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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 to May's appointment 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.

In contrast to former Chancellor George Osborne's immediate five point plan to deal with Brexit, Hammond has taken a considered approach and stated his thinking will develop over the summer following consultation, this adds more evidence to the working assumption that Brexit will not happen quickly. Theresa May's clear desire to address the vote split and focus on the *'needs of the many and not the privileged few'* will certainly feed through to departmental polices and infrastructure projects. Whether we are considering projects in transport, energy or devolution — we can expect focus on affordability, economic prosperity and a rebalancing of the economy.

Funding

Public finances were tight before Brexit and remain so. The Bank of England is holding steady on interest rates at 0.5% 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 UK economy is still a safe bet and there has already been 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. So while it is certainly encouraging that May has suggested the use of infrastructure bonds, liquidity in the market is not really the issue — it is a pipeline projects that the UK is missing and this is driven by Government policy combined with confidence in the UK economy.

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 may not be subject to EU rules post-Brexit, and this may drive 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. This may become a key requirement to future trade agreements.

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. To tackle these challenges, she has promoted Chris Grayling to Secretary of State for Transport. 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

The most remarkable change thus far has been the Department of Energy and Climate Change (DECC) being merged back with the Department for Business (BIS) to create the Department for Business, Energy and Industrial Strategy (BEIS) headed by Greg Clark. There is a cautious sense that the fundamentals of UK energy markets haven't changed but national policy remains a challenge. Delays to some initiatives, such as the next Contract for Difference (CfD) auction round, are likely to occur while BEIS shapes its priorities. Meanwhile, Theresa May has said she wants to see an energy policy that emphasizes the reliability of supply and lower costs for users. It's unclear what this means to the future of clean energy. On the one hand this may suggest the days of more expensive green solutions may be numbered, but we should remember that Clark was previously the Shadow Secretary of State for Energy and Climate Change in October 2008 and therefore understands the need to tackle climate change. Uncertainty remains on whether the Government will keep targets on low carbon, retain Membership of the EU Emissions Trading Scheme, and continue to collaborate with other EU countries on energy research and innovation. We may also see a push for new gas capacity and interconnectors. Overall, the creation of BEIS does signal a return to a far more active industrial policy which in turn should be good for the power sector.

Social infrastructure

If UK citizens were unsatisfied with the progress made on the supply of housing before Brexit, the situation has just got a whole lot worse. 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 and house prices have already dipped, the new Government therefore will need to prioritize this sector to prevent it from spiraling into further disarray during EU negotiations.

Jeremy Hunt remains the Secretary of State for Health. 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 the Chancellor Philip Hammond to consider how the funds which otherwise would have gone to the EU, will be re-channeled.

Justine Greening was appointed the new Secretary of State for Education and Minister for Women and Equalities. Restrictions on free movement may impact the need for new education infrastructure. If immigration is tightened, fewer foreign pupils would help ease capacity constraints in primary and secondary schools. There is no hit yet of a desire to reduce foreign students coming in to the country and while social factors may discourage some, the weaker pound will also make studying in the UK more affordable.

Devolution

Sajid Javid has been named the new Secretary of State for Communities and Local Government. 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 and Javid will not put the rebalancing of the UK as priority. There are early signs however that show that May was dissatisfied, as she puts it, with the "Government's obsession with Manchester". We may therefore see the spreading of attention to other regions. The critical question locally to ask is: "What does the appetite for devolution look like in the context of uncertainly and shrinking GDP?"

Conclusion

With only three Cabinet Ministers retaining their positions, two new Departments being created (Department for Exiting the EU and the Department for International Trade) and one abolished (DECC), the new UK Government has a very different look and feel compared to that under David Cameron – despite the same party being in power. The political ramifications of Brexit rather than Brexit itself was always going to have a significantly influence on the infrastructure market.

While things continue to develop fast, it is encouraging that infrastructure is featuring in early discussions. The only real change to Government policy thus far (the abandonment of the budget surplus goal by the end of this parliament) means that Philip Hammond 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 aimed at reducing any dip in GDP. Maintaining the impetus on new infrastructure projects, especially where this investment helps to rebalance the economy or drive GDP, is likely to remain important. Infrastructure will always be heavily driven by Government policy and regulatory actions. The next few months are likely to shape the direction of infrastructure investment for the remainder of this parliament.

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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