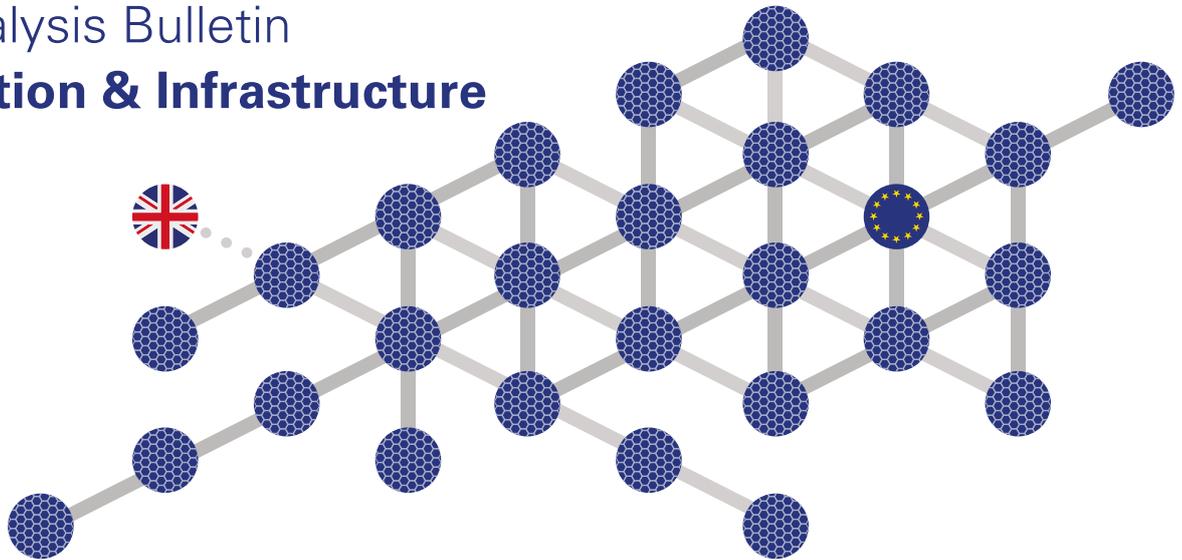


## Brexit Analysis Bulletin

# Construction & Infrastructure



On Thursday 23 June the UK public voted in a national referendum in favour of leaving the EU. The referendum result has already had a significant impact on financial markets worldwide, as banks, business and other organisations consider the possible outcomes of the vote. The discussions around the leave process are now ongoing and it will take at least two years for the UK to formally leave the EU, depending on when the UK Government begins the formal procedure.

The UK construction industry generates around £90 billion annually, accounting for 6.7% of GDP and employing over 2.9 million people. Although the UK construction industry is largely a domestic market, it will still be affected by the Leave vote. Given that the industry accounts for a significant proportion of UK GDP, the impact of Brexit on the industry will in turn affect the UK generally.

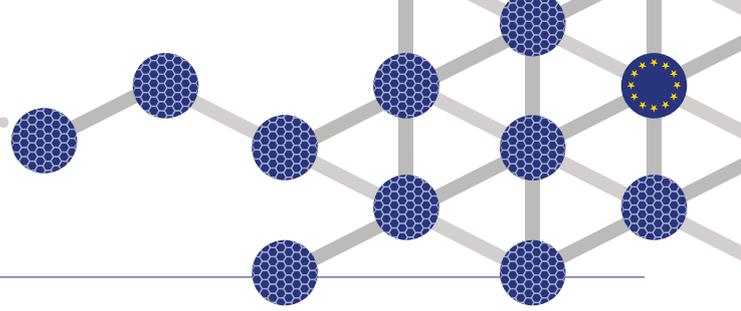
There has already been an immediate economic impact on the industry, with forecasts for growth being revised downward for 2016 and 2017. Several financial experts have predicted that the uncertainty as to the terms of a UK exit will have a negative effect on the construction industry until investor confidence returns.

It is important to note that despite the Referendum outcome, at yet nothing has legally changed. For now, until withdrawal negotiations are completed, the UK remains a part of the EU, and compliance with EU law is still required. The political likelihood of any contest to the outcome of the Referendum is currently low and therefore this note assumes that the UK will be leaving the EU and sets out the options available to the UK in that scenario.

### What will the relationship between the EU and the UK be?

It is possible that the UK will join the European Free Trade Association (EFTA) and remain part of the European Economic Area (EEA) (often referred to as the Norwegian approach). The EEA agreement incorporates the four freedoms laid down in the Treaty of the Functioning of the European Union (free movement of goods, services, persons and capital), as well as competition and state aid rule. This option may be unlikely as it would negate much of the benefit of Brexit; it would still require the UK to adopt EU market legislation and provide financial contributions to the EU, but lose its power to negotiate and vote in respect of EU regulations.

If the UK does not remain a member of the EEA, it could join EFTA but negotiate bilateral agreements with the EU to govern the on-going relationship between them in respect of matters such as freedom of movement and goods. This is the approach taken by Switzerland, which has to follow EU trading standards and make financial contributions to the EU. The outcome of this option would depend on post-Brexit negotiations, but the EU is likely to insist on the UK being bound by at least some



EU regulation if it wishes to enter into such bilateral agreements.

Given that many proponents of Brexit wanted to curtail the free movement of persons, the UK may move away from membership of EFTA, towards a Turkish-style customs union and bilateral agreements with the EU. Another alternative would be to operate under World Trade Organisation rules, which is similar to the US approach when trading with the EU. Both of these approaches would allow free movement of goods but not persons, and may involve tariffs.

### Labour supply

As a sector which relies heavily on foreign skilled and non-skilled workers, one of the key concerns within the construction industry following the Leave vote will be the potential curtailment of free movement of persons. The construction industry is already struggling with a labour and skills shortage, caused by a lasting effect of the large number of job losses resulting from the recession and an ageing workforce (and therefore a high retirement rate). This latter cause is likely to grow more influential as 22% of UK construction workers are over 50, and 15% over 60.

In a recent survey<sup>1</sup> 66% of firms reported having turned down work due to a lack of staff. As a result of the skills shortage, wages are reportedly increasing, with the same survey showing average earnings to have risen by more than 6% in the year to October 2015. With UK unemployment at a low of around 5.1%<sup>2</sup> the labour and skills shortage in the construction industry cannot be resolved domestically.

Data from the Office for National Statistics and the Organisation for Economic Co-operation and Development indicates that approximately 10% of the UK construction workforce are foreign born. There is obvious concern that the industry's skills shortage will worsen as a result of the Leave vote, though it is understood that the UK Government intends to safeguard the right of EU citizens currently resident in the UK to remain resident following Brexit.

The actual impact of Brexit will depend on the nature of the UK's relationship with Europe. If the UK were to be part of EFTA, EU nationals would continue to be able to live and work in the UK, and the effect is therefore likely to be minimal. However, immigration was one of the main arguments put forward for leaving the EU, and therefore this is perhaps an unrealistic outcome. Although the UK could grant entry to skilled workers, or introduce a flexible system of working permits to reduce

the impact on the skills shortage, the burden of this may act as a deterrent to workers, who could freely work in an EU member state.

### Procurement

The effect on procurement is covered in detail in a separate bulletin. In brief, as EU procurement rules are enshrined in UK law, the rules will remain in force until the UK Government repeals or amends the UK legislation. Many complain that the EU procurement process is bureaucratic and relies on a box-ticking mentality that is not well suited to smaller firms and which favours those with previous experience of similar project types. However, the UK will still require some form of procurement rules, and how much they will differ from the EU rules will largely depend on the emerging relationship between the EU and the UK. The current UK procurement rules, particularly the Scottish regulations, go further than is required by the EU and therefore Brexit will be unlikely to have a significant impact on procurement.

### Imports

Although the UK construction industry uses mainly domestic materials, it does import some materials, with the four largest markets for import being Germany, China, Italy and Sweden. With three of these being in the EU, the continuing free movement of goods is a concern for the industry. The outcome will depend on the eventual relationship between the UK and the EU, but there has been some suggestion that it will require compliance with the World Trade Organisation rules, which will increase costs.

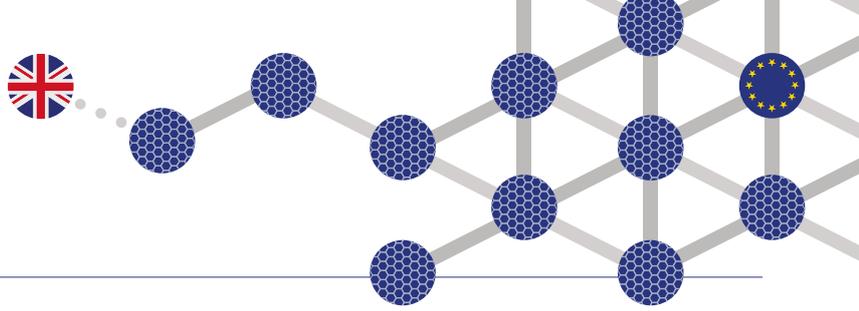
### Exports

The Construction Products Regulation 2011 lays down harmonised rules for the marketing of construction products in the EU. Whilst the Regulation will no longer apply to the UK after it leaves the EU, the UK would still require to comply with the Regulation for products exported to the EU. The result would be a need for the UK to comply with regulations in relation to which it has no powers of negotiation.

Some proponents of Brexit suggested the UK would now be more able to trade with the rest of the world in the event of a Leave vote. The UK will have to set up bilateral trade agreements to replace the multilateral agreements it currently trades under as part of the EU. Some countries, notably the USA, have strict trade barriers and only countries that they have agreements with can export there. Whilst the UK is currently able to trade with such countries, as the EU has those agreements in place, new agreements will now have to be negotiated.

<sup>1</sup>The 2015 RICS UK Construction Survey

<sup>2</sup>Office for National Statistics



## Regulation

Supporters of Brexit within the construction industry pointed to the “red tape” in the industry resulting from European directives and regulations, particularly with regard to environmental and health and safety legislation. However, this is mainly embedded into UK law and therefore Brexit itself will not result in less bureaucracy. In order for this to happen, the UK law will require to be specifically repealed, and thereafter replaced with new UK law. The on-going relationship with the EU will impact how much the domestic law can be amended.

To take an example, the Construction Design and Management (CDM) Regulations enact EU Directive 1992/57/EEC on the implementation of minimum safety and health requirements at temporary or mobile construction sites. The most recent version of these removed the exemption for domestic clients specifically in order that the UK would be in compliance with the Directive (which the two previous versions of the CDM Regulations had not achieved). Following Brexit, there may be some amendments, but core health and safety regulations would remain for obvious reasons.

Similarly, The Energy Performance of Buildings Directives include requirements for Energy Performance Certificates for all properties (homes, commercial and public buildings) when sold, built or rented, including the obligation to display Energy Certificates for larger public buildings over 500m<sup>2</sup> and regular inspections for all air-conditioning systems over 12kW. There is also a requirement that all new buildings must be nearly zero energy by the end of 2020. Depending on the on-going relationship with the EU there may be potential to reduce or repeal the obligations under the UK regulations.

## Conclusion

From a legislative perspective, Brexit is unlikely to cause any immediate change, although in the future it may give the UK more flexibility in relation to its environmental and health and safety legislation in particular. The extent of any changes will be dependent on the nature of the new relationship with Europe and/or membership of the EEA/EFTA, and it remains to be seen how this will impact on workers within the construction industry.

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### JOINING THE DOTS OF THE EU REFERENDUM

#### What next?

Shepherd and Wedderburn has been for many years offering balanced and impartial advice on how the different scenarios might play out in the event of constitutional change.

Now that the vote has been cast to leave the EU, members of our dedicated Brexit group continue to interrogate the regulatory and commercial issues and to advise clients on next steps and outcomes.

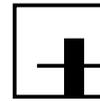
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JOINING THE DOTS OF THE EU REFERENDUM

**Where to from here?**

**What are the UK's options post Brexit?**

**Two years' notice**

- By 2017 the UK will be required to give two years' notice and transitional measures would be put in place during this time.
- The complexity of the negotiations may impact on the time taken for a Brexit referendum to be held.
- The Transatlantic Trade and Investment Partnership (TTIP), a bilateral trade agreement currently being negotiated between the EU and the US, being in additional consideration to a possible Brexit.

**Potential options could involve:**

- Continuation of free trade agreements with individual EU Member States.
- Several deals of a nature which will see the UK as a member of the European Economic Area (EEA) and/or for the European Free Trade Association (EFTA).

**EEA**

The European Economic Area (EEA) unites the EU Member States and the non-EU EFTA States Iceland, Liechtenstein, and Norway in an internal market governed by the same basic rules. These countries make goods, services, capital, and persons to move freely across the EEA in an open and competitive environment.

Joining the EEA would mean that in the event the UK would have to comply with the EU's laws and regulations.

The Agreement does not cover the Common Agricultural and Fisheries Policies, Customs Union, Trade Policy, Common Foreign and Security Policy, justice and home affairs or Monetary Union (EMU).

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Click here to read our 'What now' Brexit bulletin.

**UK writes 'Leaves''**  
SHEPHERD+WEDDERBURN

**What now?**

In the past month, the UK has been the subject of a number of headlines. In a referendum, the UK will be asked to leave the European Union. This has led to a number of headlines, including the fact that the UK will be required to give two years' notice and transitional measures would be put in place during this time.

**What's next?**

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