PROPONOMICS – MACRO VIEW

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THE UK'S EU REFERENDUM – READY, STEADY… GO?

June's referendum will probably result in a share of commercial property deals moving into 'holding pattern' until after the poll, at least. A vote to stay in the EU could be followed by a rebound in activity in the second half of 2016; a vote to leave probably means a longer period of uncertainty.

EU referendum

Uncertainty in the coming months **will push some property deals into 'holding pattern'**

If there is a vote to leave, **a 'Norwegian scenario' trade deal** should restore confidence

A 'Danish scenario' second referendum would extend the period of uncertainty

Strong economic fundamentals should support demand for UK property

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"The campaigning period will probably see a deceleration of activity, but with deals going into 'holding pattern' rather than being abandoned."

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The referendum date is now confirmed, and the politicians have declared their allegiances. So, what will be the impact on the UK economy and commercial property market? There are essentially two issues: the effect of the poll itself on business activity in the coming months, and the impact if there is a vote to leave.

The run-up to the Poll

On the poll itself, the best guide we have is the 2014 referendum on whether Scotland should remain in the UK. In the Scottish commercial property investment market, as figure one shows, the referendum unsurprisingly encouraged some investors to hold back, with a marked bounce occurring in the aftermath of the vote to stay in the UK. In the occupier market, 64% of office take-up in Aberdeen, Edinburgh and Glasgow occurred in the second half of 2014, again suggesting a post-referendum rebound.

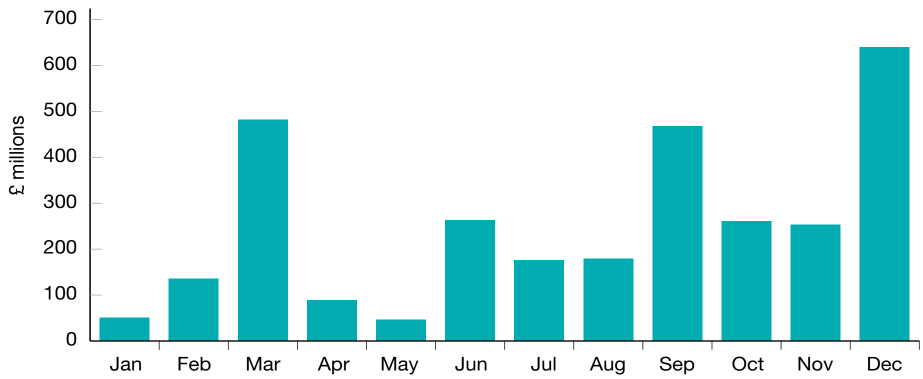
This is very much what one would expect to see, with some investors and occupiers hanging back on political uncertainty, but then coming off the side lines when the status quo was confirmed. We expect the same to be true of the EU referendum: that the campaigning period will probably see a deceleration of activity, but with deals going into 'holding pattern' rather than being abandoned entirely. Also, market sentiment will experience bouts of turbulence if we do see a closely fought campaign, as occurred in Scotland.

In the event of a vote to stay in the EU, the commercial market should be ready for deals coming out of holding pattern in the second half of the year. Indeed, if this release of pent up demand were to coincide with some better news for the global economy, it is possible property could see a strong finish to the year for both the investment and occupier markets.

If the UK votes to leave

Inevitably a vote to leave will result in an extension of the period of uncertainty, although some of the deals in 'holding pattern' may be forced across the line by

FIGURE 1
Investment in Scottish Commercial Property in 2014 (referendum was in September)



Source: Property Data

events. For instance, a tenant with an impending lease expiry will have to make a choice on whether to extend the lease with their existing landlord, or choose to relocate.

However, the UK would face a period of up to two years of diplomatic negotiations in order to exit the EU, and concurrently set up new trade treaties. We would expect relatively subdued trading conditions in the property market during this time, as occupiers and investors look for re-assurance on the shape of post-EU landscape.

Therefore much will depend on the speed of negotiation of trade treaties. If the UK is making good progress towards a free trade treaty with the EU and other major economies, confidence will return to the property market. Trade deals agreed between the EU and countries like Switzerland and Norway actually imposed many of the characteristics of the EU market on those states. Switzerland and Norway have harmonised large sections of their laws with the EU, and contribute to the budget. This could potentially smooth the transition out of the EU for British businesses.

The Norwegian Scenario

Therefore, the closer we move towards the realisation of a 'Norwegian' or 'Swiss' scenario, investors and occupiers may become more confident the UK will see continuity in its economic environment. Consequently, we would expect to see the property market return to typical activity levels, perhaps even before the trade treaties are signed. This normalisation would occur in a gradual not a 'rebound' pattern, as unlike a vote to stay, there would not be a single moment when the whole market revises its opinion on the outlook.

The Danish Scenario

However, there is media speculation that in the aftermath of a vote to leave, rather than the negotiation of an exit, we could see horse trading on a new EU deal that would be put to UK voters at a second referendum. There is precedent for this in EU history; for instance, with Denmark rejecting the Maastricht Treaty in 1992, only to accept it at a second referendum in 1993, following concessions. Similarly, Ireland had two referendums on the Nice Treaty, with a rejection in 2001, followed by acceptance in 2002.

In this 'Danish' scenario, the commercial property market would face an extended period of uncertainty, being faced with both a re-negotiation stage, and a second round of campaigning.

UK fundamentals remain strong

Irrespective of which path the UK voters choose this June, it is worth remembering that for a property investor, the bedrock beneath any asset is a robust economy. While the UK needs to reduce public sector debt, most of the key economic indicators remain strong, which we believe will provide support for the property market during this time of political uncertainty.

Unemployment is at a ten year low, prices are edging away from the dangerous deflation territory, and the country boasts world class hubs for technology, finance, insurance, media, and science-led industries. The UK is a G7 economy with a good track record, and that will always appeal to commercial property investors and multi-national corporations around the globe.

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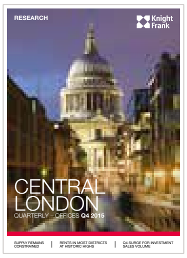

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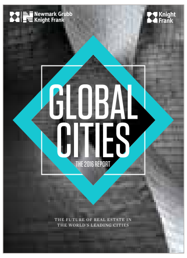

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