RESEARCH

UK MARKET OUTLOOK MAY 2015

THE EU REFERENDUM: THE SOONER THE BETTER

The Bank of England Governor, Mark Carney, has called for any future EU membership referendum to take place as soon as possible. We are inclined to agree.

In recent weeks we have seen one political uncertainty (the election result) swapped for another, namely the outcome of a future in/out referendum on membership of the European Union.

Last year Scottish commercial property did see a slowdown in activity in the run-up to the independence referendum (see figure 1). Given that the UK accesses a range of trade agreements via EU membership, it seems a near certainty that the property market will similarly slow ahead of a future poll on leaving the trade block.

There are many reasons why this would happen, that are usually neatly wrapped up in the old saying “the markets hate uncertainty”. We believe three of the reasons are particularly worth highlighting.

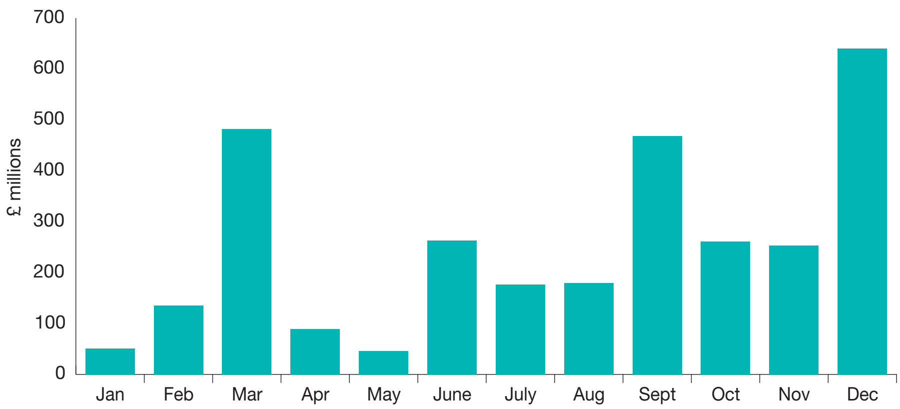
Firstly, in the occupier market, some overseas firms have offices in the UK because they view it as a good place to access the European market. Consequently, some foreign companies who are thinking of establishing their first office in Europe may decide they are better off choosing Ireland or France in order to guarantee access to the EU. Similarly, those already on the ground in the UK may place expansion plans on hold until after the poll.

Secondly, the longer the matter remains undecided the more sterling will come under pressure. While a weak pound may draw some overseas money towards UK property at first, in the long run it will fire up inflation again, and eventually the Bank of England will have to respond and increase the base rate. We already expect rates to increase by summer 2016. However, if the political uncertainty is to continue until 2017, we may see rates rise sooner and with more subsequent increases thereafter.

Thirdly, if the debate is allowed to rage for too long there is a danger that we slip into what the Canadians call ‘the neverendum’, which refers to the endless debate over Quebec’s future. Similarly there is a danger whereby a long debate on EU membership could result in the

FIGURE 1

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



Source: Property Data

The market in a minute

All property capital growth index rose by 0.5% in April m-on-m, which is down on the 0.8% reported for March*.

Offices saw the highest capital growth (1.0%), and retail the lowest (0.2%)*.

12 month total return fell to 17.9%*.

Investment volume from January to April was £20.6 bn, up from £15.4 bn for the same period of 2014**.

* Based on IPD figures.
** Based on Property Data figures.

JAMES ROBERTS
Chief Economist

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For the latest news, views and analysis on the world of prime property, visit Commercial Briefing or @KF_CommBrief issue becoming embedded in the political culture, leaving a permanent cloud of uncertainty over the economy. There is the risk the same is occurring with Scottish independence.

None of the above is to say we are hostile to the idea of the UK leaving the EU. As a G7 economy, with a large and well educated workforce, people will always want to do business here. The problem with the referendum is it creates a timeline which can only cast a shadow over business activity. First, the new membership terms are negotiated, then campaigning takes place, then (if it is a vote to leave) Britain has to negotiate new trade treaties. Once outside the EU, international investors are likely to sit on the side lines for a while to see how Britain performs as a stand-alone economy.

While all this occurs, the market will live in a state of uncertainty, and a share of business is probably going to be placed on hold, or ironically perhaps disappear to continental Europe.

On the plus side, we would expect commercial property to see less impact than highly liquid investments like equities and bonds, where money can move at the push of a button. Moreover, much of the overseas investment in UK property (at least in the larger unit market) looks to be here for the long-run, as shown by the interest shown in major development schemes. If we do end up in a 'neverendum' scenario, there is every chance investors just learn to live with it.

Were it not for the EU referendum the outlook today for UK commercial real estate would be very different. Unemployment is low, total employment rising, wages are increasing in real terms, and there are signs that many of the UK's trading partners are returning to growth. IPD total returns may be ebbing for now, as capital growth edges back from unsustainable levels last year, but we expect more rental growth to come.

Overall, this is an upbeat scenario to under-pin a market cycle. However, from a pure business perspective, the sooner the referendum is out of the way the better.

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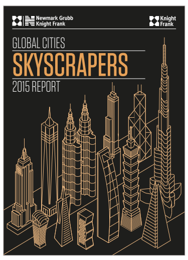

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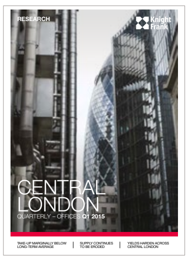

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