

INSIGHTS ON BREXIT FROM MID-MARKET BUSINESSES

Brexit means business – but not as we know it



Brexit is the momentous issue of our time, impacting on the real estate industry and indeed every business sector.

The political climate is turbulent and uncertain – and there is still much to negotiate in an extremely short period of time. What is more certain is the vast potential of Brexit to fundamentally re-write the rulebook for how business is done in the UK.

Mid-market businesses are the engine room of the UK economy. Last year we reported the findings of our Brexit survey which provided an insight into the sentiment of this robust and vibrant group. At the beginning of 2018, and with just a year to go until the country's departure from the EU on 29 March 2019, we've returned to this influential cluster of over 500 cross-sector business leaders to capture their outlook on Brexit today. The results are presented in our Brexit Means Business report series.

This report gives a snapshot of the survey's sentiment from 70 business leaders nationwide operating in real estate and related areas, such as construction and planning. Most (69%) have been operating for over 20 years. It also recommends actions businesses can take to get ready for a post-Brexit economy.



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"Ever since the UK pressed the Brexit button, mid-market businesses have felt the spectre of uncertainty. Real estate is highly cyclical – its entrepreneurial people thrive on imprecision; while others wait for clarity they see an opportunity.

But due to its complex and indeterminate nature, Brexit is unlike most other structural instability. As our survey reveals, real estate businesses know their inherent optimism, coupled with prudence and adaptability, will position them for the best advantages. Now is the time to capitalise on this mindset and prepare for the unparalleled changes ahead."

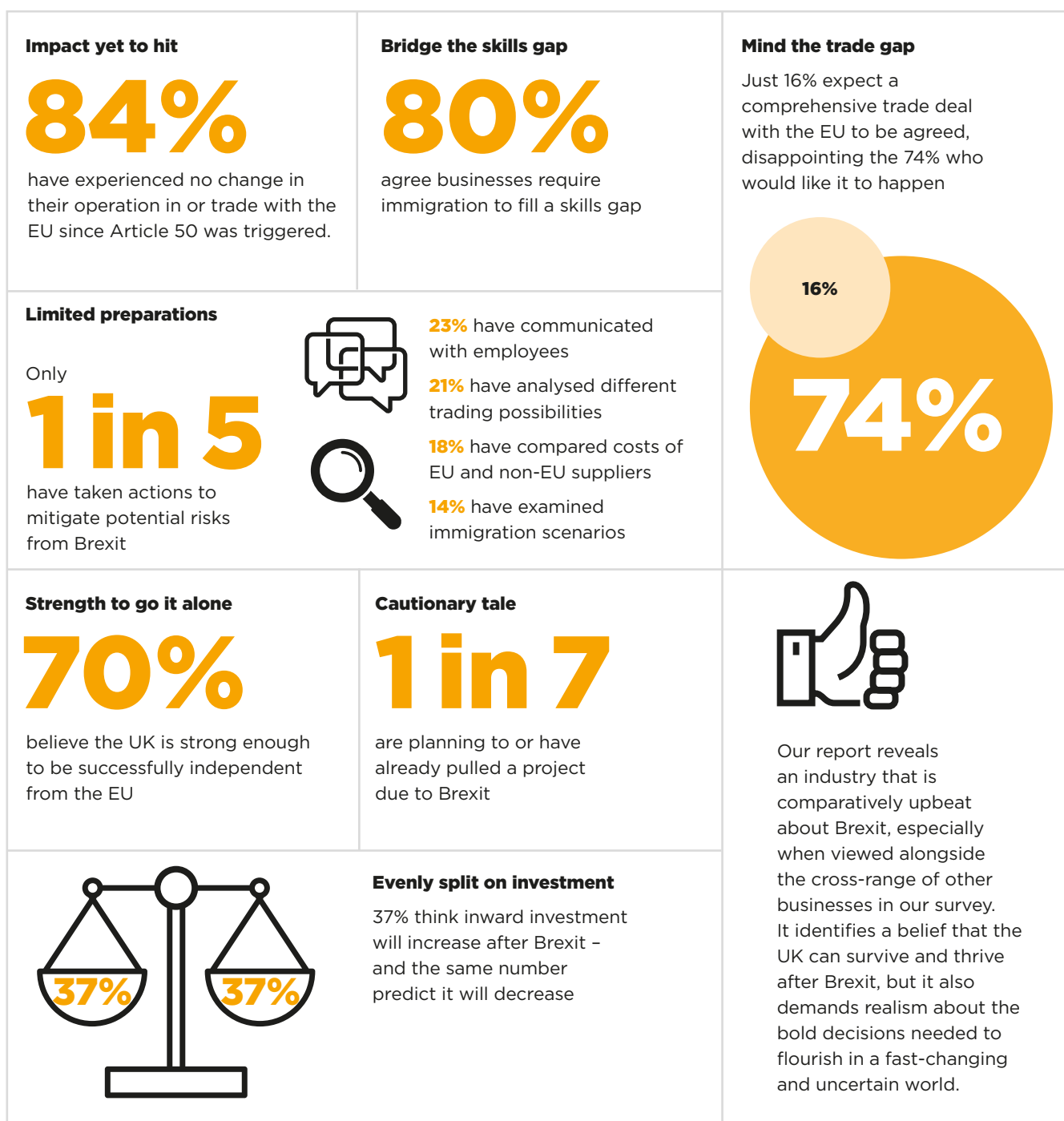
The pre-Brexit pulse of UK real estate

Commercial real estate is one of the fundamental building blocks of the UK economy, contributing over £94 billion each year.

The wealth of the nation is inextricably linked to the value of real estate. The investment it attracts drives growth, productivity and is a catalyst for urban regeneration. Mid-market businesses are a particularly dynamic and ambitious force.

Undoubtedly real estate has a vital role in building a positive future for the UK outside of the EU. What matters to this highly entrepreneurial sector matters for our economy overall. So has the enduring uncertainty around Brexit created a confidence slump or an opportunity boost?

Key survey findings:





People and skills

Brexit is an unfolding event. The UK real estate sector takes a pragmatic view of both the opportunities and challenges it presents. It's a mood reflected in our survey.

People are what make businesses tick, so access to a pool of talent and labour is vital. Brexit's impact weighs on the minds of many, together with qualms about other geopolitical issues. There are other growing influences at play too, including the effect of social and technological change on the future role of the built environment and property cycle.

For example, the overall mood at MIPIM can be described as cautiously optimistic given its focus on risk management during the market's prolonged late stage of the economic cycle and the uncertainties of Brexit.

At the same time, there are good reasons to be confident. Urbanisation, housing need and changing consumer habits mean market opportunities often focus on cities and city-regions, with industrial and logistics development a particularly go-getting area. This is good news for large regional cities, like those in the Midlands buzzing from the vibrancy of intensive new development and infrastructure activity. There have also been major wins such as High Speed Two (HS2), the Commonwealth Games for Birmingham and Coventry's City of Culture.

Immigration partly fuels housing demand but also provides construction labour for developers and public sector infrastructure projects. In our survey, Brexit's **restrictions on the free movement of people** remain a top concern regardless of businesses' varying levels of reliance on migrant labour.

Unsurprisingly for a sector which is characterised by having a contracted labour supply and large projects being managed by developers with a small nucleus of staff, migrant workers make up less than a fifth of the direct workforce of most (75%) of our respondents. Although not reliant on immigration themselves, 80% say that **immigration is needed by businesses** to fill a skills gap. This sentiment is even higher than that expressed strongly across all businesses.

There is unease about the **flow of skilled foreign workers** being stemmed: 73% expect a decrease in workers moving into the UK and 57% expect the number moving out of the UK to increase.

This carries over into concern about the difficulties businesses will face when sourcing skilled workers: 73% think **migration restrictions** from Brexit will make the labour market less flexible to demand. They also rate the likelihood of restrictions on immigration widening the skills gap as being over 7 out of 10, reflecting the widespread awareness of skills shortages enveloping areas beyond construction, like planning, engineering and surveying.

Conflictingly, only 55% believe **red tape around immigration** needs to be reduced, perhaps indicating a dilemma between personal attitudes and commercial rationale. Plus, 71% have no plans to analyse **potential immigration scenarios**, which is significantly higher than the 51% of businesses overall. This may be because EU labour is perceived to have no direct impact. But if it's a feature of a business's supply chain, it's wise to ask those thorny questions now to be ready and forewarned to act.



Trade and projects

Much of the current experience and commentary relating to real estate explains the muted sentiment that surrounds Brexit. The uncertainty ushered in since the referendum has fuelled existing levels of cautiousness and risk awareness. Now it is even harder to get things done.

This is reflected in our survey. Although real estate business leaders are not perceiving exposure to the risks of Brexit as acutely as other businesses, 15% have or are planning to pull at least one project due to Brexit.

Others have indicated that rather than pulling a project it has been cancelled or not renewed. Businesses are more inclined to reappraise a potential deal, so after enthusiastic overtures there often comes a reality check. Speculative development is largely consigned to the past, and future projects are about risk-sharing collaboration and prudent forward commitments.

A significant number of real estate businesses are UK-focused and not involved in exporting. As a result, only 6% are **moving functions or operations from the UK** to an EU site, compared to 20% of businesses overall. In addition, 8% are moving functions to Ireland. But although they see overseas investment coming into the market, they are not immune to the mood music coming from businesses generally that Brexit will hamper trade.

Over the past year there's been a shift to a gloomier view. Over half of real estate business leaders (53%) agree with the overall thinking in our survey that the UK's **leverage for trade deals** will decrease after Brexit.

Anxieties around trade are also evident by 83% seeing an increased **cost of imports** and **loss of access to the single market** (76%) as the main pitfalls of Brexit. This is understandable given concerns around custom tariffs and VAT on imports, now heightened by the Government confirming that leaving the single market and customs union remains the UK's central intention.

The sector's keen concerns about import costs are likely to be due to the reliance on construction materials coming from Germany and other EU countries. Overcoming the challenges are far from straightforward but businesses importing in volume may consider bulk buying in advance or opportunities to onshore manufacturing in the UK.

Concerns are also raised by over half (51%) about Brexit having a negative effect on **supply chain stability**, with just 11% thinking it will have a positive effect and around a third seeing no impact.

Optimism is curbed with realism when it comes to what real estate businesses would like to see from a **trade deal** and what they expect to happen. A majority of business leaders (74%) want a comprehensive trade deal with the EU but just 16% expect it will happen. This is a large 58% gap between preference and expectation.

While only 8% would like no trade deal with the EU after Brexit – perhaps reflecting the notion that “no deal is better than a bad deal” – the general view is that a partial trade deal will be reached, with 62% expecting this outcome.



National strength

Real estate mid-market businesses are predisposed to find the opportunities to succeed, whatever the market conditions. So amid the Brexit noise of uncertainty and pessimism, there is an upbeat forecast from the sector for the UK after its departure from the EU.

Business leaders are seeing that a weak sterling and the UK's perceived status as a safe haven for capital investment has continued to attract overseas investment around the country.

Certainly in our clients' experience, especially in London, the fundamentals which make the UK an attractive proposition for overseas investors remain strong and compelling: a robust rule of law, a transparent and open approach, and a business-friendly language and timezone connecting east and west. These factors will be critical to the sector's long-term resilience.

For the moment, our survey reveals that belief in the UK's **ability to be successfully independent** is robustly strong at 70%. This is stronger than for businesses overall (60%) and on a par with the overall feeling we found last year. Clearly the inherent political uncertainty of Brexit has not spread as quickly into the sentiment about the implications of Brexit for real estate businesses as it has for other parts of the economy.

But realism often outplays optimism which may explain why the more operations a UK business leader has in the EU, the less likely they are to feel that Britain is strong enough to be independent.

Increased pessimism is also evident in the findings about the **UK's influence after Brexit**, with half (50%) predicting a fall in our global sway. It's not a rosy picture for the EU either, with 72% of business leaders believing Brexit will damage the reputation of the EU. However, the worries about the country's influence diminishing are less than for businesses overall and just over a third (36%) of real estate businesses think our global influence will increase.

In contrast with businesses overall, there's also greater positivity about whether the **level of inward investment** into the UK will change after Brexit, with an equal number of real estate business leaders thinking it will increase or decrease (both 37%).

The sector is also significantly more upbeat about the UK's **attractiveness as an inward investment destination**, with 37% forecasting an increase and less than half (45%) thinking it will fall compared to 60% of businesses overall. This is perhaps reflective of the inflows of funds over the last year, particularly from China and the Far East.

Similarly, there is a cheery view about the potential benefits of Brexit. A significantly high 81%, compared to 64% of businesses overall, see a top opportunity being the greater **freedom to strike new trade deals**, along with the chance for the government to **flex the tax regime** to encourage investment (84% compared to 70%).

This sentiment around tax may be influenced by the positive effects of tax relief in enterprise zones and hopes for a lighter touch approach to Stamp Duty Land Tax. Belief in the benefit of laws applying to UK being made in the UK after Brexit is also extremely strong: 74% compared to 42% overall.

In stark contrast with this perhaps wistful optimism, is the hard-hitting finding that over half (58%) predict a negative **impact on the sector** due to Brexit. Just 27% expect a positive impact and 15% no impact at all. Clearly, there are some hairline cracks in the high levels of confidence and ambition felt by the real estate industry towards the ambiguity of Brexit and its effects on the UK.

Take action for Brexit

As the deadline for Brexit emerges into view, real estate businesses need to steer a path through the uncertainty and be driven by their innate determination and self-sufficiency. Now more than ever is the time to take realistic and cost-efficient steps to prepare for Brexit.

On the other side, business will go on but not as we know it now.

These 4 actions are an overview of how to power through in the run up to Brexit.

1 Develop financial resilience

Do you feel as ready as possible for unpredictable economic consequences? Use available information to assess the risk from Brexit and ways to tackle challenges or capitalise on opportunities. Consider introducing more flexibility, such as diversifying your portfolio so you're not concentrated in one market or dependent on a single supplier. Fine tune the ways you manage your cash flow and offset commercial risk to keep your business financially sound and running smoothly.

2 Manage supply chain risk

Are you prepared for the unprecedented changes ahead? The free movement of goods, services, parts and people could all come to an end, either abruptly or gradually – accompanied by the burden of administrative costs and delays. Knowledge is key to running a lean and agile operation which can more readily withstand disruptions and cost hikes. Aim to gain end-to-end oversight of your supply chain to gauge your direct and indirect risks and find efficiencies.

3 Put a focus on people

Have you assessed the impact of a widening skills gap, exacerbated by a new era of reduced and restricted immigration? Consider your potential exposure now and going forward, both in your own workforce and indirectly through your suppliers. Brexit is an unsettling time for EU employees so do all you can to reassure and protect any you may have, and find out what your suppliers are doing too. A tightly squeezed labour market also calls for creative recruitment and retention strategies, such as upskilling existing staff.

4 Collaborate for support

How good is your network of supporters, not just for particular projects but in helping you overcome Brexit's volatility or general obstacles in your path? Make connections with sector organisations which understand the challenges you face. With a shared voice they can act as advocates to influence policy changes or simply be your supportive allies. Make relationships with advisors who can help you chart the most profitable course through to the time and place where the landscape is clearer.



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