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# Brexit – implications for real estate

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## How will Brexit impact upon the legal risks associated with UK real estate transactions?

Despite UK membership of the EU, real estate law in England, Wales and Scotland has remained essentially national with minimal intervention at EU level. As a result, Brexit will have little impact on the manner in which UK real estate is held or dealt with.

In particular, Brexit will not impact upon the legal formalities relating to property ownership, land registration, leasing and the taking of security over land in England, Wales and Scotland. It is this body of land law, which is certain, stable and commercially orientated, coupled with a transparent registered ownership system and investor friendly leases which makes English law attractive for real estate investors. This will not change.

Brexit is also unlikely to impact upon the property structures which are currently used or their tax efficiency as in general these do not rely on EU principles. Equally, the choice of English governing law for UK real estate transactions should be unaffected by Brexit and the same is broadly true in relation to jurisdiction clauses and the enforceability of English judgments (please see Allen & Overy's specialist papers on these topics which can be found at www.allenovery.com/brexit).

In relation to completed UK real estate transactions, Brexit should not impact upon the substance of existing contractual rights and obligations and any contracts or agreements which have been entered into will remain in full force and effect unless specific termination rights exist.

However, there are some areas of EU law which do impact upon real estate transactions particularly in relation to:

– the regulatory environment surrounding investment funds (such as the Alternative Investment Fund Managers Directive which provides the regulatory framework for AIF managers (including managers of real estate funds) and which critically allows for passporting into the EU – please see Allen & Overy's specialist paper on this topic at www.allenovery.com/brexit for further information);
– environmental legislation (such as the Energy Performance of Buildings Directive which sets minimum energy performance requirements for new and existing buildings and requires energy performance of buildings to be certified); and
– planning legislation (such as the Environmental Impact Assessment Directive which details the requirements for environmental impact assessments on development projects and the Habitat and Wild Birds Directives).

The future status of the relevant laws in these areas is currently uncertain and much will depend upon the nature of the post Brexit UK/EU relationship. However, it seems unlikely that the UK will turn away from these principles and it seems probable that much of the legislation which has emanated from the EU (particularly in relation to environmental and planning matters) will be retained. Scope will, however, exist to look again at these controls and this could assist UK real estate development.

# How will Brexit impact upon the legal risks associated with UK real estate finance transactions?

Real estate loan agreements typically have financial covenants relating to loan to value and interest cover. These will help to protect lenders against a Brexit related deterioration in value or income stream.

Other than specific Brexit termination clauses (which we have seen invoked) the view is that it would be difficult to rely on a general material adverse change (MAC) clause (even with a forward looking element) on the basis of a vote to leave the EU. However, this will depend on the specific wording of the MAC in each case. For more information on the impact of Brexit on financing deals, including a more detailed analysis of the position in relation to MAC clauses, please see Allen & Overy's specialist paper on the impact of Brexit on debt and equity financing transactions at www.allenovery.com/brexit).

# What will be the commercial impact of Brexit on the real estate market?

There is much less certainty as to the commercial impact of Brexit on the real estate market. In large measure this will be determined by the wider impact of Brexit on the UK economy and the sterling exchange rate.

In the run up to the referendum activity decreased as parties adopted a 'wait and see' approach and this looks set to continue. In the short term most commentators are in agreement that many investors and occupiers are going to sit tight whilst the new terms of engagement with Europe are negotiated. There is likely to be considerable market volatility with uncertainty over pricing, valuations and debt availability. Most valuers are already negotiating caveats to their valuations given the levels of uncertainty surrounding Brexit. This is likely to result in reduced prices and a reduction in the number of transactions in the short to medium term.

The impact of this can already be seen in the stock markets. House builder stocks have been badly hit along with listed property companies. Sectors such as manufacturing will be concerned about the potential reduction in foreign labour upon which they depend. There is an expectation of lower rents as occupier demand falls, particularly in the City of London and Canary Wharf where the overseas banks and financial service providers who use the UK as a base to gain passporting rights into the EU markets are located. There is concern that such organisations will move staff to cities within the EU such as Paris, Frankfurt and Dublin with a commensurate increase in occupier demand in these cities. However, other sectors may weather the storm better. The hotel and leisure industry, for example, could benefit from the fall in sterling which will increase the cost of holidays abroad and encourage foreign tourists to the UK.

At this stage with so many unknowns there is a considerable degree of crystal ball gazing. Cautious investors are likely to be deterred and will want to see how well the UK market operates outside the EU before entering/returning to the market. However, opportunities will also be created. A drop in pricing combined with low interest rates (now expected to stay lower for longer) and falling sterling could make the UK real estate market more attractive to international investors. It may be possible to take advantage of less competitive processes and secure 'bargains.' Savvy investors are likely to play a long game banking on the ability of the property industry to bounce back. Indeed, whilst we are seeing increased caution from European investors, there remains considerable interest in the UK from US and Asian investors and other investors with currencies linked to the US dollar.

Much of the commentary for the longer term is therefore more optimistic. In the coming months the impact of the referendum and the nature and timing of Britain's exit will hopefully become clearer. Many commentators emphasise that the factors which make the UK an attractive international business and cultural centre remain - a robust legal system, transparency, investor friendly leases and an open approach to overseas investment. These factors will be critical to the sector's long term resilience.

It is currently impossible to predict with any certainty what will happen to the UK commercial real estate market, particularly until we know what form Brexit will take and what it will mean for the wider economy. There will no doubt be opportunities. Careful pricing based on thorough due diligence will remain key. The UK commercial property market has clearly been impacted but is still performing well by historical standards and the fundamentals remain robust.

 

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