only an estimate; a comparison between predictions, and one that was made in March last year. No one knows what will actually happen between now and 2035. Even if the recovery isn't as fast as it might have been, the country is still expected to achieve positive growth in the coming years. With the new deal, the economy should soon see improvements in commercial investment and productivity, especially if the new Covid vaccines live up to expectations. The two factors together should certainly create improving conditions for investors.

## House Prices

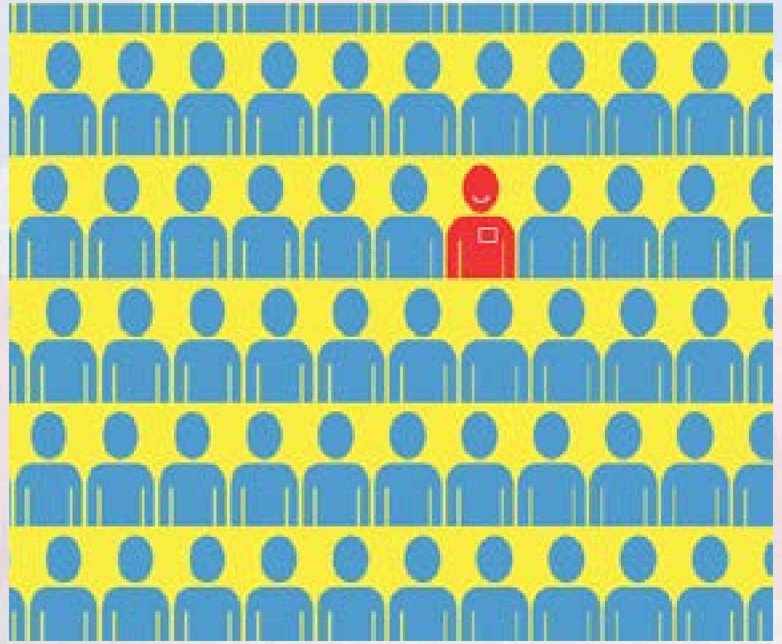
A year ago, many lenders, estate agencies and professional institutions were in clear agreement that house prices would fall in 2020 – some forecasting dire reductions of 10% or more. Gradually, however, as the reality of the house price boom became apparent, those forecasts were amended and updated.

Today, there is a mix of forecasts but the majority now seem to be bunching up around the 'zero' mark. There is a widespread expectation that prices will stay relatively flat this year, as the market takes account of rising unemployment and the likely end of the Stamp Duty holiday.

Until very recently, all these projections had been caveated with stern warnings about a no-deal Brexit. Generally, they were based on the assumption that the UK would find some reasonable way to trade with its European neighbours. In the event of no deal, they warned, the projections could be substantially worse.

Now, of course, we have a deal. It might not be frictionless, but crucially, it avoids the spectre of trade tariffs. These could have posed a considerable threat to average incomes (and therefore to average property values) because additional tariffs on everyday items could have seen weekly shopping bills rise alarmingly. Sky News estimated that "No-deal would have seen tariffs slapped overnight on everything from cars to carrots, raising the price of a family saloon by £1,900 and adding nearly a fifth to the price of the weekly shop."

Any such hit to people's disposable incomes would almost certainly have translated into less willingness to take on bigger mortgages or to live in rented accommodation that stretched the purse strings too tightly. Or, to put it another way, avoiding no-deal might well have helped to forestall a sharp decline in both house prices and rental values. The Daily Express summed this up in January, noting that "the post-Brexit trade deal has removed the biggest threat to the housing market in 2021."



## Employment and Housing Demand

The introduction of tariffs was also a serious concern for major employers. Many of them warned that they might be forced to relocate or shift investment to overseas plants in the event of no-deal. One of them was Nissan, which had already cancelled the UK production of two car models and cautioned that its Sunderland plant would be unviable in the event of a no-deal departure. By signing a deal at the eleventh hour and avoiding tariffs, the Government will have restored some confidence to many of these large employers. On Christmas Day, Nissan announced that it welcomed the EU agreement. Business Live quoted a company spokesperson, who said "We look forward to the continued success of our UK-based design, engineering and manufacturing operations, which have been serving the European market for more than 30 years."

Nissan is only one example, but it illustrates a broader pattern within large manufacturing industries, and what will presumably be a collective sigh of relief from some of the country's biggest employers. Earlier in December, the Society of Motor Manufacturers and Traders, which represents members such as Honda and Jaguar Land Rover, had warned that "UK car production would fall to less than half the 2019 level if the UK fails to agree a trade deal with the EU." In the same month, Bentley's CEO, Adrian Hallmark, said that "a hard Brexit could cost Bentley a quarter of its global profits."

Again, this really matters to property investors, particularly to those owning property in British towns and cities that rely on major corporations to sustain a large proportion of local jobs. The new Brexit deal should deliver much more certainty to these businesses, enabling them to invest, expand and to create new jobs. That in turn, should support more robust employment, boost living standards and prevent localised economic decline.

It's also important because some UK property hotspots are attractive precisely because they are seeing rising levels of employment and population. Often, this is the result of business growth and the presence of one or more top-tier employers who sustain large local supply chains – for example in the defence, automotive, energy or aerospace industries. When those larger companies are confident about the future and committed to staying, that has a strong knock-on effect on the businesses that supply them. That, in turn, helps to drive new job creation, which tends to draw in new workers, increase the local population and boost demand for housing.

## Brexit, Travel and Tourism

The Brexit agreement imposes new restrictions on Britons wanting to travel, live or work in Europe. In an article entitled 'Seven things changing on 1 January', the BBC reports that "From January, UK nationals will only be able to travel without a visa to Schengen area countries for up to 90 days in any 180-day period."

British people who are already living in Europe will have certain protections under the new agreement, but the rules will vary from country to country. In France, for example, British residents will need to apply for new residents' permits. Earlier this year, Spain launched its Tarjeta de Identidad de Extranjaro document, which British nationals can use to declare their long term residency status in the country. The Gov.UK website now has a page explaining the rules for each country.

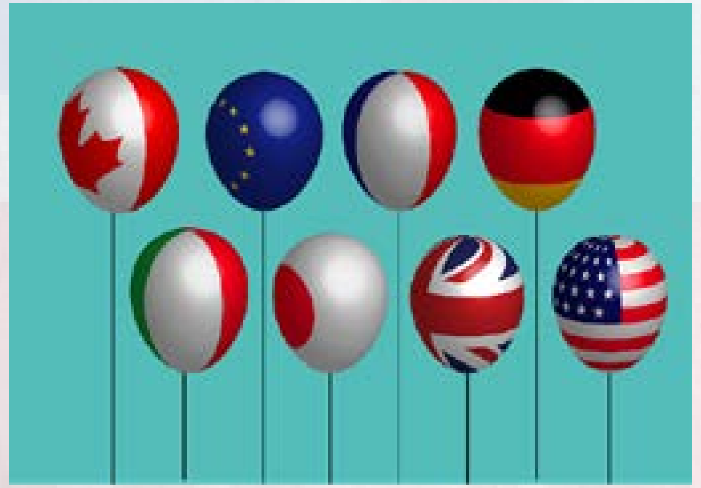
Those who are considering moving into Europe for the first time will face bigger obstacles because they no longer have an automatic right to do so, whether that is for work or retirement. Anything other than a short holiday will now require a visa.

This is important for property investors for a number of reasons. First, it looks very likely that the popular habit of buying a holiday home and living there for many months of the year may no longer be quite as attractive or simple as it was. The 90-day time limit restricts the potential usefulness of a holiday property and might force a change of strategy. That might include renting the property out for at least half the year, or simply selling it in an effort to avoid new bureaucracy.

Whatever the details of the withdrawal agreement with respect to travel and residency, it's likely that fewer British nationals will now want to buy holiday homes for themselves in the EU. That, in turn, could prompt a change in both the domestic tourism and property markets.

We wrote recently about the rise of the UK Staycation, mainly in the context of the Covid-19 pandemic and how it has changed behaviours. However, by limiting the prospects of buying (or making full use of) holiday homes abroad, Brexit might also drive a new trend towards UK-based holidays and investment in short-stay British property.

It is worth noting that the withdrawal agreement does very little to deter EU holidaymakers from visiting the UK for short periods. Consequently, British tourist hotspots of all kinds should still remain popular, and the prospects for tourist accommodation in these areas still look very good.



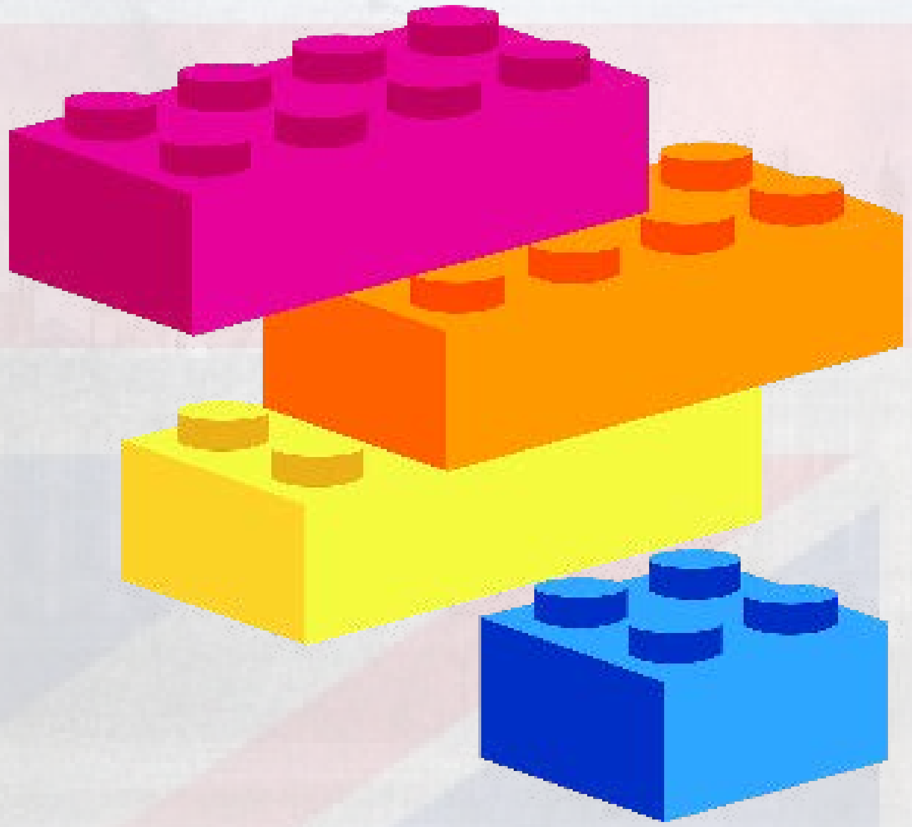
## Foreign Investment in UK Property

Ever since 2016, the uncertainty over Britain's future relationship with Europe has hung like a cloud over the UK economy. It will certainly have deterred some foreign investors from making any big commitments until they could be surer of the economic path ahead.  Now, with that uncertainty dispelled, it's conceivable that many of those who were postponing a decision might be tempted to invest in British property. That's even more likely now that there are realistic hopes of the Covid vaccine putting an end to the pandemic.

What is more difficult to predict is where the bulk of that investment will fall. Historically, foreign investment has tended to focus on the country's best-known cities – especially London – even when other destinations have offered considerably better returns. This may prove to be the case again, as many London-based estate agents are keen to argue. Savills is one of them, noting that "We expect prime central London to be a particular focus for Middle Eastern buyers once travel restrictions begin to ease."

In an article for Arabian Business, Hamptons International notes that it expects substantial investor interest from the Gulf states, especially in the first quarter of 2021, before the Government introduces a 2% Stamp Duty surcharge on properties sold to foreign buyers. Interestingly, the same article also suggests that London may not be the principal focus; instead, it suggests that investors may look to northern markets such as Manchester, Scotland and the North East.

For UK investors, the prospect of more price competition from abroad is a double-edged sword. If prices rise, then it becomes more expensive to buy new investment properties, but price inflation also equates to better capital gains for all those who already own property. Whether that represents good or bad news depends on individual investors' plans. Later in 2021, however, the additional Stamp Duty costs might limit the scale of foreign investment, especially if it coincides with gains in the value of the Pound. Consequently, it might only be a short-lived phenomenon.



## Brexit and House Building

The under-supply of good, affordable housing seems to have been a permanent characteristic of the UK property market. It's one of the main factors that have underpinned long-term house price growth and the rising popularity of rental property.

House-building rates have been inadequate even in times of relative economic boom. In 2020, Covid caused those rates to slow even further, and for months, the prospect of a no-deal Brexit threatened to bring some sites to a standstill. Partly, there was the risk of long border delays for the vehicles bringing materials in from Europe, and partly, the prospect of fewer foreign operative being allowed or available to work on site.

The new agreement is therefore good news for the construction industry. James Butcher, head of policy at the National Federation of Builders declared that "The agreements reached will enable construction companies to continue to reliably forecast the cost and availability of products and materials imported from the EU ... 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."

However, an article published in December by the Institute of Civil Engineers notes that "The construction industry relies heavily on foreign migrant labour for skilled and non-skilled roles. It is feared that outside of the EU, which guarantees the right to free movement, the skills shortage could worsen."

It remains to be seen how the combined effects of Covid and Brexit will play out but even if conditions return to normal, that 'normal' is still unlikely to make a dent in the continuing under-supply of housing. As a result, investors can be confident that property values should hold relatively strong and that rental demand will remain as robust and dependable as ever.

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