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# Foresight

**A global infrastructure perspective**

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## Brexit & UK infrastructure: what next?

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**Prime Minister David Cameron has resigned and Theresa May is the United Kingdom's new leader. With several twists and turns over the past few weeks, Brexit has already had a dramatic impact on British politics. We focus on what it might mean for UK infrastructure.**

The consistent message from Government is that the UK is open for business and infrastructure projects 'in the bucket' should continue as before. In terms of Brexit, the future hinges on Theresa May's road map to negotiate the country's exit from the European Union (EU). In her first hours in office, May appointed two new positions for 'Leave' campaigners David Davis and Liam Fox. Davis is to become the Secretary of State for Exiting the European Union and Fox the Secretary of State for International Trade. She also named Philip Hammond as the new Chancellor of the Exchequer, and Boris Johnson as Secretary of State for Foreign and Commonwealth Affairs.

Markets have reacted positively and confidence is growing thanks to increased certainty following a quick political transition. However, uncertainty remains as to when the Government will actually trigger Article 50 formalizing the UK's intention to leave the EU. It will not happen immediately and there appears to be time for companies to continue to study the impacts of Brexit and prepare for it. Critically, politicians and civil servants also have time to fully develop their thinking.

### Funding

Public finances were tight before Brexit and remain so. The Bank of England is holding steady on interest rates at 0.5 percent but could announce stimulus in August. The good news for infrastructure businesses is that Theresa May is actively thinking about the sector and has suggested the use of UK Treasury-backed bonds to fund projects. The post-Brexit downgrade of the UK sovereign ratings could affect the gilt rates and has already impacted local authority and university projects. This could be extended to housing associations. Longer-term, the UK economy is still a safe bet and there may be a flight to infrastructure investments as volatility in other sectors increases. However, with limited opportunities to invest, supply is unlikely to outstrip the demand providing a brake to increasing pricing.

The extent to which European Investment Bank (EIB) funding will be available going forward is unclear. From 2011 to 2015 the EIB invested more than €29 billion in the British economy, and the bank has indicated that it is currently proceeding with 'business as usual'. EIB does lend to projects in the European Economic Area (EEA), but not at the same level as within the EU. If the EIB were to decrease its lending into the UK market, infrastructure bonds or more expensive commercial options might fill the gap but you would likely see a direct impact on pricing. The UK has become accustomed to low interest rates and any increase will have an impact on the affordability of future projects.

### Procurement

In terms of procurement and environmental standards, UK public bodies will no longer be subject to EU rules post-Brexit, and may have greater flexibility. However, countries with access to the EEA single market typically follow EU procurement rules and use the Official Journal of the European Union (OJEU). In any event, the UK Government favors an open playing field which includes non-public providers and thus regulated procurements and competitions are likely to continue to be implemented to show that decisions are fair and in the public's interest.

### People and skills

Immigration controls, free movement and the future status of EU nationals living in the UK are two of the core issues of Brexit uncertainty. International businesses benefit massively by the mobility of labor and being able to attract talent from across the world — not just Europe. Infrastructure businesses are no different. Ten percent of construction workers are reported as being born outside of the UK. Whether you run a hospital and need access to doctors or a building site and need access to a technically skilled labor force, the reality is that immigration has served to fill the gap for many UK businesses. The uncertainty will be felt immediately as potential employees and employers weigh options and may choose to migrate to more stable economic environments.

## Transport

Theresa May has promised an "early decision" on a new runway at Heathrow and a "review" of the new HS2 rail line between London and the North to consider "alternatives" following publication of a post-Brexit National Audit Office report critical of the project's costs and timelines. Rail franchising and more advanced local projects should be able to push forward. However, there may still be some political risk for the more contested schemes. Prior to Brexit, Transport for London (TfL) postponed the contract notice for Silvertown Tunnel until later this year pending a full review by new London Mayor Sadiq Khan. Meanwhile, less developed transport projects like Crossrail 2 are likely to slow as Government departments turn their focus to EU negotiations. Transport projects are often dependent on the directional impact of the economy; if growth is abated, then the required investment may be called into question.

## Utilities

Brexit will have limited or no impact on inward-focused regulated utilities assuming current regulatory frameworks remain in place. However, some EU regulations directly affect these sectors — such as the European Water Framework Directive — and are key areas to watch post-Brexit. There is an expectation of a rise in consumer price index (CPI) in the short term, and any increase in inflation will have a positive impact on the cashflows of regulated utilities.

## Power

There is a cautious sense that fundamentals of UK energy markets haven't changed but national policy remains a challenge. Theresa May has said she wants to see an energy policy that emphasizes the reliability of supply and lower costs for users. In the past she has been supportive of renewables and critical of subsidies to new nuclear. However, these do not appear to be hard positions. Overall, uncertainty remains whether the new Government will keep EU targets on low carbon, and we may see a push for new gas capacity and interconnectors. As with transport, more will depend on the new Government's energy priorities than EU negotiations.

## Social infrastructure

Theresa May has indicated that the Government needs to deal with the housing deficit, and it remains the biggest issue for the new London Mayor Sadiq Khan. Concerns around GDP growth have already hit house builders in the UK, the new Government will need to prioritize this sector to prevent it from spiraling into further disarray during EU negotiations. Healthcare was a major campaign point for the 'Leave' camp who wanted to divert some of the money the UK sent to Europe into the National Health Service (NHS). This will be for Philip Hammond to consider how the funds which otherwise would have gone to the EU, will be re-channeled. Restrictions on free movement may also have an impact on education infrastructure. Fewer foreign students would help ease capacity constraints in primary and secondary schools, but it is generally bad news for universities where non-UK students pay higher tuition and have been an attractive revenue resource.

## Devolution

Local authorities are taking greater economic risk and devolution seems more likely now than ever before. This was demonstrated by the regional split of the referendum and it is hard to see how Theresa May will not put the rebalancing of the UK as priority. The critical question locally to ask is: "What does the appetite for devolution look like in the context of uncertainly and shrinking GDP?"

## Conclusion

Things are moving fast, and infrastructure will likely be part of the new Government's strategy to neutralize Brexit uncertainty. Philip Hammond is leaving austerity behind, and will have more latitude to stimulate the economy through carefully targeted higher public spending and lower taxation. This together with the actions of the Bank of England will be targeted at reducing any dip in GDP.

Maintaining the impetus on new infrastructure projects is also likely to be important. However, there may be greater financial scrutiny and need for assurance to ensure projects stay on budget and schedule during their pre-construction and construction phases. There is a strong desire amongst public and private sector businesses alike to reduce the total cost of ownership of their infrastructure assets.

Infrastructure will always be heavily driven by Government policy and regulatory actions. Although Brexit will be Government's highest priority — stabilizing the economy and investing in infrastructure should also be high on the agenda.

*This article is a commentary on the current state of Brexit and its implications on the UK's infrastructure market and broader economy. This content will be updated according to new developments.*

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