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Briefing Paper

Brexit: The Implications for Housing

October 2016

Introduction

On 23rd June 2016, a referendum was held in the United Kingdom concerning the country's future membership of the European Union. The result was a decision to leave. The purpose of this briefing paper is to consider the implications of this for housing services.

The full implications of the vote for Britain to leave the European Union will not be known until after the negotiations between Britain and the European Union are completed (if then) but some implications are already apparent.

Macro-Economic Implications

The United Kingdom based Institute for Fiscal Studies has highlighted analysis that United Kingdom Gross Domestic Product might be reduced by between 2.1% and 3.5% in 2019 because of Brexit. Such a reduction, after taking account of the reduced European Union contribution, would imply a hit to the public finances of between £20 billion and £40 billion in 2019/20.

The Treasury released a report in April 2016 that estimated that leaving the European Union and negotiating a bilateral agreement could reduce British Gross Domestic Product by 6.2% by 2030. Other studies suggest the impact will be more modest, affecting United Kingdom growth approximately 1% either way.

Clearly, the question of the short and long term effects of Brexit on the United Kingdom economy – including its impact on exchange rates, growth, investment and employment – all have direct and indirect effects on the United Kingdom and especially on its poorest people and places.

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The United Kingdom trading position was already worsening prior to the vote. The deficit in goods and services was £2.3billion in May 2016, a widening of £0.3billion from April 2016. Exports decreased by £2.0 billion and imports decreased by £1.7 billion.

Commenting on the United Kingdom trade figures for May 2016, published by the Office for National Statistics, Rob Johnston from Cumbria Chambers of Commerce, said:

"Although it has narrowed since the start of the year, the widening of the United Kingdom's trade deficit in May is disappointing. Taken together with the recent confirmation of a near record current account deficit, the figures paint a rather bleak picture of the United Kingdom's external position.

"While the significant decline in the value of sterling in the wake of the European Union referendum will benefit some exporters in the coming months, a weak pound is something of a double-edged sword, as many United Kingdom exporters are also importers as a result of global supply chains and so will be facing higher input costs due to the weakening currency.

"It is crucial that the government achieves the best possible trade arrangements with the European Union and further afield."

Philip Hammond, the Chancellor of the Exchequer, made an interesting speech at the 2016 Conservative Party conference. In it he said that:

"We must expect some turbulence… There will be a period of a couple of years or perhaps even longer when businesses are uncertain… We have to expect a period when confidence will go up and down – perhaps a bit of a roller-coaster… During that period, we need to support the economy to make sure that consumer confidence remains, to make sure that business confidence is stable, so we get the investment that keeps the jobs that keep Britain going."

So with the economy depressed with low levels of investment and exports the government will do all that it can to maintain demand, not only by cutting interest rates to encourage private borrowing and discourage saving, but by increasing public expenditure and paying for it through increased public borrowing.

Some ministers have made comments that have encouraged people in local government, housing and other public services to hope for increased funding. However, I would advise caution. The only announcement that government has made so far is £3billion to fund housing but of this £2billion is already committed and the 'new' £1billion is to provide subsidised loans to private builders. If we see any significant increases in budgets for social care or social housing I would be surprised.

Since June 2016 the value of Sterling has declined by about 20% when compared with the Euro and the Dollar. Chris Jones of the Financial Times has calculated that the purchasing power of the United Kingdom population has fallen by £700billion since the European Union referendum or £10,000 for every man, woman and child in the United Kingdom.

The decline in Sterling has also led to a fall in demand for United Kingdom government gilts. Angela Jameson, a business and financial journalist wrote in the 'New European' that:

"Higher gilt yields now suggest that Government will have to pay much more to borrow making its longer-term goal of balancing the books even harder."

The declining value of Sterling is stoking inflation through higher import prices. In September 2016 inflation increased from 0.5% to 1.0% - not a large increase but if the trajectory continues and inflation doubles every month it would reach 32% in six months! And Anna Leach, the Head of Economic Analysis at the Confederation of British Industry told the 'New European' that:

"It's still too soon for Sterling's recent depreciation to affect today's inflation figures, however, we do expect it to push up prices through the course of next year, which will hit the pound in people's pockets."

In July 2016, Sir Vince Cable addressed the annual conference of the Chartered Institute of Public Finance & Accountancy and said that the United Kingdom faces lengthy instability following the vote to leave the European Union, including a possible second referendum on the terms of a Brexit deal. He said that successful negotiations were usually 'played long', but the longer these went on the greater the uncertainty that would hamper the economy. There are currently 12,500 laws and directives in force in Britain that are derived from the European Union.

In particular, he said that it would be difficult for the government to negotiate an arrangement whereby Britain would stay in the European single market but would also be permitted to opt out of the free movement of labour. He said that:

"It is not widely understood here that part of the reason the European Union has been inflexible on freedom of movement is that the single market with free movements of capital and labour was a British idea created by Margaret Thatcher and they cannot see why the United Kingdom is now walking away from that."

He said the United Kingdom had still not recovered from the financial crash of 2008 and that living standards are no higher than in 2007 for the average worker. Protection for health and education budgets had meant that 'a lot of cuts fell on local government so that services deteriorated'.

Moody's credit rating agency changed the outlook on 55 government-related organisations in the United Kingdom after the referendum result was announced (including all the housing associations that it rates), after changing the United Kingdom's overall credit outlook to negative. These entities include local authorities, universities and 42 housing associations, as well as several subsidiary bodies and vehicles.

A negative outlook means that further credit downgrades are likely in the future. Credit ratings are crucial in securing finance at cheap rates, particularly on the capital markets.

Standard and Poor's that also has several housing associations in its portfolio, downgraded the United Kingdom's overall credit rating from AAA to AA because of the vote. Because housing association ratings are affected by the strength of the United Kingdom government downgrades for housing associations followed.

In its rationale for changing the United Kingdom's overall outlook to negative, Moody's said:

"During the several years in which the United Kingdom will have to renegotiate its trade relations with the European Union, Moody's expects heightened uncertainty, diminished confidence and lower spending and investment to result in weaker growth.

"Over the longer-term, should the United Kingdom not be able to secure a favourable alternative trade arrangement with the European Union and other countries, the United Kingdom's growth prospects would be materially weaker than currently expected."

It has also been announced that government revenue from corporation tax has decreased due to lower corporate profits; and it has been reported that several banks and financial institutions are already considering relocating some of their operations to continental Europe.

The Joseph Rowntree Foundation has considered the impact on poverty and the poorest in communities across the country because of ‘Brexit’. They consider that the crux issue is how the hole created in public finances by the loss of European Union regeneration money can be filled. According to the Joseph Rowntree Foundation, leaving the European Union:

“Could lead to a significant devaluation of the pound, with some predicting devaluation of up to 20%. People could be relatively poorer, affording less with their pages in term of buying imports or travelling abroad.

“Leaving the European Union could save the United Kingdom its net contribution of £9.9billion which could be spent on poverty reduction. The North East, Northern Ireland and the East Midlands would be hardest hit by any increased barriers to trade with the European Union.”

The decision to ‘leave’ the European Union has resulted in sharp falls in the value of sterling. The United Kingdom economy dropped from being the fifth largest in the world to being the sixth largest overnight. The government's credit rating has already been downgraded, followed by a downgrading of housing associations’ credit ratings, causing an increase in interest rates faced by housing associations. This is despite the Bank of England cutting interest rates to a record low of 0.25%. In these circumstances, it will be important for the government to pay careful attention to the economy and public finances. The government has backed away from George Osborne’s original proposal to have an emergency budget and is instead considering ways of ‘reflating’ the economy in the short-term However, in the long-term it is likely that measures will need to be taken to protect the value of assets, pensions and savings including changes to interest rates, taxation and public expenditure. As local government, housing and welfare budgets have been ‘unprotected’ since 2010 it is likely that any reductions in public expenditure would impact heavily in these areas.

UK Government abandons budget surplus target

Despite suggesting during the European Union referendum campaign that a vote to leave the European Union would necessitate an emergency budget to reduce expenditure, increase taxation and thereby balance the government’s books, George Osborne reacted to the vote by announcing that the government would abandon its fiscal rule that requires the public finances to be in surplus by the end of the parliament, saying that he must be ‘realistic’ about the impact of Brexit.

In a speech in Manchester, the then Chancellor said that the referendum result was likely to lead to a ‘significant negative shock’ for the British economy, and how the country responds to this will determine the impact on people’s jobs. He said:

“As the governor (of the Bank of England) has said: the referendum is expected to produce a significant negative economic shock to our economy. How we respond will determine the impact on jobs and growth.

“The Bank of England can support demand… The government must provide fiscal credibility so we will continue to be tough on the deficit but we must be realistic about achieving a surplus by the end of this decade. That's exactly what our fiscal rules are designed for.”

Speaking at her Conservative party leadership campaign launch, Theresa May, the Prime Minister said:

"While it is absolutely vital that the government continues with its intention to reduce public spending and cut the budget deficit, we should no longer seek to reach a budget surplus by the end of the parliament. If before 2020 there is a choice between further spending cuts, more borrowing and tax rises, the priority must be to avoid tax increases since they would disrupt consumption, employment and investment."

The pledge to reach a surplus by the end of the decade is the last of the former chancellor's fiscal rules to be abandoned. A target to reduce debt as a proportion of gross domestic product year on year has been missed, as has the cap on welfare spending.

The government had announced plans to make additional savings of £3.5billion by 2019/20 in this year's Budget to ensure that the surplus was met, but the Institute for Fiscal Studies concluded that they were only on track thanks to some 'fiddling around' with incomings and outgoings of the public purse.

Reaching and maintaining a surplus in the public finances is part of the Charter for Budget Responsibility that was passed by MPs in October 2015. However, this can be suspended if the Office for Budget Responsibility has judged the economy to be facing abnormal pressures or when gross domestic product growth is below 1%.

In his speech to the conference of the Chartered Institute of Public Finance & Accountancy in July 2016, Sir Vince Cable, congratulated Bank of England governor Mark Carney on having smoothly implemented a Plan B in the aftermath of the referendum to ensure liquidity, but he noted that:

"Bank shares have crashed so it's difficult for them to make a profit so we may see a credit crunch that will hit small and medium enterprises."

He also pointed out that much of the ammunition that could be deployed to help the economy had already been deployed. He added that:

"The argument by Brexiteers that there can be a bonfire of regulations and we become like Hong Kong or Liechtenstein-on-Thames seems not to be accepted by Theresa May, who sounds more interventionist."

Until 2008, the United Kingdom government based its finances on the principle that the budget would be balanced in the long-term with deficits at times of recession balanced by surpluses during times of growth. If the United Kingdom is to avoid bankruptcy it will need to return to this policy eventually.

According to the 'International Spectator', the United Kingdom's external debt as a proportion of Gross Domestic Product is now 267%. This compares with 205% in France and 194% in Greece. Looking forward, United Kingdom debt is projected to increase.

In August 2016, the Bank of England reduced interest rates to a record low of 0.25% and announced a programme of £70billion of quantitative easing. Apparently, further reductions in interest rates are planned. It is also expected that in the autumn the United Kingdom government will introduce a budget that will increase public expenditure and reduce taxation at a time when government revenues are already falling. The government was already projecting at the time of the last budget that the 2016/17 deficit would be £75billion and that total debt would increase to £1.6trillion.

This appears to me to be the biggest reflationary package using both fiscal and monetary measures that any United Kingdom government has ever introduced and underlines the threat to the economy caused by falling investment, exports (despite the fall in the value of sterling) and consumer demand. Whether this approach will be effective remains to be seen. However, it appears to me that it will not be sustainable in the long-term and certainly does not appear to be 'prudent'.

And it is not only the United Kingdom government that is reacting in this way. The Scottish Government has also announced a package that will see capital spending on projects to support and create employment accelerated, starting with an additional £100million of funding in 2016/17. A statement said that the capital funding will be used to speed up delivery of health and other infrastructure projects and that 'projects will be assessed for accelerated funding against a range of criteria including how quickly work can start, the number of jobs that will be supported or created, the likely impact on the supply chain and geographic spread'.

I remember attending the annual conference of the Chartered Institute of Public Finance & Accountancy in 2010. One of the presentations was made by Goran Persson, the former Social-Democratic Prime-Minister of Sweden from 1996 to 2006, who tackled that country's budget deficit successfully in the 1990s. He described a meeting that he held shortly after becoming Prime-Minister with American bankers with whom the Swedish government was in debt. They were insisting that Sweden reduce its expenditure on specific budgets and insisting that specific changes were made to the way education, health, welfare and other services were provided. He said that he initially felt angry that the bankers dared to make these demands but then concluded that:

"An indebted government and people have no political freedom because the markets will act independently".

Looking further back I can remember angry scenes at the Labour Party Conference in 1976 when Denis Healey explained that the then Labour Government had no alternative but to reduce public expenditure because it was a condition of the loans that had been agreed with the International Monetary Fund.

In short – debtors have no sovereignty because they surrender it to their creditors. My fear is that in trying to borrow and spend their way out of the Brexit crisis, the United Kingdom government will create an even greater financial crisis in the long-term with prosperity and sovereignty being lost.

Impact on the Housing Market

It had been widely predicted both during and after the referendum campaign that there would be a decline in the housing market and a reduction in house values should Britain leave the European Union. To date there has been some evidence of a slow-down in the housing market in London but the effect in other areas is less clear. Falling house values are likely to result in impairment charges on the balance sheets of local authorities and housing associations and reductions in the income that could be expected from regeneration schemes and building units for market sales.

Predictions have been made by financial and property analysts. KPMG has predicted house price falls of 5% in the United Kingdom, and possibly more in London with transaction volumes 'deflated' until the spring of 2017. JLL has predicted a 'modest down-tick in prices'. Hometrack, predicted a 5% to 10% fall in transaction rates in London as buyers pause amid the market uncertainty.

Credit agency Standard & Poor's warned of 'a correction in the United Kingdom's highly-valued housing market' as one of the reasons for downgrading the country's credit rating.

Research carried out by 'Inside Housing' during early 2016 found that 21% of housing associations had not 'stress tested' their business plans against a fall in house prices. It would now be appropriate for this to be done. It was found that 27% have only stress-tested against a 10% drop, with around 30% testing against a 30% drop in property values.

Jonathan Walters, Deputy Director of Strategy and Performance at the Homes and Communities Agency, told 'Inside Housing' that:

"I suspect everyone will be reviewing their plans. We have been saying for some time that a downturn would come and associations should be testing business plans against that. It's quite worrying that some of these numbers don't reflect what we've been hearing. We are absolutely of the view that providers need to be testing against not just price falls, but volume (of sales) as well. In 2008, the real thing that killed people was the drying up of volume."

Matthew Bailes, former Regulation Director at the Homes and Communities Agency and Chief Executive of Paradigm Housing Association told 'Inside Housing' that:

"Associations need to keep very, very close tabs on what's going on with existing sales and have an absolutely iron grip on things like covenant compliance. The question isn't just about what happens if house prices fall, but what happens if you can't sell housing for any reasonable price."

Elizabeth Froude, financial director at Genesis, told 'Inside Housing' that in the event of a 20-30% dip in house prices, the association had plans to convert houses developed for sale to rented properties for two years and added:

"We develop stock with the view to keep it in the long-term, whereas house builders have a very short window with which they have to dispose of their stock."

In the global accounts earlier in 2016, the Homes & Communities Agency warned associations should have 'mitigation strategies' in place to cope with a market downturn. The accounts revealed substantial growth in the associations' surplus from for-sale activity, from £324million in 2014 to £501million in 2014/15.

Following the Brexit vote last month, property consultants predicted either a modest reduction in house prices or that house price growth would slow to about 1% in 2017. To date, there has been evidence of a down-turn in the housing market in London but house prices have continued to increase in other parts of Britain.

Impact on Housing Associations

The housing sector is already experiencing some effects, some of which may be caused by short-term uncertainty and some of which will be permanent.

The short-term impacts will probably be largely financial. Uncertainty about the future terms of trade will make financial bodies and other businesses cautious, so it may be more expensive or harder to borrow money to invest in homes or regeneration, and the offer or agreement of contracts for services may be put on hold. If uncertainty lasts for a while then house prices may fall, that would make it harder for landlords to build new homes and generate surpluses from sales activities.

The longer-term impacts depend very much on what terms are negotiated for post-European Union trading. There may be effects on the costs of materials to build and improve homes, the ability to get workers for big development and investment projects, and the regulations applied to companies providing goods and services. Much of the immediate post-referendum commentary assumes regulations will be similar, costs will go up and availability of skilled labour will go down. The housing sector has made good use of European Union grants that support work on regeneration, social inclusion and energy efficiency - access to these will certainly be lost and the capacity and willingness of the United Kingdom government to replicate these sources of funding is open to doubt.

David Orr, Chief Executive of the National Housing Federation has said that:

"Leaving the European Union could… affect housing associations' ability to build homes. Boards should consider that Brexit could make it harder to source labour and materials, and make investment more expensive."

In an edition of '*Inside Housing*' prior to the referendum, three quarters of housing association chief executives warned a leave vote would be negative for their organisations, with the impact on the economy and borrowing prices flagged as key concerns.

One effect will be that housing associations will lose access to the European Investment Bank. The European Investment Bank committed £1billion to housing in April 2016 with a further £0.6billion in the process of being negotiated. Before the referendum, Peter Apps wrote in 'Inside Housing' that:

"The European Investment Bank has provided more funding to social housing projects in the United Kingdom than any other member state… (It) is able to offer lower rates than other long-term investors in the sector in part because of its not-for-profit status… While the deals which have so far been announced will not be affected by Britain's status in the European Union, future investment may be threatened if Britain votes to leave."

Housing Association Credit Ratings

Housing associations' credit ratings have already been reduced following the downgrading of the credit rating of the United Kingdom government. Moody's said the vote would 'lead to a prolonged period of uncertainty' and 'will be credit negative for the United Kingdom sovereign and other rated entities', and added:

"The immediate financial market reaction has been pronounced, with sterling depreciating sharply and global equity markets falling… Heightened uncertainty during negotiations over new arrangements between the United Kingdom and the European Union will likely dent investment inflows and consumer and business confidence in the United Kingdom, weighing on its growth prospects."

Standard and Poor's has issued credit downgrades to most of the housing associations it rates because of the Brexit vote. Housing associations are considered 'government-related entities' and therefore receive an uplift in their rating. A downgrade for the United Kingdom has therefore had a direct effect on housing associations' credit ratings that are crucial in securing cheap debt, particularly on the capital markets. In its judgements Standard and Poor's said that the likelihood of government support for housing associations now has a neutral effect on the ratings, rather than an uplift

For example, in its downgrade of Town and Country Housing Group, Standard and Poor's said that:

"We are lowering our rating on Town and Country Housing Group… following our downgrade of the United Kingdom… In our view, the moderately high likelihood of Town and Country Housing Group receiving extraordinary support from the United Kingdom government, working through the Homes and Communities Agency, now has a neutral impact on the ratings."

Moody's has published a report setting out its reasons for putting all the housing associations that it rates on a 'negative outlook'. It listed potential cuts to housing benefit and grant, the loss of European Investment Bank funding and impact on housing demand and house prices as the sector's key exposures to Brexit. It said that:

"(Housing associations) adversely affected in 2015 by policy changes that reduced their core social housing rental revenues, are vulnerable to potential fresh government austerity measures that might further squeeze their revenues and exacerbate the policy.

"We expect economic uncertainty to have a negative impact on the property market… This will negatively affect those with a higher exposure to outright market sales and shared ownership products."

The agency mentioned the loss of European Investment Bank funding - £2billion of which has been directed to housing associations in recent years. The agency also warned that associations with 'higher exposure' to the sales market through outright sale and shared ownership products could be negatively impacted. Many housing associations have scaled up sales activity in line with government policy and to generate cross subsidy to compensate for the reduction of housing grant.

Swan Housing Association was downgraded and given a negative outlook, after the agency said it is particularly exposed to the property market in London as follows:

"In our view, Swan's size and relative exposure to development for sale activity compared with peers makes it more vulnerable to the risks that a lengthy Brexit process would pose for London's housing market."

The ratings agency Moody's has downgraded Genesis Housing Association to Baa1 – the joint lowest in the sector ahead of its merger with Thames Valley Housing Association. It cited its exposure to the sales market – that could reach 54% of turnover by 2020 – as a reason for the downgrade following the Brexit vote. In response to the downgrade, Genesis said it would 'look again' at its development pipelines and business plan.

A Genesis spokesperson told 'Inside Housing' that:

"In a post-Brexit world with high levels of market and political instability, a downgrade is not unexpected. That said, this requires us to look again at our business plan as we approach the formal merger with Thames Valley Housing Association. The downgrade narrative states that there is reliance on income from property sales and so we will look again at our own development pipeline plans in light of the new landscape in which the merged organisation will operate - a process we had started in any event, following last week's referendum result. That said, we are clear that building new homes is fundamental to tackling the housing crisis."

The merger was subsequently abandoned.

Credit ratings are crucial in securing cheap long term debt, particularly on the capital markets.

Housing Association Borrowing

It could have been expected that lower interest rates would be beneficial for housing associations but the Homes and Communities Agency has warned that cash calls due to falling borrowing costs were the 'most immediate risk' to social landlords. With government gilt rates falling to historic lows of below 1%, associations have been required to provide millions in additional security. It is understood that they met these commitments without difficulty, offering cash and property as security to banks.

Several housing associations use fixed-rate derivatives, financial instruments that enable landlords to swap variable interest rates for fixed rates. Under the terms of the derivatives, if swap rates fall then landlords are required to put up extra security. The ten-year swap rates fell sharply from 1.38% to 1.9% following the Brexit vote that Howard Webb, a director at Capita, described as unprecedented.

Many housing associations have struck swap deals to agree a fixed rate rather than a variable interest rate on long-term loans. But when rates fall, landlords must put up additional security to cover the gap between the variable and fixed rate – known as 'mark to market exposure'.

Jonathan Walters, Deputy Director of Strategy and Performance at the Homes & Communities Agency, has told 'Inside Housing' that associations have put up tens of millions in additional security and have met these commitments. However, there are concerns about the consequences if the interest rate is reduced further. Housing associations struggled to meet cash calls on derivatives totalling £400million in the 2008 financial crisis and in 2012, the Dutch housing association Vestia was forced into a mass sale of homes after losing £20billion in derivatives deals.

In June 2016, the Homes & Communities Agency said that the sector's mark to market exposure had increased from £2.4billion to £2.9billion between December and March. In 2015 the Agency wrote to the 47 associations with freestanding derivatives asking them to disclose if they had concerns over their 'ability to collateralise increased margin calls'. Mr Walters of the Homes & Communities Agency told 'Inside Housing' that:

"We've looked at those associations that have significant sales exposure or refinancing needs, and then we've looked at what happens if they don't make the sales or they can't make the refinancing that they expected, and who has particularly got cash shortfalls."

The Agency has asked for additional information from these landlords about how they manage and mitigate exposures, and how their boards are providing oversight.

Housing associations are taking advantage of falling government borrowing rates in the bond market, despite a leap in the 'spreads' on their deals. Analysis of the secondary market in housing association bonds – trading between investors after bonds are sold – show overall rates have fallen nearly 50 basis points (0.5 percentage points) since the referendum.

This is despite spreads (the price over the cost of government debt) widening by ten to twenty basis points on average, with some landlords' spreads pushed out to more than 200 basis points, according to an analysis by Santander. The reduced price comes as gilt yields (the cost of government bonds) have fallen to a historic low of just over 1.5%, 60 basis points lower than pre-Brexit levels.

The rise in spreads comes after rating agency Standard & Poor's downgraded most of the sector, and Moody's placed housing associations on negative outlook. Poplar Harca's £140million bond from July 2013 is priced at 206 basis points over gilts – up from 150 when it was issued; and Genesis' £250million issue from 2009 is priced at 209, up from 170. Both associations have been downgraded to a credit score of Baa1 by Moody's – the lowest ratings in the sector – and are the only landlord bonds priced at more than 200.

Swan Housing Association has released £60million of retained bonds at 35 basis points lower than the 3.68% of its original £250million issue in February 2015. The retained bond issue was two times oversubscribed. Swan Housing Association's Deputy Chief Executive Jamie Smith told 'Inside Housing' that there is still a lot of appetite for housing associations among investors and that:

"We had a lot of questions about the impact of Brexit and (what it would mean for) property prices. But this represents an opportunity: there is demand for long-term debt and positively-rated entities, which housing associations are… This represented a good time to lock in some long-term, fixed rate debt and ensure that we have sufficient capacity to deliver our long-term corporate strategy ambitions, including the delivery of our pipeline of new homes."

The proceeds from Swan's bond sale will be used to refinance existing bank debt. The association retained £100million of its £250million bond last year, meaning £40million is still to be issued.

However, some commentators have suggested that new issues would be difficult to achieve in the current market on the grounds that selling a retained bond is quite easy, but doing a bond from scratch is difficult in terms of getting property ready.

London Housing

Sadiq Khan's Deputy Mayor for Housing has attempted to reassure London's housing associations in the light of the Brexit vote. In a keynote address at Housing 2016, James Murray said he was holding meetings with G15 landlords to reaffirm the message that 'meeting the housing crisis is our top priority', and pledged to support the sector through measures such as accelerating some planning rules. He said that:

"Our message to you, the message that I have been saying over the last few days since the outcome of the referendum – that we are here to give you support and certainty… We need to work with housing associations, developers and local authorities, investors, businesses… to say to you we are here for you, we want to give you the support and certainty you need, and we want to build the homes in London we so desperately need."

The Greater London Authority is still negotiating with government over the size of its share of the government's nationwide 2016/21 Affordable Housing Programme. City Hall has been lobbying for an element of the Shared Ownership and Affordable Homes Programme to be set aside for affordable rent.

Housing Associations and Development

Following the vote to leave the European Union, house builder shares dropped 40%, with housing experts predicting a slow-down in development. Development teams are reassessing ambitious plans to build more than 175,000 homes over the next five years. 'Inside Housing' published a development survey in July 2016 that revealed that 40% of starts by the fifty largest builders are either for open market sale or shared ownership, an increase from 36% the year before.

This leaves associations' development plans vulnerable to the slow-down in the sales market. David Montague, Chief Executive of London & Quadrant, told 'Inside Housing' that:

"Our business plans may adapt as things become clearer."

A spokesperson for Genesis, that had its credit rating downgraded by Moody's partly owing to its reliance on sales, said it will look again at its development programme. Inside Housing also understands other associations are formally reassessing risks for all major schemes.

Fiona MacGregor, Executive Director of Regulation at the Homes and Communities Agency, said:

"Organisations that are reliant on sales for surpluses which they are applying to support their development programmes, may say 'we'll pause to work through the impact of this before we enter new commitments'."

Associations have increased building in for-sale tenures to generate surpluses, in many cases to cross-subsidise building sub-market rent homes as grant disappears, but Matthew Bailes, Chief Executive of Paradigm Housing Association told 'Inside Housing' that:

"We have a much more pro-cyclical model of development than we have had before. In the last recession, we kept on building social rented housing through the downturn, but it is not clear that housing associations would be able to carry on in the same way this time around."

Some commentators have predicted that the turmoil in the market could encourage the government to restart grant for sub-market rent as a way of stimulating demand in the construction industry.

Local Authority Development

The Chartered Institute of Public Finance & Accountancy (CIPFA) has recommended six priorities to the new Prime Minister, Theresa May. One of these relates to housing. Rob Whiteman, the Chief Executive, said:

"Allow councils to build homes – Free up councils to build hundreds of thousands of new homes against future rent receipts through prudential borrowing; and taking advantage of unprecedentedly low interest rates to lift borrowing limits for the next decade. This would get construction moving and support more thriving communities.

Ministers and other commentators have indicated that the government may attempt to 'boost the economy' by increasing investment in infrastructure, including housing, at the autumn statement that is due on 23rd November 2016.

Building and Development Costs

There are likely to be increases in the costs of building maintenance and construction due to the reduced value of sterling and increased difficulties in recruiting labour from outside Britain.

Construction materials are estimated to have increased by between 6% and 12% since Britain voted to leave the European Union, putting building firms under pressure.

Ted MacDougal, Development Director for Forrest, told delegates at a session at Housing 2016 on the European Union referendum that these price rises would put contractors under pressure:

"Six to 12% in a five-day period is worrying, especially when you are poor contractor. Where is it going to come from: contractor's margins? Normally the trade is done at the point of purchase but the deals are in transit but I would predict between 6% and 12% typically. In the short to medium-term there will be a lot of contractors, us included, under a lot of financial pressure. We've just got to get on with it but be very fleet of foot, very capable, very efficient."

And Angela Jameson, a business and finance journalist wrote in the 'New European' that:

"House builders and construction related stocks have seen their values plummet on the stock market in the months after Brexit. Now Travis Perkins, which has builders merchants nationwide is saying that it is closing thirty branches, hitting 600 jobs in the face of uncertain trading."

The total value of net imports of building materials and components from the European Union was £4.9billion in 2015, according to the Office for National Statistics.

Housing Associations and Pensions

Volatility in the stock exchange because of the Brexit vote has raised fears that the deficit on the already underfunded Social Housing Pension Scheme could increase again. For example, financial consultant LCP estimated that on the day after the Brexit vote, movement in the equities and United Kingdom gilts markets added around £300million to the scheme's deficit in less than 24 hours, equivalent to the total added since the last valuation in September 2014. This meant that the overall deficit approached £2billion. Since then share values have recovered mainly due to the fall in the value of sterling but in the long-term greater volatility and reduced values could be expected.

Although the next calculation of the Social Housing Pension Scheme deficit is not due to take place until September 2017, the unprecedented increase is likely to dismay landlords that have seen their contribution to the scheme rise for a number of years.

The 700 housing association members that contribute to the Social Housing Pension Scheme had to increase their annual contributions by £32million from this April to tackle the latest deficit. A further increase in the gap between liabilities and assets in the scheme could see an even greater burden added to landlords' finances, despite plans by the Social Housing Pension Scheme to reduce the deficit.

Free Movement of Labour

One of the issues that was prominent during the referendum campaign and will be prominent during the negotiation of Britain's new treaties with the European Union will be the free movement of labour. Currently, citizens of any European Union state are free to sell their labour in any of the European Union states. One of the arguments for leaving the European Union that was put forward during the referendum campaign was that this right should be curtailed or removed.

Free movement rules give workers and other categories of European Union citizen the right to move across the European Union and have access to benefits. The rules on eligibility are complex. They are not based solely on membership of the European Union but of the European Economic Area that includes non-European Union countries like Norway. While nationals from these countries are generally able to enter the United Kingdom freely and, once resident, are eligible to apply for social housing, there are exceptions (such as job seekers). However, if the United Kingdom decides to remain in the European Economic Area to benefit from the free market in trade, and part of the agreement is maintenance of free movement of people, then the rules may stay the same – with the same categories of people still eligible.

Many of our public services including housing and housing maintenance rely on workers from other European Union countries.

Sue Evans, the President of the Public Service People Managers' Association and Head of Human Resources & Organisational Development at Warwickshire County Council is reported in the 'Local Government Chronicle' as saying that Councils will find it harder to employ the staff they need because of leaving the European Union, potentially affecting the quality of services. Mark Rogers, President of the Society of Local Authority Chief Executives and Chief Executive of Birmingham City Council has also said that there are potential staff shortages.

The construction industry operates on a pan-continental basis (remember 'Auf Wiedersehen Pet'?) with many British construction companies currently dependent on labour from other European Union countries. Any restrictions on the free movement of labour would have an adverse effect on their ability to provide construction, major repairs and revenue maintenance services to local housing authorities and housing associations at a reasonable price. Brian Berry, Chief Executive of the Federation of Master Builders told 'Inside Housing' that the United Kingdom construction industry is heavily reliant on migrant workers from Europe and 12% of British construction workers are of non-United Kingdom origin. He said that it was the government[1]s responsibility to ensure that the 'free-flowing tap of migrant workers from Europe was not turned off.

Migration and Housing Need

The Brexit vote has already led to speculation that there will be more controls over immigration and on migrants' eligibility for services such as welfare benefits and social housing. Nothing will change in the short term and timescales are not yet known. However, If European Union migration is reduced significantly, this could have a considerable effect on household growth and therefore on future housing demand. Across the United Kingdom, in any one year, about half of new migrants are from other European Union countries. In England, net migration (the difference between numbers coming in and going out) accounts for 37% of the projected growth in numbers of households over the next 25 years, hence demand for extra homes.

In Wales, Scotland and Northern Ireland, in contrast, migration is projected to have little impact on household growth.

However, the current household projections are now subject to revision once it becomes clearer what future levels of net migration might be. There is speculation, for example, that there could be a surge in European Union migration in the next two years, by those wanting to take advantage of the right to enter the United Kingdom before it is curtailed. An alternative scenario is one in which economic stagnation results in the United Kingdom becoming a country with net emigration rather than net immigration without the need for the government to take any action!

Apart from new migration, there are nearly three million citizens of other European Union countries already living in the United Kingdom (excluding those who already have United Kingdom citizenship). Some 70% have lived here for more than five years. It seems likely that all – or a majority – of those already here will be allowed to stay. If they do not, it will create severe problems for construction and other industries where many are employed.

Most new European Union migrants enter the private rented sector and, even if eligible for social housing, are unlikely to get a housing allocation until they have been in the United Kingdom for several years. Overall, 15.9% of European Union migrants are in social housing compared with 17% for United Kingdom nationals. In terms of new social lettings each year, only 4% go to nationals from other European Union countries. If new rules were to deny social tenancies to new European Union migrants, the effect on supply would therefore be very small.

The eligibility rules for housing or housing benefit are not likely to change soon although they may change in the long-term. In England, 'right to rent' checks on documents apply to private landlords and to housing associations where they make their own allocations. But any citizen of the European Union or the wider European Economic Area is not covered by the legislation and has an automatic right to rent regardless of their work or benefit status, until the rules change. If right to rent checks are later extended to Scotland, Wales or Northern Ireland, the same will apply.

Conclusions

It is difficult at this stage to be precise about the impact that Britain leaving the European Union will have on housing. Some implications are already apparent but these may be short-term rather than permanent effects. The long-term implications will depend on the 'deal' that the United Kingdom government manages to negotiate with the European Union and the policies that it chooses to pursue as a state outside the European Union.

A major issue is the effect that leaving the European Union will have on economic growth and the tax revenues of the United Kingdom government. Here, forecasts differ with some predicting short-term stagnation due to uncertainty followed by a return to rapid growth; and others forecasting lower growth or even contraction in the long-term. Which forecasts prove to be accurate will be critical but if economic growth and tax revenues fall that will have an implication for public budgets including those for housing.

Most commentators are agreed that house prices will increase less rapidly or may even decrease because of 'Brexit'. This will have implications especially for the balance sheets of housing associations and local authorities, the level of impairment in revenue accounts and their ability to make a surplus on market housing. Most commentators are agreed that the value of sterling will continue to fall and that will increase the costs of imported materials including building materials. With the United Kingdom government and housing associations facing reduced credit ratings, their ability to borrow despite low interest rates may become more constrained.

In the short-term the government is attempting to sustain demand in the economy through fiscal and monetary policies. It is planning to continue to borrow extensively to fund public expenditure until after 2020 and to reduce interest rates – perhaps even to a negative level. In my view this approach will prove not to be sustainable and will result at best in even more severe reductions in public expenditure than have been envisaged to date and at worst in a financial crisis of unprecedented severity. As 'Brexit' will force the United Kingdom to compete with developing countries such as China rather than with developed countries, reductions in public expenditure appear to be more likely than increases in taxation.

While the government is keeping interest rates artificially low in an effort to stimulate the economy; a combination of the declining value of Sterling and increasing inflation rates are likely to force them to abandon this policy and increase interest rates. Similarly, the policy of stimulating the economy by borrowing money to sustain a large public budget deficit will lead to increasing debt and reduced credit worthiness with the danger that at some point further borrowing will become impossible unless the government surrenders control of economic policy to its creditors. Any who would these creditors be? Multi-national banks or the Chinese government?

Increased restrictions on the freedom of movement of labour will adversely affect the ability of British businesses to recruit staff and this will be felt especially keenly in the construction industry. With increased raw materials prices and labour shortages the construction industry may be able to build fewer new homes in future than in the past rather than more.

Housing Association development programmes are likely to be affected by reduced credit ratings, reduced surpluses from market sales and the reduced capacity of the construction industry.

I am often accused of being a pessimist and it must be said that nothing is certain. My predictions may, therefore be proved wrong. However, in such a fluid and risky environment, the best advice for housing organisations is to ensure that they have robust business plans and a robust approach to risk management.

Adrian Waite
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'AWICS' is a management consultancy and training company. We specialise in providing support in finance and management to clients in local government and housing in England, Scotland and Wales. We are well known for our ability to analyse and explain complex financial and management issues clearly.

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