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OXFORD CITY COUNCIL

To:	**Finance Panel (Panel of the Scrutiny Committee)**
Date:	**4 September 2017**
Report of:	**Head of Financial Services**
Title of Report:	**The Implications of Brexit**

	Summary and recommendations
Purpose of report:	To update Finance Panel on the implications of the UK's decision to leave the EU on local government.
Key decision:	No
Executive Board Member:	Councillor Ed Turner, Finance & Asset Management
Corporate Priority:	Efficient Effective Council
Recommendation(s):	**That the Finance Panel resolves to:**
1. Note and comment on the report	

Introduction and background

1. The Head of Financial Services provided an update paper to the Finance Scrutiny Panel in March 2017 following the vote for Brexit on 23rd June 2016 and the triggering of article 50 on 29th March 2017 signalling the commencement of Britain's exit from the EU. This paper provides an update on the issues affecting the economy generally and Oxford City Council in-particular, since that paper.

Executive Summary

2. Before the referendum in June 2016, many economists produced gloomy forecasts of what would happen. In the post Brexit months this gloom did not materialise as predicted. Nationally the UK economy has struggled over the last few months and has been weak in comparison to EU counterparts. Inflation has continued to rise, which together with a falling pound against the Euro has had a negative impact on consumer confidence.
3. The Brexit event in June 2016 caused some initial unrest in the financial markets. Investment interest rates with banks and building societies decreased and have remained low with no recovery in base rates forecast until spring 2019; therefore, suppressed investment returns are likely to prevail for some time to come.

4. There appears to be little impact in the Oxford economy following the Brexit currently with 0.9% of the working population (measured by JSA claimants) compared to the national average of 4.5%. Income flows from fees and charges to the Council still seem buoyant, borrowing costs are the lowest they have been for many years and recent studies by the LSE's Centre for Economic Performance indicate that in either a 'hard' Brexit or 'soft' Brexit the effect on the economy within Oxford will be limited with larger negative impacts experienced by both London and cities in the South. In addition recent concerns around future investment by one of the city's largest employers, BMW, have since subsided.

5. Whilst negotiations have only just begun and it is early days it remains to be seen whether the national or local picture, as experienced in Oxford City, will improve or deteriorate. This will only truly be known when the UK has left the EU.

The story so Far

6. Following the triggering of Article 50 the Government officially opened negotiations with the EU on 19th June 2017. They were reported as saying that the most urgent items for discussions were:

   - Dialogue on Ireland.
   - Protection of Good Friday Agreement – ensuring the continuance of the Northern Ireland Assembly with a power-sharing executive, new cross-border institutions with the Republic of Ireland and a body linking devolved assemblies across the UK with Westminster and Dublin.
   - Maintenance of common travel area.

7. Phillip Hammond confirmed that Britain will leave the EU's single market and the bloc's Custom Union but in doing so it would look to secure the best deal for Britain's business and industry.

8. Initial negotiation groups that have been established include:

   - **Citizens' Rights** – The Government plans to seek a deal which ensures that Europeans living in Britain for 5 years will be entitled to new 'settled status', granting them permanent rights to healthcare, education, welfare, and pensions equivalent to British Nationals.
   - **Financial Settlement –** the potential cost is reported 60 billion euros

The implications of Hard and Soft Brexit

What is Hard and Soft Brexit?

9. **Hard Brexit -** Hard Brexit is at one end of the spectrum. It's about moving further away from the EU and cutting the main formal ties with the EU. Three of the ties that the Prime Minister talks about ending is the right of freedom of movement between EU countries, so that any citizen of the EU can work and live in any other EU country; the need to pay money to be a member of the EU; and the fact that EU law overrides UK law.

10. **Soft Brexit -** Soft Brexit is at the other end of the spectrum, where we continue to have close formal ties with the EU. It might look more like what Norway has, for example. They are in the EU single market which means they pay money, citizens can move between EU countries freely, and they have closer trade links than non-EU countries.

11. A recent paper produced by the LSE's Centre for Economic Performance (CEP) and Centre for Cities, examines the potential impact of both a 'hard' and 'soft' Brexit on British cities in the ten years following the implementation of new trade arrangements with the EU. Their conclusions are:

- All British cities are set to be negatively affected as a result of higher trade costs between the UK and EU, and this impact will be greater in the scenario of a 'hard Brexit'. Economic output in cities (as measured by Gross Value Added, GVA) is predicted to be 1.2 per cent lower on average under a 'soft Brexit' and 2.3 per cent lower under a 'hard Brexit' than if the UK remained in the EU.
- Cities with large shares of employment in private-sector knowledge-intensive services (KIBS), predominantly in the South, are predicted to be most negatively affected due to the increase trade costs linked to Brexit.
- Cities that are predicted to be most negatively affected by Brexit were more likely to vote remain in the 2016 referendum.
- Cities predicted to be most negatively affected tend to be more productive and have highly skilled workforces; which means they may find it easier to adapt in the longer term.

Impact across Local Authority Areas

12. Basic summary statistics for the impacts across Local Authorities are reported in Table 1 below. In line with the national estimates, the average Local Authority level effect is negative under both scenarios, and more negative under hard Brexit. As discussed above, this is not particularly surprising given that the same sectoral effects that underpinned predictions of the national impact are also used to predict the Local Authority level results. The average Local Authority decrease in GVA is predicted to be 1 percentage point larger under hard Brexit than under soft Brexit (-2.12% compared to -1.14%, respectively). These figures are essentially unchanged if we use the median instead of the mean, suggesting that there are no particularly extreme predictions that drive the average effect. The figures for the 10th and 90th percentile are also consistent with this interpretation.

Table 1: Basic Summary Statistics for GVA Impacts of Brexit on Local Authorities

	Soft Brexit	***Hard Brexit***
	%	***%***
Mean	*-1.14*	*-2.12*
Median	*-1.16*	*-2.11*
10th Percentile	*-1.34*	*-2.57*
Oxford City Council	***-1.0***	***-2.0***
90th percentile	*-0.91*	*-1.65*

13. Oxford contrasts with their headline statement to some extent, with a loss of 2% GVA under hard Brexit and 1.0% GVA under soft, and predicted to be in the 10 least negatively affected cities under a soft Brexit. Worthing, Slough, Swindon and Reading are among the top 10 towns that will suffer the most, with a predicted cut of between 1.4% and 2.8% in economic output, according to the study. Barnsley, Burnley, Blackpool and Hull are among the towns that will be least affected by the

split from Europe. The worst affected city is projected to be Aberdeen with 3.7% and 2.1% and under each scenario.

14. There is the following health warning which demonstrates the general uncertainty around the predicted impact over the long-term:

    "It is important to note that the model predicts the static effects of Brexit-related increases in trade costs on city economies. This is likely to underestimate the impact of Brexit as the model does not take account of the other effects of Brexit, for example on innovation, foreign investment and migration. Factoring in these additional effects at the national level increases the costs of Brexit to a loss of 6.3 per cent to 9.5 per cent of national income. The predictions also do not account for how cities might adjust to these shocks."

Investments and Borrowing

Credit Rating of UK

- The UK's Sovereign credit rating continues to stand at AA with negative outlook with both Standard & Poors and Fitch. This reflects their view of the economic uncertainty following the Brexit vote and the expectation of slower UK economic growth over the medium term.
- Since the last report, Moody's has also downgraded the UK's outlook from stable to negative
- The UK continues to be deemed less credit worthy than the US, Australia and Canada
- Yields on 10-year Government bonds have recovered from their historic low levels in June 2016 as markets have stabilised since the Brexit vote
- The shareholders of the European Investment Bank (EIB) are the 28 Member States of the European Union and the UK has a 16.11% shareholding in the EIB. This position has not changed since the Brexit referendum or the subsequent triggering of Article 50

Interest rates

15. The Bank of England's Monetary Policy Committee cut bank base rates by 0.25% to 0.25% in August 2016. Base rate looks set to remain low for the foreseeable future.

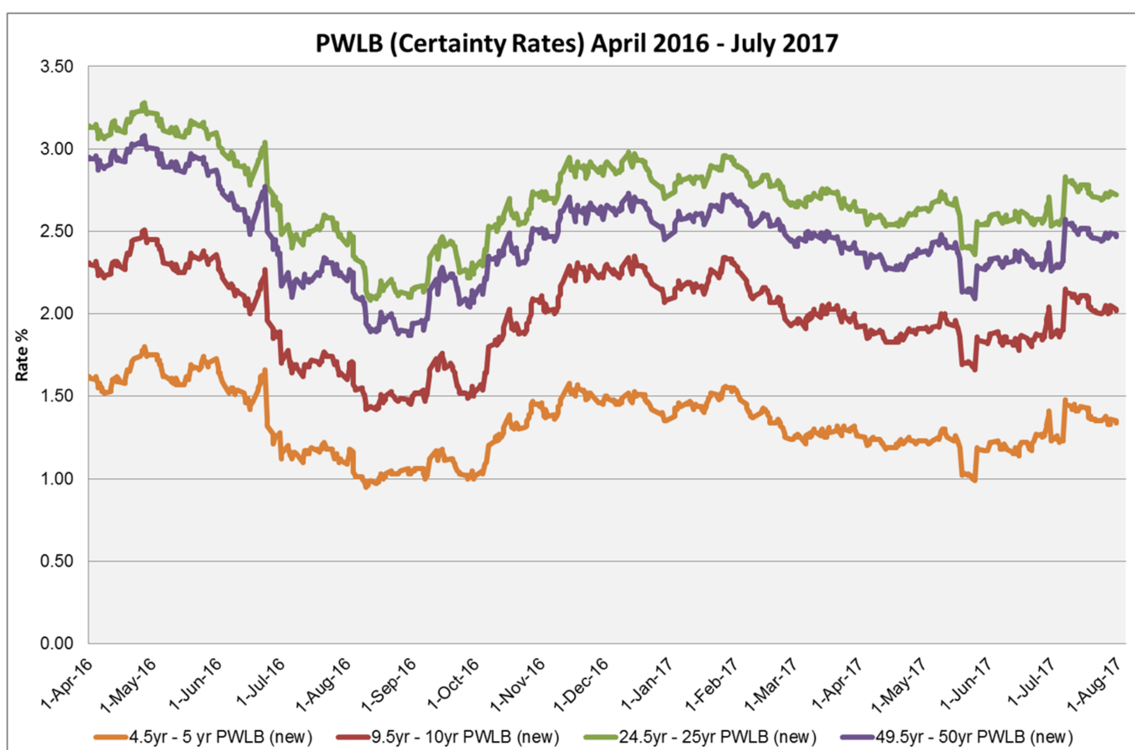
16. The Bank of England continued with their Quantitative Easing programme buying corporate bonds, in order to support the British economy. In addition the Term Funding Scheme which gives cheap funds to banks has continued. Both of these measures mean that banks are not short of cheap funds, meaning they don't need to offer very competitive investment rates.

17. Capita; the Council's Treasury advisors have revised their interest rate forecasts and expect base rate to remain at 0.25% throughout 2017 and 2018 before rising 0.50% in June 2019. This is shown in the table below.

Economic Forecasts – Capita Asset Services 31st July 2017

	End Q3 2017	End Q4 2017	End Q1 2018	End Q2 2018	End Q3 2018	End Q4 2018	End Q1 2019	End Q2 2019	End Q3 2019	End Q4 2019
Bank Rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%
5yr PWLB rate	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%
10yr PWLB rate	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
25yr PWLB rate	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%
50yr PWLB rate	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%

18. PWLB borrowing rates continue to fluctuate but remain at an all-time low. The chart below illustrates the movement in rates from April 2016 to July 2017 thus encapsulating the periods immediately before and after the Brexit referendum.



City Council Investments

19. As at the 31st July 2017, the Council held £90.06 million of Investments in the following institutions:

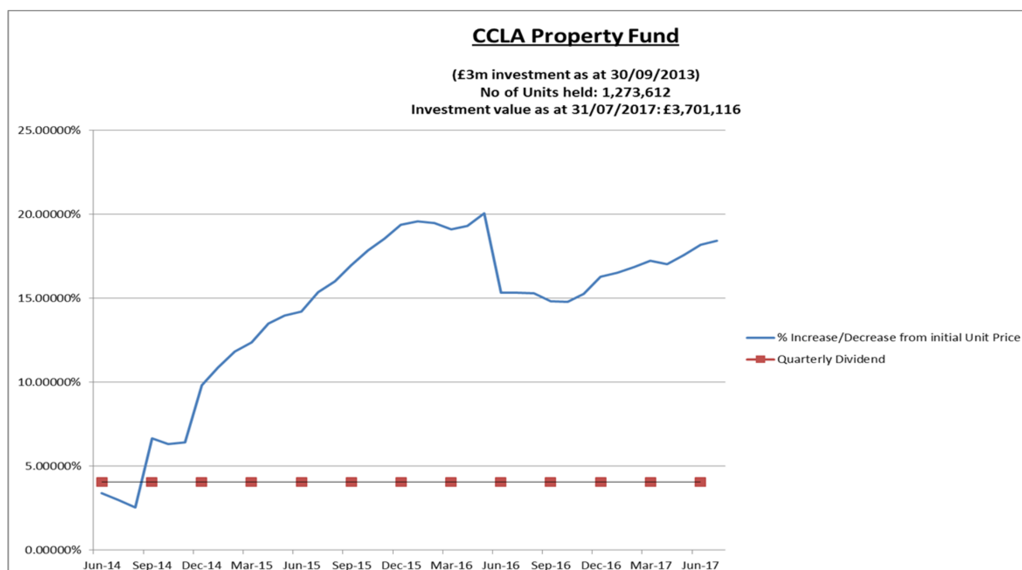
	Maturity Period			
	0-3 months £millions	**3-6 months £millions**	**6-12months £millions**	**>12 months £millions**
Banks	7	33.99		9
Building Societies		8		
MMF's	5.07			
Enhanced Cash Plus		8		
Local Authorities		6		3
Property Funds				10
Total	**12.07**	**55.99**	**0**	**22**

- Average investment returns in July 2017 was 0.55% for banks and building societies excluding property funds and 0.94% including property funds. This position remains relatively unchanged since the last report in March 2017 when the return was just 0.01% lower. Although it would appear that the market has stabilised in the last 6 months, rates remain less attractive, averaging 0.30% for a 6-month trade.
- Investment duration limits have remained constant at 6 months. As mentioned above banks are not short of cheap available funds and seen as relatively stable institutions.
- Within the medium term financial plan an amount of £1,047k has been included for investment interest based on an average interest rate of 0.38% excluding property and 1.57% including property funds. With the base rate decrease and the potential for a further decrease it is likely that this financial pressure will increase.

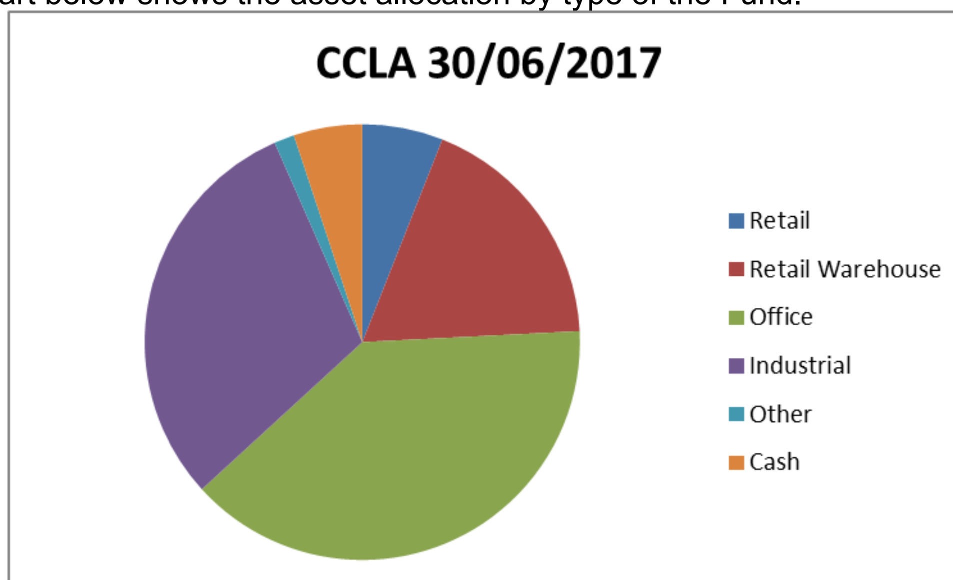
Property Funds

20. The Council has invested in three property funds. The primary reason for the Council investing in the CCLA and Lothbury property funds was to achieve a revenue return. Following the Brexit vote, the capital value of these funds fell, as concerns over slower economic growth and in turn demand for commercial/office property grew. As those concerns eased, both funds have recovered their value and in the case of Lothbury, levels have surpassed the pre-Brexit position whilst CCLA is almost back to its former position. Both funds are still significantly above their purchase value. Investments in property funds are long term and it is expected that there will be fluctuations in the capital value throughout the period that the property fund investments are held. More detail on the property funds the Council holds are as follows:

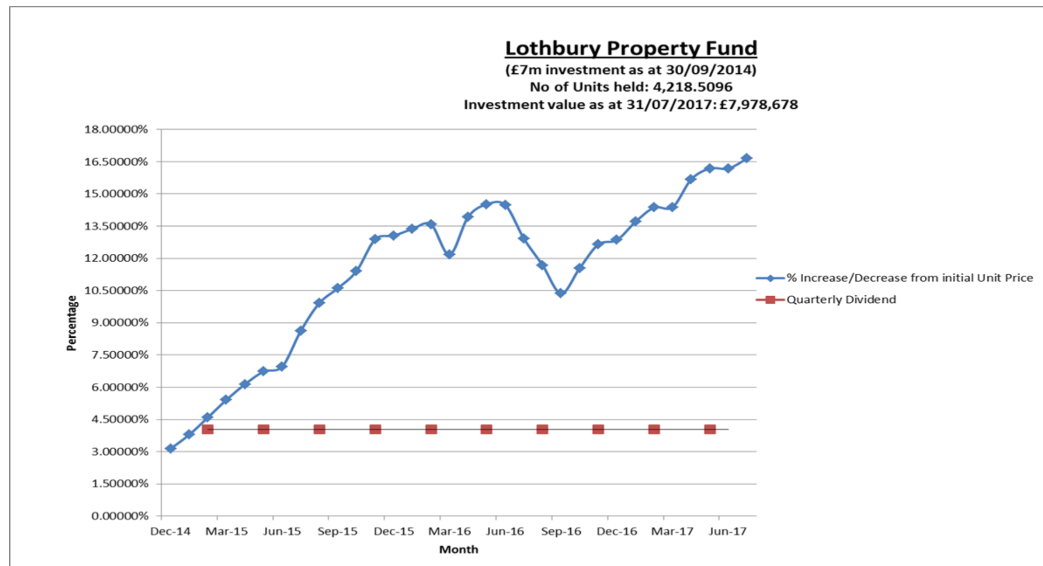
- **CCLA** – £3 million investment in the Local Authorities Property Fund held in two tranches. The total capital value as at the end of July 2017 was £3,701,116
- The Council has enjoyed growth since joining the Fund although the Brexit result did have a considerable effect on the net asset value as shown on the chart below. It has gradually recovered some value and the fund managers are confident the Fund will continue to improve via careful asset selection, tenant management and property improvement. As at 30 June 2017, the fund size has grown to £765 million
- The Fund managers believe the portfolio of properties remains attractive with strong and robust long-term tenants, low void rates of 4.8%, no gearing and relatively low exposure to City of London and Central London properties
- The Fund still allows redemptions.



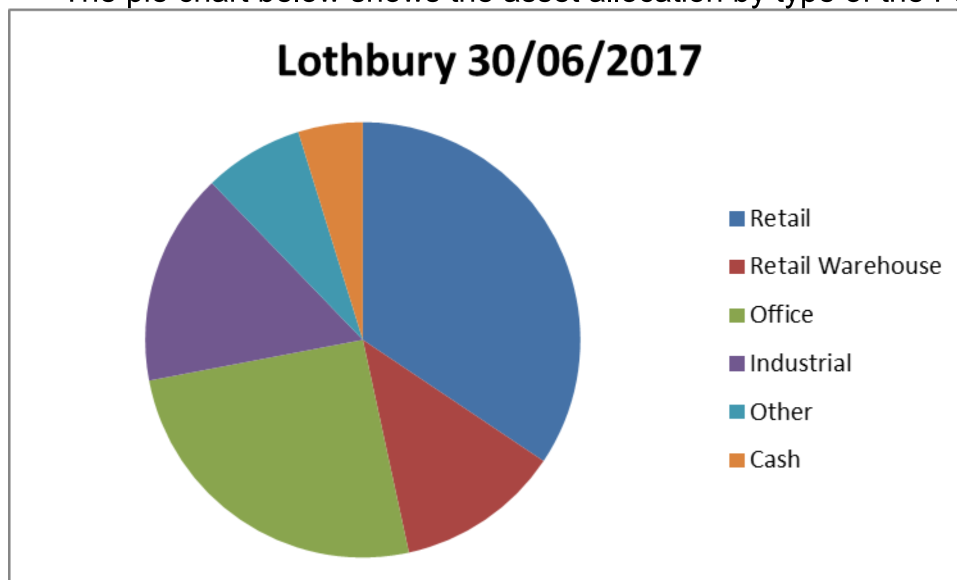
The pie chart below shows the asset allocation by type of the Fund.



- **Lothbury** – £7 million is currently invested in the Lothbury Property Fund held in two tranches. The capital value as at the end of July 2017 was £7,978,678.
- The Council has enjoyed growth since joining the Fund, although the Brexit result did have a considerable effect on the Fund as shown on the chart below. However the Fund has recovered strongly and has now surpassed its pre Brexit levels. The Fund managers believe the Fund comprises investments in prime properties that are high quality, well located and secured with excellent tenants. As at 30 June 2017, fund size was £1.597 billion
- The Fund still allows redemptions



The pie chart below shows the asset allocation by type of the Fund.



- **Real Assets Lettings** – At the end of 2016, the Council invested £5million with match funding from the Big Society to purchase houses for homeless families. Although essentially this is a service requirement, the Council expects to achieve a 3% rate of return commencing in 2017/18 as well as a share in the uplift in the value of the 50 properties purchased

Borrowing

21. Within the Council's Medium Term Financial Plan, provision has been made for the following prudential borrowing:

	HRA	General Fund	Housing Company	Total
	£000's	£000's	£000's	£000's
2017/18	-	14,712	3,000	17,712
2018/19	-	5,039	29,000	34,039
2019/20	-	708	17,000	17,708
2020/21		705	12,000	12,705
Total	-	21,164	61,000	82,164

22. There is currently no external borrowing on the General Fund, or Housing Company. The HRA currently has £198million of fixed interest self-financing debt. In addition the Council currently has around £20 million of internal borrowing and reserves and balances of around £60 million which potentially provide additional headroom dependant on the Council's expenditure profile. However, as highlighted earlier; borrowing rates are at historically low levels so officers are monitoring the situation carefully.

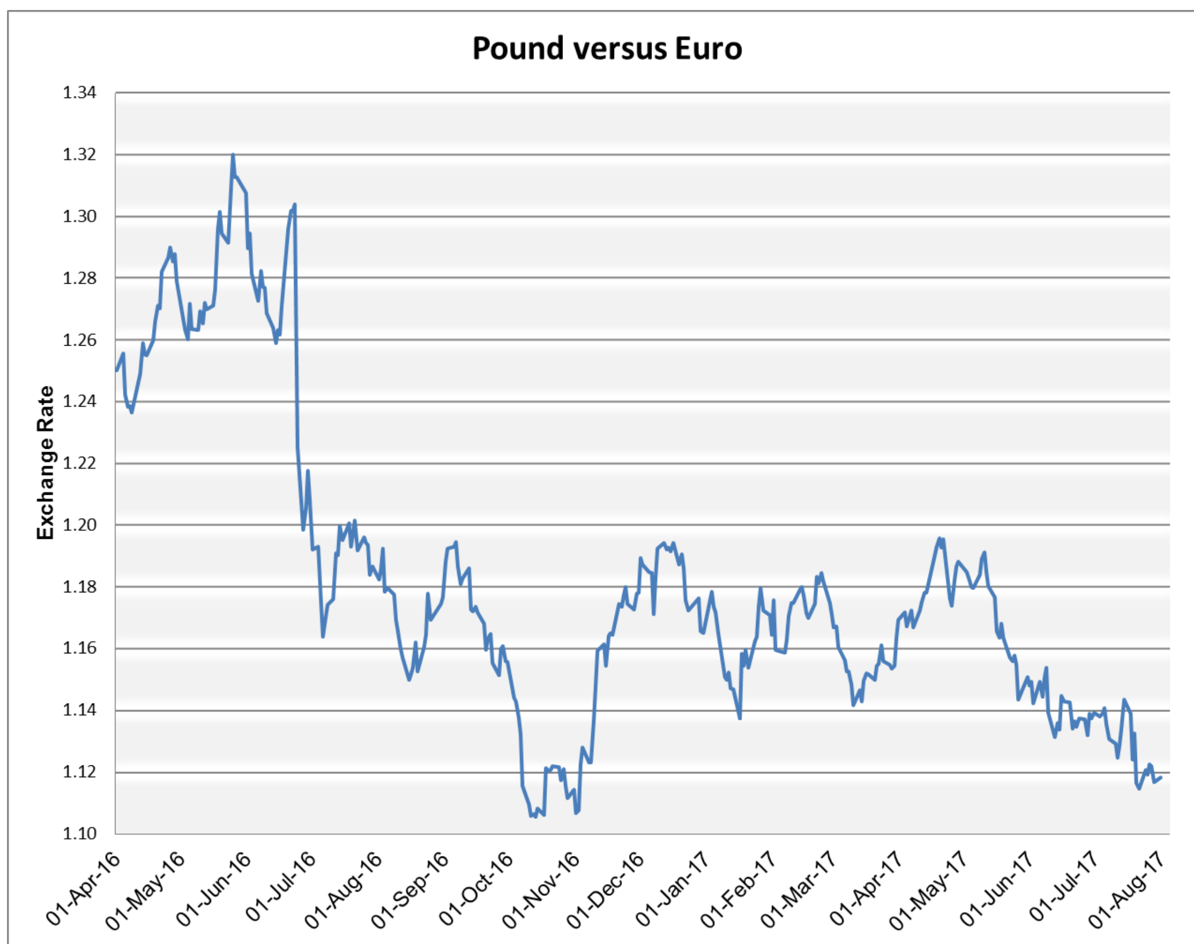
Britain's Contribution to the EU

23. From 2010 to 2015, the UK's average annual gross contribution to the EU amounted to around £16.8 billion. However the UK also receives a rebate and funding from various EU initiatives. This means that the UK's average annual net contribution to the EU budget over these same years is estimated to be around £8.8 billion, or around 0.5% of GDP.

24. Although in the near term budgetary contributions to the EU must still be made, and funding flows into the UK will continue, the longer term position is uncertain and is dependent on the exit negotiations between the UK and the EU.

Pound versus Euro

25. The pound has fallen consistently against the euro since the Brexit vote to a current low of 1.11 as at July 2017. This compares to a 52 week high of 1.20 euros and a peak of 1.32 euros in May 2016 before the Brexit vote. Whilst the fall in the pound has helped exporters it has made many imported goods more expensive and foreign holidays more expensive for British tourists !



EU Funding

26. As previously reported the City Council has actively pursued European Funding for relevant projects in recent years. Additionally, the Local Enterprise Partnership (LEP) has secured funding from the European Structural Investment Funds (ESIF) (c£20million). In December the city council was awarded a contract by the Big Lottery Fund to manage a programme of employment support and training for unemployed young people in Oxfordshire. “Unlocking Potential for Oxfordshire” is a new project that will receive up to £734,000 over the next three years as part of the Building Better Opportunities (BBO) programme, jointly funded by the Big Lottery Fund and the European Social Fund (ESF).

27. In recent announcements the Local Government Association (LGA) has called on Whitehall to grant councils the £8.4 billion they were due from European Structural Investment Fund between 2014 and 2020 amid concerns over EU regeneration funding

EU Obligations

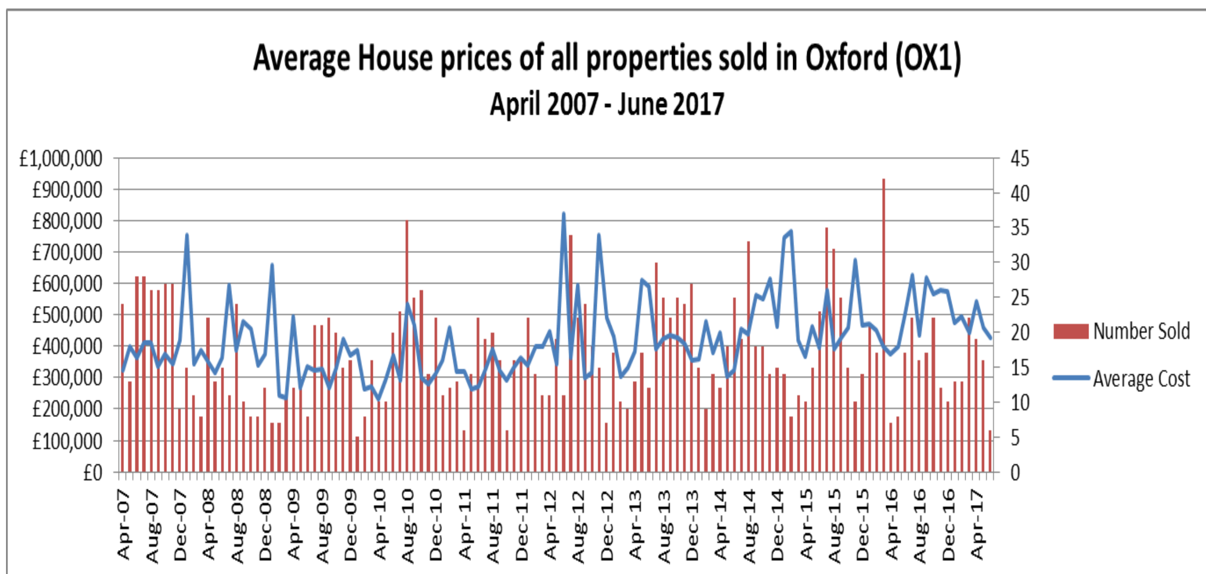
28. There are a range of EU obligations affecting local authorities. Procurement, local economic development, waste and employment are all determined by EU regulations. It is probable that some of these regulations will remain enshrined within UK law, others may be repealed or overturned in the fullness of time.

State Aid Rules

29. Potentially some EU state aid rules would be relaxed, which could mean it is easier in some circumstances to support companies with public funding when warranted, although we would still have to comply with restrictions that may be imposed as part of a negotiated European Free Trade Agreement. The Council has applied state aid rules in the calculation of interest charged on loans made to the recently established Housing Company and similar calculations will be applied to loans to the Councils Local Authority Trading Company

House Prices

30. UK house prices fell for the third consecutive month in May 2017, the first time since the financial crisis and despite small increases in June and July the annualised growth figure still dropped from 3.1% to 2.9%. It is fair to say however that even with the recent market fluctuations the average cost of dwellings in Oxford continues to be buoyant.



31. UK house prices accelerated in February 2017 rising by 4.5% in a year according to Nationwide. The outlook for the market however is uncertain with the Nationwide predicting a 2% rise in UK house prices over the course of 2017.

UK Gross Domestic Product Growth

32. The UK economy was the worst performer in the European Union in the opening months of 2017 as the Brexit vote took its toll, according to official statistics that underscore the challenge facing the next British government.

33. With economic growth of just 0.2% in the first three months of this year and 0.3% in the second 3 months, the UK was well behind its European neighbours. Official EU figures showed the growth for the whole of the EU was 0.6% in the first quarter. The Eurozone single currency bloc also grew 0.6% in the opening quarter, buoyed by strong domestic demand.

34. Every nation in the 28-member bloc reported first-quarter GDP figures growing faster than the UK. The strongest expansion was in Romania at 1.7%, followed by Latvia at 1.6% and Slovenia at 1.5%. The closest countries to the UK's weak pace of growth were France and Greece, with GDP growing 0.4% in both.

35. However, in year-on-year terms the UK was closer to the EU performance and ahead of the 19-nation Eurozone. After a strong second half to 2016, when the economy defied predictions of a post-referendum slump, UK GDP was still 2% bigger in the first quarter of 2017 than a year earlier. The EU's economy was 2.1% bigger on the year while the Eurozone was up 1.9%.

36. Recent business surveys have suggested the UK economy has picked up some momentum in the second quarter after its slow start to 2017. But with higher inflation weighing on consumer spending, most forecasters expect growth to be lackluster over 2017 as a whole and even weaker in 2018.

37. The main pressure is expected to come from higher inflation, stemming largely from the pound's sharp fall since the Brexit vote last year (see below). That has made the many imported goods to the UK more expensive and been passed on to consumers. Wages meanwhile have failed to keep pace with those price rises and so workers are worse off in real terms and have been cutting back.

"Brexit has been partly to blame for slower UK growth, as higher prices due to lower sterling and uncertainty hit retail spending and the willingness of firms to invest," said George Buckley, economist at the financial firm Nomura.

"But it's not all bad news – this is as much a story about global strength as it is about downside risks to the UK, which should eventually support exports"

Employment

38. In recent announcements it has been reported that almost a million EU citizens are either planning to leave the country or have already made their minds up to go as a result of Brexit.

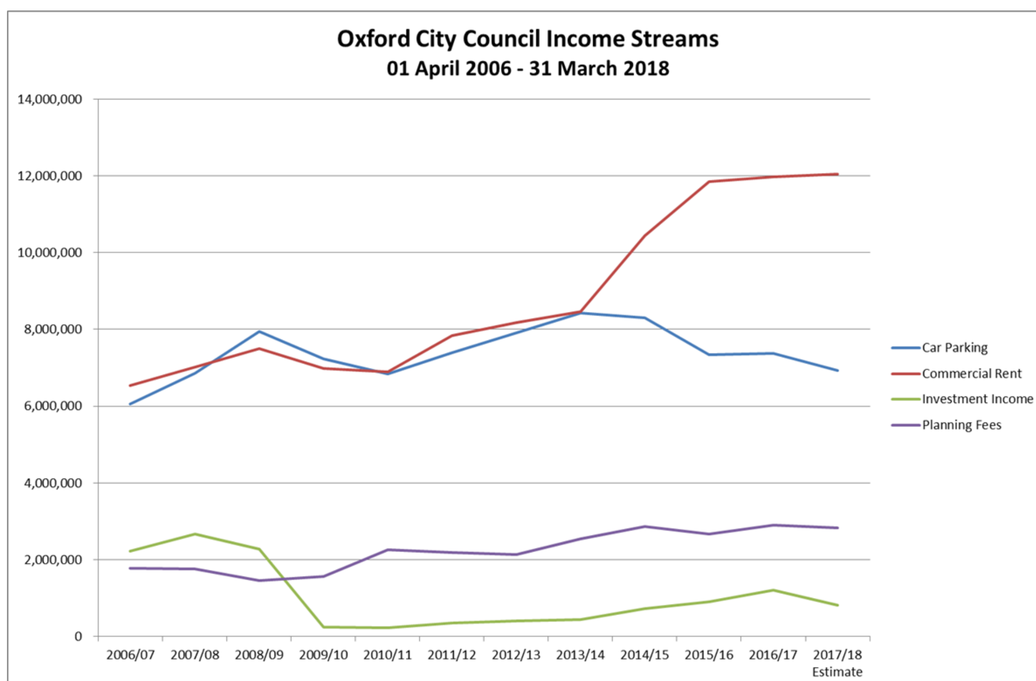
39. A survey of 2000 EU workers in Britain by KPMG found that 55% of those with PHds and 49% of those with postgraduate degrees were either planning to go or were actively considering it. The fall of the Euro against the pound has compounded these views to the extent that some foreign workers see little financial gain to working in the UK.

40. In Oxford City Council we currently have 146 employees who may be EU nationals (89 undeclared and 57 specified on ITRENT). The cost of applying for a UK Registration Certificate or Permanent Residence Card is £65 and in order to mitigate additional recruitment costs the Council has agreed to fund this cost at a total potential cost of £9,490. To date only 7 employees have applied for the reimbursement. Whilst these are relatively small numbers in comparison to the Councils workforce, the Councils does make use of temporary recruitment agencies to fill temporary absences which could have a bigger effect on the council's ability to recruit in these circumstances.

The Council's Key Income Streams

41. For an indication of what the effect of Brexit may have on the Councils own income streams it is worth looking at what happened in the last recession and the effect on some of the Council's main income streams, i.e. car parking, planning fees, investment income, commercial property income and Business Rates. It will appreciated that past history may not be reflective of the future.

42. Following 6 successive quarters of negative growth the UK finally moved out of recession in the final quarter of 2009. The graph below shows the Councils' main income streams between 2006/07 and 2016/17 which shows the trend before, during and after the recession.



43. The main observations include:
- The figures for 2017-18 are based on actuals up until August 2017 and then estimated outturn for the remaining 7 months.
- Investment income dropped significantly as base rates were cut to 0.5% and will drop further following the cut to 0.25%
- Some dip in car parking income in 2010/11 but equally this could be explained by the transfer of 2 park and ride sites to the County Council. Car parking income in 2016-17 at year end will be in line with 2015-16 levels.
- Planning fees show some plateauing in 2008/2009 but with steady growth thereafter
- Commercial rents have continued to climb over the period, more significantly in 2014/15 which arises due to the switch of car parking income from the Westgate in favour of a fixed rental from the Westgate Development Partnership.

Focus on Investment Property

44. The Council has a commercial portfolio that currently is estimated to deliver a rental stream of around £12m in 2017/18.

Analysis of Commercial Property Rental Income By Type of Holding

Property Category		Annual Rent	% Income
Agricultural	£	14,350	0.1%
Café/ Snack bar	£	232,550	2.0%
Easement	£	10,276	0.1%
Hotel/Guest House	£	168,500	1.5%
Licence	£	333,178	2.9%
Mooring	£	47,643	0.4%
Residential	£	1,148,843	10.0%
Restaurant	£	1,496,079	13.0%
Retail	£	5,636,660	48.8%
Offices	£	1,806,336	15.6%
Light Industrial	£	226,296	2.0%
Community Facility	£	101,390	0.9%
Museum/Theatre	£	320,000	2.8%
Total Budget	**£**	**11,542,100**	

Retail Catergory includes Covered Market and all income expected from Westgate Development

45. There has been no marked change in income since the Brexit decision.

Business Rates

46. The business rates net collectable debit in Oxford City is shown as follows

Business rates net collectable debit	
	£000's
2013/14	85,581
2014/15	86,669
2015/16	88,488
2016/17	89,497
2017/18	91,129

47. The table above shows our Business Rates income has remained resilient despite all the development going on in the City Centre. From October 2017 we can expect to see growth through the new Westgate development. In the latest 2017 valuation list (dated July 26th 2017) we have 23 properties with rateable values of £1 million or over totalling £61.1 million (24.3% of total rateable value) out of a total of 4,059 properties with a total rateable value of £251.5 million.

48. Our second highest assessment is the BMW Motor Vehicle Works in Garsington Road (RV £8.6m). In recent announcements in July 2017 BMW confirmed that the next generation mini would be built in Oxford. There had been fears that future investment in the battery-electric Mini could be hampered due to uncertainty surrounding Britain's departure from the European Union. Production of this vehicle is due to commence in 2019. In a recent update the German car giant BMW

insisted that it did not ‘seek or receive’ any assurance from the Government on post Brexit trade before making its decision. Ministers faced questions last year about any assurances given to Nissan before the company announced that new versions of its Qasqai and X-Trail would be made in the UK.

49. If production is moved away from Oxford the rating assessment could be drastically reduced with the authority dropping to safety net in respect of Business Rates Retention, a loss of around £450k per annum. The knock on effect to the Oxford economy could be significantly worse than this.

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Background Papers: None