#02 2017

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UNDER THE EYE

A REAL ESTATE NEWS SURVEY

Brexit

A love-hate relationship... And it's not over yet!

How did Brexit come about?

What will happen next?

What are the potential economic consequences?

What are the repercussions on corporate real-estate investment?

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Brexit

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CENTRAL POSTER

Chronology
How did Brexit come about?

WHAT WILL HAPPEN NEXT?

«Brexit means Brexit». In January 2017, almost seven months after the referendum and facing criticism over her indecision and lack of determination, Theresa May asserted her resolve regarding her government's strategy. A clear, clean break from the European Union was outlined – a «hard» Brexit.

There was to be no more dilly-dallying, with Brexit veering between soft, hard, grey or even «red, white and blue» (reflecting the colours of the Union Jack) – epithets widely satirised in Britain, with alternative proposals including Lemon-and-Herb Brexit, Medium Rare Brexit and Bombastic Brexit.

Theresa May declared that there could be no vacillation. The UK wants to leave the European Union Customs Union and take back full control of its borders. A new partnership is sought but not with the status of partial or associate member, leaving the country half in and half out. The nature of this possible partnership will depend on future discussions with European delegates but there is no question of compromising on issues of sovereignty. Even if it means losing access to the single market. As Philip Hammond, the British Chancellor of the Exchequer, indicated in Welt am Sonntag, the Sunday edition of German daily Die Welt, if the European Union cuts the UK's access to the single market, the country will seek to revive its competitiveness by becoming a tax haven: «I personally hope we will be able to remain in the mainstream of European economic and social thinking. But if we are forced to be something different, then we will have to become something different.» The British government has also announced that it plans to cut the corporation tax rate from 20% currently to 17% by 2020.

The position is therefore clear, but London continues to wave the carrot and the stick. Hard Brexit does not preclude a smooth Brexit, i.e. an amicable divorce resulting in agreement between all parties. This outcome would avoid Black Brexit – a leap into the unknown due to failure to reach a negotiated agreement.

It is therefore shaping up to be a real game of chess, with the complex combinations of strategies and uncertain outcome that entails. Rather than clarity, it would be better to talk of contrasts between light and shade. This is no surprise since all the parties involved are entering unknown territory. Although, over the course of its history, the European Union has had to manage the integration of new members with a wide variety of profiles, this is the first time a country has chosen to leave. In fact, European rules did not even specify an exit procedure until the Treaty of Lisbon, signed in 2009. Many considered the idea absurd, since the scenario of a country wanting to leave seemed impossible. Lord Kerr, a British diplomat and committed europhile, was nevertheless tasked with considering the question in his role as Secretary-General of the Convention on the Future of Europe (the body responsible for drafting the European Constitution, which was eventually abandoned in 2005 after the French and Dutch referendums). As Lord Kerr explained, he drew up the only text now governing the British exit one evening at his kitchen table. The article was not subject to any particular discussion and was subsequently included in the Treaty of Lisbon, which replaced the draft constitution, under the name Article 49A (which became Article 50 of the 1992 Treaty on European Union, amended by the Treaty of Lisbon).

In February 2017, the House of Commons passed the law authorising Theresa May's government to begin the process of leaving the European Union by asking to invoke Article 50. The House of Lords began examining the bill and is due to give its final ruling in early March. While it appears unlikely that it will go against the vote by the British people, it is possible that it will seek to impose conditions on the government regarding the terms of departure. Whether or not this proves to be the case, it is unlikely to prevent Theresa May from triggering Article 50 before the end of March 2017, as she has promised.

This will begin a maximum period of two years for determining the terms of the divorce and future relations between the parties. The form of these negotiations remains a mystery. Article 50 does not provide any blueprint. Theresa May simply has the option of requesting its activation. But she could equally present a series of proposals as a framework for future discussions. This is the most likely option, according to Lord Kerr, the author of Article 50. A series of proposals will be put on the table, such as: «We, the United Kingdom, do not wish to be members of the single market except for financial services» or «We do not want any customs unions, except for the automotive industry.» And such proposals will likely be immediately

rejected by the other 27 members and by the European Commission's chief Brexit negotiator, Michel Barnier.

What next? Nothing. Nothing for several months. The European Union is entering a long electoral tunnel, with general elections due to be held in March in the Netherlands, from April to June (presidential and legislative) in France and, finally, in September in Germany. Not to mention Italy, which could hold early elections after summer 2017, following the fall of the Renzi government. This raises the possibility of a wholesale replacement of leaders across the continent, with as-yet unknown agendas. Negotiations with the UK will be put on hold while they establish themselves and put their teams in place (which may be a long process, as we are currently seeing in the United States).

We can therefore expect a period of tactical positioning between now and the end of the year. The serious business will begin from Q4 2017, leaving barely a year to reach an agreement. A year is not long to unravel an institutional, budgetary and legal entanglement created over half a century of tumultuous relations and avoid a dreaded Black Brexit. Unless the parties (all 28 countries) unanimously decide to extend negotiations, as provided for in Article 50. In the meantime, the UK remains a member of the European Union.

Article 50 of the Treaty on European Union

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.
2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament. 26.10.2012, Official Journal of the European Union, C 326/43 EN
3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.
4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it. A qualified majority shall be defined in accordance with Article 238(3)(b) of the Treaty on the Functioning of the European Union.
5. If a State which has withdrawn from the Union asks to rejoin, its request shall be subject to the procedure

WHAT ARE THE POTENTIAL ECONOMIC CONSEQUENCES?

A mishmash of ideas… Brexit is a divorce and as such inspires passions and dreams. More than six months on from the British vote, supporters and opponents are still battling it out with their respective predictions of the blissful or bleak future which lies ahead. And, on both sides of the channel, each camp cherry-picks from this chaos what suits them while lining up for the next bout. The boot's now on the other foot after the red carpet rolled out for French business leaders by Boris Johnson in 2012, when he was Mayor of London. Now French and Parisian authorities are seriously courting business leaders and entrepreneurs based over the channel and nervous about the loss of the European passport (see inset). Frankfurt, Berlin, Amsterdam, Dublin and others are also in the running. Their dream is to attract companies, management and high-paid employees in finance and ITC who are internationally open and will find it hard to tolerate a country turning in on itself – due to fears over the business hurdles this could present as well as the obstacles in terms of recruiting the necessary talent and skills. The boss of Easyroommate, a collaborative economy startup based in London, from where it manages its activities in around 20 countries, with employees of a dozen different nationalities, recently confirmed on France Info that such a move would be possible: «this is precisely what has made London attractive until now. If restrictions due to Brexit are confirmed, that would be a problem for us.»

He is not alone. HSBC recently announced that it will be moving around 1,000 staff from the British capital to Paris, representing 20% of the investment bank's turnover in London. These are staff who cannot legally operate outside the European Union. Nothing is official, but Goldman Sachs could do the same, although heading to Frankfurt. In mid-February, British employers highlighted increasing difficulties recruiting European nationals, who are essential in sectors such as retail, manufacturing, construction, hotels and catering. All these sectors will need to rapidly review their recruitment policies and no doubt also increase wages – or else change their economic model. Prestigious British universities are meanwhile complaining of a 7% fall in applications from foreign students since the referendum. Oxford University, which has appointed a Head of Brexit Strategy, is considering relocating some of its courses and qualifications to Paris. Along with other British universities, it would move to a future international campus. A campus enjoying French legal status and which would therefore continue to receive European funding.

The consequences of the UK's departure currently appear limited, however, insofar as the exit itself remains virtual.

This is no doubt because there is unlikely to be any revolution or sudden transition from the dark to the light (or vice versa). The priority of many companies is to adapt to the new regulatory and legal framework rather than leave. Although this will mean trimming their sails. At the same time as confirming the relocation of 1,000 jobs, Stuart Gulliver, managing director of HSBC, announced his conviction that «London will remain the dominant financial centre» in Europe. Some services and skills will go, but there is unlikely to be a mass exodus. As an example, approximately 20% of turnover in Britain's banking sector depends on the right to a «financial passport», representing between €26bn and €31bn. In terms of insurers, 28% of exported products are destined for countries covered by the passport, while 21% of assets under management in the UK are held on behalf of European Union clients. The Financial Conduct Authority (FCA), the UK financial regulator, estimates that 5,500 companies registered in the UK use 336,000 different financial passports.

In this scenario, London would be able to retain a recognised place for its specific skills. Recognised, or even dominant, as Stuart Gulliver said. Although perhaps not as dominant as before – a sort of «first among equals». Who will benefit? Paris and Frankfurt look in a position to cash in, thanks to the effectiveness and reputation of their banking regulators. The collapse of Irish, Belgian and Portuguese banks during the financial crisis has left its mark. The outcome is likely to be a more multi-polar organisation, favouring an approach based on individual business lines, with the industries in question seeking to avoid placing all their eggs in one basket, as they have done in London since the 1980s.

This restructuring of business centres remains theoretical for the time being, however, and will only really be tested according to the conditions for Brexit. Despite the posturing on both sides, it is still possible that the UK could eventually come out with a rather

favourable agreement. In the coming negotiations, Theresa May will face 27 other heads of state and government. This vast bloc will therefore provide numerous opportunities to divide and conquer. Europeans' capacity for division should never be underestimated – that was the warning issued by Jean-Claude Junker, President of the European Commission, in an interview with German radio station Deutschlandfunk in February 2017. London could also seek to obtain equivalence, a special status allowing its companies to companies to enjoy special access to the European area. This would require the European Commission recognising that British regulations are equivalent to those in force in the European Union – which will be the case immediately post-Brexit. Points remaining to be agreed will then relate to guarantees of subsequent non-divergence and organisation of dispute settlement (for which the European Court of Justice currently has jurisdiction). This possible, though somewhat unconventional, outcome for Brexit would turn on the head the maxim: «If it looks like a duck, walks like a duck and quacks like a duck...»

Moreover, the appeal of continental economies in the eyes of British and global businesses will only be reinforced by Brexit if they themselves remain committed to the European project. The europhile, eurosceptic or euroindifferent political options chosen by German, French and Dutch voters over the coming months will be decisive in this respect. For if there's no longer a European Union, then there's no longer a Brexit…

What is a financial passport?

The European financial passport is an obscure legal concept which has moved into the public arena as a result of Brexit. So what is it?

Firstly, there is not just one but several types of European passport. All financial activities regulated at European level are affected. A total of nine financial directives – concerning the collection of deposits, trading in derivatives, issuing of credits or bonds, payment services, portfolio management and, finally, insurance and mortgage brokerage – include a passport system. This enables a company to sell its products and services throughout the European Union and associated countries in the EEA (European Economic Area), i.e. Iceland, Liechtenstein and Norway. It covers banks, insurance providers, asset management companies, investment funds and finance startups (FinTech).

Only companies based in an EEA country are entitled to a passport. In order to access European markets, other companies must open a representation office in the EEA. This is the case, for example, with Swiss banks and insurance companies, which currently use London as their entry point to the European Union. Many US and Asian companies do the same.

Why are Liechtenstein and Norway members of the EEA but not Switzerland? Because membership requires the application of European rules and directives (or rules recognised as equivalent by the European Union) and recognition of the authority of the Court of Justice of the European Union.

The Hard Brexit scenario currently favoured makes it unlikely that the UK will remain in the EEA. That is the City's main cause for concern.

WHAT ARE THE REPERCUSSIONS ON CORPORATE REAL-ESTATE INVESTMENT?

The London market has traditionally been a mecca for corporate real-estate investment from continental Europe. Ever since statistics have been available, London has always attracted unrivalled investment volumes, far exceeding other European markets. Including Paris, which has managed to take second place in Europe, although as the eternal challenger.

Eternal? Not any more. A minor revolution occurred in 2016. With the help of Brexit, investors, particularly international investors, adopted a more wait-and-see attitude in respect of acquisition opportunities in the British capital and refocussed their attention on other cities in the European Union, starting with Paris. New investors, along with several Asian funds, therefore emerged, encouraging an acceleration in investment activity.

This situation has had a tangible impact on yields due to a scissors effect, since they have increased in London, while continuing to fall in Paris and other European financial centres such as Frankfurt.

As a result, the Paris market drew level with London for the first time ever in 2016. While the Paris region attracted €19.5bn in corporate real-estate investment, Greater London (Central London + M25) saw its investment volumes fall by between €18.4bn (based on the current exchange rate fixed at the end of 2016) and €21.2bn (based on a like-for-like exchange rate, as at the end of 2015).

Is this movement transitory or could it reflect a more long-term shift? Shock and uncertainty certainly led to a slump in London which magnified the fall in 2016. This will be subject to correction, as already demonstrated by the pick-up in investment volumes in Q4 2016. It is possible, however, in a reflection of movements on financial markets, that Brexit could reduce London's dominance in real-estate investment. Paris and cities such as Frankfurt would then benefit. However, this depends on their status as the entry points to a vast single market not being undermined by forthcoming elections. Until the outcome is known, a wait-and-see attitude could become widespread on the Continent.

	VOLUME INVESTED IN 2016	ANNUAL CHANGE	YIELD AT THE END OF 2016	ANNUAL CHANGE	TAKE-UP IN 2016	ANNUAL CHANGE	PRIME RENT AT THE END OF 2016 (IN €/SQ M/YEAR)	ANNUAL CHANGE
London (*)	€21.2bn (***)	↘	3.50%	↗	1.43m sq m	↘	1 530€ (***)	↘
Paris (**)	€19.5bn	↗	3.00%	↘	2.45m sq m	↗	770€	↗
Frankfurt	€4.7bn	↗	3.80%	↘	0.53m sq m	↗	460€	↗

(*): London including Central London and M25
(**): Paris including the Paris region
(***): On a like-for-like exchange rate, as at the end of 2015

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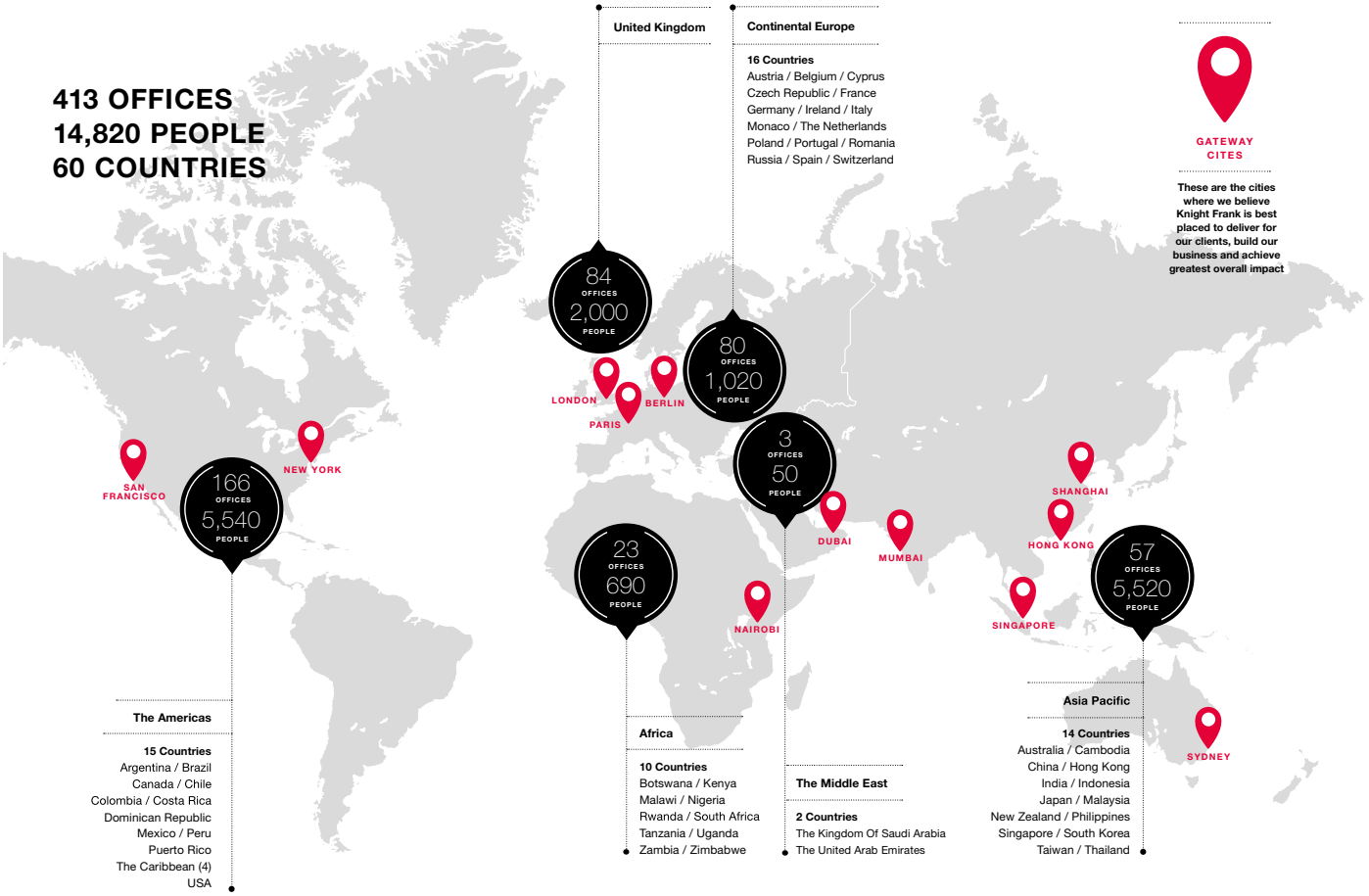

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HOW DID BREXIT COME ABOUT?

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EVENTS ON THE CONTINENT

EUROPEAN DECISIONS

EVENTS IN BRITAIN

1946 — **«We must build a kind of United States of Europe»** Winston Churchill (Conservative), Zurich speech.

1950

1957 — **The Treaty of Rome, creating the EEC (European Economic Community), was signed by 6 countries** (Germany, Belgium, France, Italy, Luxembourg and the Netherlands). The UK refused to become involved in this supra-national approach.

1960

1961 — First British request to join by Harold Macmillan's government (Conservative). French veto.

1967 — Second British request to join by Harold Wilson's government (Labour). French veto.

1969 — **Georges Pompidou became French President** and showed himself to be more open to British membership.

1970

1973 — **January: The UK joined the EEC,** at the same time as Denmark and Ireland. Edward Heath (Conservative) was the Prime Minister.

1973 — Denmark and Ireland join the EEC with the United Kingdom (9 members)

1973 — Labour was mostly against membership («No entry on Tory terms») and demanded a referendum, resulting in the resignation of their pro-European leader, Roy Jenkins (1972). A Conservative fraction, led by Enoch Powell, opposed membership.

1974 — Harold Wilson (Labour) became Prime Minister again and announced his desire to renegotiate the EEC agreement and then consult voters in a referendum.

1975 — The Dublin Agreement established an agreement on the correcting mechanism for the budget in favor of the United-Kingdom.

1975 — The Dublin Agreement established an agreement on the correcting mechanism for the budget. A referendum was held: 67% of British voters declared themselves in favour of belonging to the EEC. Labour remained strongly divided.

1979 — **« I want my money back »**. Margaret Thatcher (Conservative), became Prime Minster and sought renegotiation of the UK's contribution to the EEC budget, the correcting mechanism set out in the Dublin Agreement being deemed inadequate.

1980

1981 — Greece joined the EEC (10 members).

1981 — Labour's pro-European branch broke away to form the SDP (Social Democratic Party), which later merged with the Liberal Party in 1988 to form the Liberal Democrats (Lib Dems).

1983 — Labour leader Michael Foot asked for the UK to leave the EEC

1984 — An agreement on the British rebate was reached at the Fontainebleau summit.

1985 — Jacques Delors became President of the European Commission and stated his desire to relaunch European integration via a large single market based on free movement of goods and people.

1986 — Spain and Portugal joined the EEC (12 members).

1987 — Entry into force of the Single European Act, completing the internal market and expanding the competences of the Community and the European Parliament. Qualified majority voting became the rule for the internal market. The British government supported this integration providing it was restricted to the creation of a border-free single market.

1988 — Margaret Thatcher used her Bruges speech to reaffirm her categoric opposition to a federal Europe and the idea of specific resources for the EEC. She also opposed the creation of a single currency.

1989 — **« Wir sind ein Volk » (We are one people).** German reunification began after the fall of the Berlin Wall. Germany agreed to make the process part of a move towards European integration.

1990

1992 — **Treaty of Maastricht instituting the European Union (EU),** with the goal of economic and monetary union, a social charter and provisions relating to Common Foreign and Security Policy (CFSP) and policing and judicial cooperation.

1993 — Austria, Finland and Sweden joined the EEC (15 members).

1993 — **Opt-out**. The UK obtained an opt-out clause in the Maastricht Treaty exempting it from the social charter and the adoption of the euro. Despite this clause, the treaty faced strong opposition in the Conservative Party. John Major (Conservative), Margaret Thatcher's successor in Downing Street, had to threaten to resign to have the treaty approved. Creation of the UK Independence Party (UKIP) as the successor of the Anti-Federalist League (AFL, founded in 1991), notably appealing to the anti-European fringe of the Conservative Party.

1994 — Tony Blair became leader of Labour with a reformist and more pro-European agenda. UKIP won 1% of votes in the European elections.

1995 — **The Schengen Area came into force**, creating a space without internal borders between Germany, Benelux, Spain, France, Italy and Portugal. The Schengen Convention had been signed in 1990 (following the Schengen Agreement, signed in 1985).

1997 — **Treaty of Amsterdam institutionalising the Schengen Area**, defined as an area of freedom, security and justice and incorporating a social protocol. The UK, represented by Tony Blair (Labour), was a signatory but, along with Denmark and Ireland, obtained agreement to defer its application.

1999 — On 1 January, **the euro became the currency** of 11 European countries. Notes and coins entered into circulation in 2002. The United Kingdom and Denmark remained outside the European monetary process.

2000

1999 — UKIP won 7% of votes in the European elections.

2001 — Denmark enters the Schengen area. The United Kingdom and Ireland remain outside.

2004 — 10 countries in central and eastern Europe joined the EU (25 members).

2004 — UKIP won 16% of votes in the European elections.

2005 — The draft European constitution was rejected in a referendum by French and Dutch voters.

2006 — BOO (Better Off Out). Anti-European campaign launched by the Freedom Association and led in particular by former Conservative Party Chairman, Lord Tebbit.

2007 — Bulgaria and Romania joined the EU (27 members).

2009 — Following the rejection of the draft European constitution, the Treaty of Lisbon reorganised the European architecture. The Charter of Fundamental Rights would not apply to the United Kingdom or Poland. London won the right to only cooperate in certain areas, although without being able to prevent other members from moving forward.

2010

2009 — UKIP won 16.5% of votes in the European elections. In view of 2010 General Election, David Cameron (Conservative leader) committed to limiting the transfer of power to Brussels but rejected a referendum on the Treaty of Lisbon.

2013 — Croatia joined the EU (28 members)

2013 — David Cameron (Conservative), the Prime Minister since 2010, announced that he wanted to renegotiate relations between the UK and the EU and submit the result to a referendum if re-elected in 2015.

2014 — UKIP won 27.5% of votes in the European elections.

2015 — With Lithuania, 19 countries were now using the euro as a single currency

2016 — **BREXIT !** Following a campaign marked by immigration issues, British voters chose to end 43 years of EU membership by a majority of 52%. Theresa May (Conservative) replaced David Cameron in Downing Street with the task of beginning negotiations on the terms of leaving the EU.

2017 — Article 50. In February, the House of Commons authorised the May government to trigger the process of leaving the EU as specified in the Treaty of Lisbon (Article 50). The House of Lords will have the final say in March. Article 50 must be triggered by the end of March.