

21 December 2016

Briefing

Exiting the EU: updates, risks and opportunities

Summary of key points:

This briefing seeks to enable boards and executive teams to better understand the risks and opportunities associated with leaving the EU.

- The Government has committed to beginning the process of exiting the EU before the end of March 2017.
- There are a variety of possible legal scenarios. Those furthest away from EU membership carry the most risk for housing associations and bring the most opportunities.
- The National Housing Federation is working with the sector to shape an operating environment outside the EU which is as good if not better for housing association delivery than the status quo.

1. Introduction

Shortly after the EU referendum, the Federation published a [briefing to support members](#) to think about what the decision to leave the EU means for their business. Since then we have consulted widely and spoken about the issues raised at more than 15 member engagement

events, several Federation conferences and three external seminars with more than 600 members and at least 200 sector stakeholders.

Through these conversations we have learned that the mood of housing associations in response to the exit vote varies widely between and within the regions, and in organisations of different sizes and specialisms. Broadly we have identified three strategic priorities for the sector as a whole:

- care skills
- construction skills and materials
- flexible investment.

Many housing associations that we have spoken to have told us that the questions raised by exiting the EU feel quite distant and uncertain, and that the day to day management of their business is their priority. This briefing is designed to enable housing association boards to think about the risks and opportunities of leaving the EU to do so simply and constructively.

This briefing is broken into three parts:

- updates on the exit process and policy detail
- scenario-planning risks and opportunities
- Federation activity.

2. Updates on the exit process and policy detail

We published a detailed briefing, [The vote to leave the EU – considerations for housing associations](#), in July 2016. The substance of this earlier briefing need not be repeated.

2.1 The exit process

The Government has expressed its intention to trigger Article 50, the formal legal mechanism for commencing the process of exiting the EU, before the end of March 2017. The legal case decided by the High Court on 3 November 2016, and now in the process of being appealed to the Supreme Court, does not alter this intention.

The legal case concerns the constitutional mechanism for triggering Article 50 (whether notice can be given by the Government alone or requires an Act of Parliament), rather than the decision to exit the EU itself. The High Court decided that Parliament must give notice to exit the EU, but legal opinion is divided about whether or not this was the correct decision as a matter of constitutional law.

Whatever the Supreme Court decides (likely to be in January), either the Government or Parliament will trigger Article 50 as soon as is practicable. There is the possibility of a delay beyond March, and there has been some discussion about a possible General Election, or the intervention of MPs or peers to add caveats to the exit negotiations in the form of legislative

amendments. It is not appropriate to speculate about the likelihood of any of these occurrences. What is clear is that it remains the intention of the Government and of a considerable proportion of the political establishment to formally enact the decision of the electorate to exit the EU.

Two new government departments have been set up following the vote. They are the Department for Exiting the EU (DExEU) and the Department for International Trade (DIT). The Federation has been working with both departments directly, and indirectly through the Department for Communities and Local Government (DCLG) at a number of different levels.

DExEU will be responsible for overseeing the exit negotiations and establishing the future relationship between the EU and the UK. They are working collaboratively with every other government department, including DCLG and DIT. It is not yet clear which individuals will lead negotiations for the UK, but it is likely that senior ministers including Theresa May as Prime Minister will be closely involved.

Michel Barnier has been appointed chief negotiator for the European Commission. Other key negotiators include Martin Selmayr and Cecilia Malmström, both from the EU Commission, Didier Seeuws from the European Council and Guy Verhofstadt from the European Parliament. Negotiations from the EU side will be led by the European Commission, acting on a brief from the Council and the Parliament (the two key democratic bodies of the EU infrastructure).

2.2 Policy updates

Our briefing in July identified the following key issues for housing associations:

- securing private funding
- securing public funding (EU structural funding, the European Investment Bank and State Aid)
- construction and housing supply (labour and materials)
- procurement
- regulation
- the housing market.

Our consultation with members indicated that access to care workers is an additional business-critical concern for some housing associations, especially those providing supported housing and related services, often in partnership with private care providers.

The considerable uncertainty associated with many of these issues remains, and our original briefing provides an overview of their scale and potential impact. Additional intelligence on some of these issues worth noting include:

- The Government has committed to attaching a guarantee to all contracts under European Structural and Investment Fund streams (including the European Regional Development Fund (ERDF) and the European Social Fund (ESF)) which are signed before the UK has legally exited the EU. In practice, this means that funding up until 2020 should be secure.
- The [Farmer Review of the construction sector labour model](#) has found that 'based purely on existing workforce age and current levels of new entrant attraction, we could see a 20-25% decline in the available labour force within a decade'. These figures reveal the critical importance of securing long-term solutions to construction sector labour challenges.
- [Research by think tank Independent Age](#) estimates that 78,000 EU workers in the care sector risk losing their right to live and work in the UK, depending on future migration policy. This represents one in nine care workers in London.
- The question of whether housing associations in England are subject to the EU public procurement regime (OJEU) is once again up for discussion. The decision to apply the regime to housing associations came about because of a decision of the Court of Justice of the European Union (CJEU) against France in the early 2000s. The Federation is actively making the case to government officials that, outside the jurisdiction of the CJEU, this no longer needs to be the case.

3. Risks and opportunities

There are a number of risks for housing associations which might arise depending on the nature of the exit and the future relationship between the UK and the EU. Through our research and consultation with members, we have identified a menu of possible risks, which might inform board conversations about risk management. The table below outlines what these risks are, their timings, which housing associations are likely to be most exposed, and what the dependencies for each risk are likely to be.

As the exit process develops, this briefing should enable boards to maintain an informed conversation about EU exit risk which responds to developing policy.

Possible risks of the UK exiting the EU for housing associations

Risk	Timing	Exposure	Dependencies
There are macro-economic impacts which have not been factored into assumptions in business plans, including those relating to interest rates or inflation	At any time during exit	Housing associations with a higher percentage of variable debt	The greater the levels of uncertainty about the direction of travel post-exit the more likely this risk is to arise

Risk	Timing	Exposure	Dependencies
Lack of foreign investment drives down productivity and growth. If the Bank of England respond with quantitative easing measures, this could drive down interest rates on gilts.	Up to and post-exit	Housing associations with interest rate swaps	If the trading relationship and/or regulatory frameworks between the UK and the EU diverge significantly, this might be a disincentive for foreign investment
Housing associations lose access to European Social Fund (ESF) finance	Post-exit	Housing associations that carry out ESF-funded skills and apprenticeships work	Outside the European Economic Area or Swiss approaches (described in more detail below), continued access to ESF is highly unlikely
Housing associations lose access to European Regional Development Fund (ERDF) finance	Post-exit	Housing associations that carry out regeneration or green retrofit programmes funded by ERDF	Outside the European Economic Area or Swiss approaches, continued access to ERDF is highly unlikely
The UK loses access to European Investment Bank (EIB) loans for social housing	Post-exit	Housing associations that receive loans direct from the EIB, or those who receive funding through The Housing Finance Corporation (THFC)	Outside full European Union membership no country has access to EIB loans for social housing. As a shareholder in the bank it is possible that the UK might establish itself as an exception. THFC currently accesses significant EIB finance.
It becomes more expensive or more difficult to access private finance	At any time	All housing associations	If credit ratings agencies further downgrade the Sovereign rating, or ratings of individual housing associations
EU migrants working in housing associations and their supply chains, and/or who are housing association	Post-exit	Housing associations that employ, and/or sell or	If the Government places restrictions on EEA migration

Risk	Timing	Exposure	Dependencies
customers, lose their rights to live and work in the UK		let properties of any tenure to, EU migrants	
The construction skills shortage worsens as a result of a decrease in European Economic Area (EEA) migration	Post-exit and beyond	Developing housing associations, especially in London and the south east	If the Government places restrictions on EEA migration
A care and support skills shortage worsens as a result of a decrease in EEA migration	Post-exit and beyond	Supported housing providers, especially in London and the South East	If the Government places restrictions on EEA migration
Construction materials become more expensive	Through exit and beyond	Developing housing associations	If the value of sterling remains low or falls further, and/or if new trading relationships give rise to tariff or non-tariff barriers to trade
Contractor businesses fail	Through exit and beyond	All housing associations	There are many possible dependencies for this risk arising
The UK develops a new public procurement regime which is more expensive and/or more time consuming for housing associations	Post-exit	Most housing associations	Dependent on the new trading arrangement with the EU not incorporating the current OJEU procurement procedure directly, and the Government then choosing to develop a more costly process
The new trading relationship between the UK and the EU includes restrictions on government subsidies but without the protections for social housing grant which exist under the current State Aid regime OR the Government responds to the softening of subsidies	Post-exit	All housing associations that receive government grant	If the UK adopts a model similar to the EEA or Swiss approaches, the current State Aid regime will be applied as it currently operates. If the UK adopts a model further away from the status quo, it is more likely that these risks might arise.

Risk	Timing	Exposure	Dependencies
restrictions by making grant funding available to private developers at the expense of housing associations			
New trade deals outside Europe restrict government subsidies in the housing sector	On the completion of new international trade deals	All housing associations that receive government grant	n/a
The UK reshapes its regulatory regime to the detriment of housing associations in areas including VAT, employment law, environmental regulation, data protection and/or health and safety	Post-Great Reform Bill when individual ministers review legislation	All housing associations	Ministerial discretion
A slump in the housing market means that homes which housing associations are building are no longer saleable in particular tenures and/or geographies	At any time	Housing associations with greatest market exposure	There is a decrease in market confidence, interest rates or foreign investor interest
Cash-flows are negatively impacted by a shift from sale to renting because association debt levels remain higher	At any time	Housing associations that choose to shift from sale to rent	Housing association discretion

Possible opportunities for housing associations of exiting the EU

There are a three key opportunities for housing associations associated with the decision to leave the EU. The first is that we have a real opportunity to be right at the heart of the Government's conversations and help shape developing policy. The Federation has already been actively engaged in these conversations through the Department for Communities and Local Government, the Department for Exiting the EU and the Department of International Trade, as well as beginning to work with the Crown Commercial Service and the Department for Business, Energy and Industrial Strategy on procurement and State Aid.

Secondly, housing associations are vital stakeholders for national and local government to engage with, in part because 64% of housing association tenants voted to leave the EU. Politicians are actively seeking to engage leave voters, and housing associations are a possible conduit not just for having those conversations but also for delivering services to improve the life chances of “just managing” families and communities, some of whom voted for exit.

Finally, associations might have a part to play in recalibrating the way that we think about and deliver construction, care and investment. In January 2017 the Federation will be holding a series of discussion events to begin shaping some of this work. You can read more on this at section 4 below.

Risks and opportunities – legal scenarios

To put these risks into some context, below are four legal scenarios for what the new UK—EU relationship might look like. The Government has indicated that it will not pursue an off-the-peg relationship model, and so the real outcome is likely to sit somewhere on a spectrum from full EU membership to operation under WTO rules.

Beginning with the clear assumption that full EU membership is not a viable scenario, these four models in order of proximity to the status quo are below. Some have referred to these options existing on a spectrum from ‘soft Brexit’ to ‘hard Brexit’.

1. EEA membership – the Norwegian model
2. Bilateral treaties within the European Free Trade Area – the Swiss model
3. A Free Trade Agreement (FTA) – the Canadian model
4. The World Trade Organisation (WTO) approach

In the following sections we outline the broad principles of each of these approaches, and allocate the risks and opportunities that would most likely align with each.

3.1 EEA membership – the Norwegian model

The key principles of EEA membership are the retention of the four pillars of free movement: goods, capital, workers and services; financial contributions to the EU budget, and compliance with significant portions of EU regulation including State Aid and procurement rules.

Risks for housing associations

- ESF, ERDF and EIB finance.
- Possible construction and/or care skills challenges.
- Possible new or different pressures on the housing market.

Opportunities for housing associations

This scenario is closest to the UK's current status as an EU Member State. It is more likely to retain access to the funding which has enabled housing associations to deliver, and ensure that construction and care workforces remain buoyant and able to flexibly respond to changes in the market and levels of need. Because it is relatively similar, there is likely to be less change and therefore less scope for reform.

3.2 Bilateral treaties within the European Free Trade Area (EFTA) – the Swiss model

The key principles of the Swiss approach are the free movement of goods, capital and workers with slightly lesser financial contributions to the EU budget than under the EEA model. Significant portions of EU regulation are also included, albeit with reduced enforcement mechanisms for non-compliance.

Risks for housing associations

- ESF, ERDF and EIB finance.
- Possible construction and/or care skills challenges.
- Possible new or different pressures on the housing market.

Opportunities for housing associations

Like an EEA approach, the Swiss model might retain access to EU funding and free movement of labour to secure the future of the construction and care workforces. There are also fewer enforcement mechanisms for national breaches of EU rules than under full EU membership, although Switzerland is subject to the jurisdiction of the EFTA Court. Due to its similarity to EU membership, there is less scope for reform than might be viable under a hard exit scenario.

3.3 A Free Trade Agreement (FTA) – the Canadian model

The key principle of a Free Trade Agreement is the establishment of tariff-free trade in some specified sectors. There is no free movement of services, capital or workers in any FTA which is currently in operation. There would be no contribution to the EU budget. There would be some harmonisation of regulatory principles, in support of free trade objectives in those sectors to which the agreement applied. It is worth noting that since EU—UK regulation is currently harmonised to a significant degree it might be difficult to negotiate a change from the status quo. From a housing association perspective this could mean that the EU procurement regime (OJEU) and subsidies rules (State Aid) might be lifted directly into any potential EU—UK FTA.

Risks for housing associations

- ESF, ERDF and EIB finance.
- Possible construction and/or care skills shortage.
- Possible new or different pressures on the housing market.
- Imports might become more expensive.

- It might be more difficult or more expensive for housing associations to access private finance.
- The Government might make grant available to private developers at the expense of housing associations, or the State Aid regime might be incorporated without the exceptions which currently exist for social housing.
- The UK might reshape its regulatory regime to the detriment of housing associations.

Opportunities for housing associations

The Canada—EU trade deal includes some provisions which harmonise EU and Canadian law, where it is relevant for promoting free trade in the sectors to which the agreement applies. If the UK replicated a similar arrangement in its own relationship with the EU, depending on its scale, there might be scope to revisit a proportion of our regulatory frameworks.

3.4 The World Trade Organisation (WTO) approach

The WTO approach has a baseline principle of maximising free trade. As a full 'Most Favoured Nation' member of the WTO, the right to apply tariffs and offer subsidies must be agreed with the consensus of the whole WTO membership (163 states). Under this approach there would be no financial contributions to the EU budget, and no EU regulation (although under the WTO there are alternative procurement and subsidies regimes which would probably be applied instead).

Risks for housing associations

- ESF, ERDF and EIB finance.
- Possible construction and/or care skills shortage.
- Possible new or different pressures on the housing market.
- Imports might be subject to trade tariffs and become more expensive.
- It might more difficult or more expensive for housing associations to access private finance.
- The Government might make grant available to private developers at the expense of housing associations, or the State Aid regime might be incorporated without the exceptions which currently exist for social housing.
- The UK might reshape its regulatory regime to the detriment of housing associations.
- The new procurement regime (whether the WTO's Government Procurement Agreement or a new model) might be more expensive and more time-consuming to comply with.
- A slump in the housing market might mean that homes which housing associations are building are no longer saleable in particular tenures and/or geographies.

Opportunities for housing associations

If the UK were to trade with the EU under WTO rules, there would be no obligation to comply with EU rules and regulations (although continued compliance might in practice make the

trading process more straightforward). In this scenario the UK would have a blank page to revisit its regulatory frameworks, including on procurement. The WTO has a 'Government Procurement Agreement' (to which the EU is a signatory), which is much more principled and less procedural than the OJEU procurement regime in the EU.

4. Federation activity

The Federation recognises that, pending the outcome of negotiations between the UK Government and the EU institutions, there are possible business-critical risks for some housing associations connected to the UK's exit from the EU. We have consulted widely with our members and industry partners and have identified three strategic priorities for the sector as a whole. These are:

1. care skills
2. construction skills and materials
3. flexible investment.

The UK is leaving the EU and our operating policy environment is going to change. There are strong messages that asking for the status quo is not good enough. Either our sector can be a part of shaping our new environment, or we can accept what is designed for us further down the line.

We are making space to think boldly and creatively about how we might respond as a sector to some of the challenges raised by the EU referendum and exiting the EU. In early 2017 we will be holding a series of conversations between a selection of housing associations and our industry partners to flesh out this thinking in relation to our three strategic priorities (above). The outcome of these conversations will give us a sense of what the housing association offer in the context of housing and housing-related service transformation through Brexit and beyond might look like.

If you would like to be a part of shaping that conversation, please [get in touch with us](#).