

Impact of a no-deal Brexit on real estate finance transactions

Preparations, additional clauses, documentary changes, changes to the way deals are structured, any other issues (legal or practical), that real estate finance lawyers and market participants should be aware of for Brexit.

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1. What impact would a No-deal Brexit have on the real estate finance market?

The residential and commercial markets are already experiencing a slowdown with the threat of a recession also hanging over the economy. In particular, there is a significant slowdown in development and investment and it is anticipated these sectors will come to a grinding halt for a period of time should a No-deal Brexit take place.

Contrast this with the strongly performing shed sector which I expect will continue to perform strongly in the short to medium term due to the need to stock pile to replace just-in-time supply chains. Funding options are not expected to close in this sector in the short term.

The challenger banks are expected to be busier with a No-deal Brexit. The market commentators are predicting a fall in property values for both residential and commercial property. A fall in property values will test current LTV covenants and investors approaching a breach of their LTV covenants will likely need to seek alternative funding with higher LTV covenants which will be at higher cost.

I would expect Homes England to fill any funding gaps for housing developers if there is a squeeze or withdrawal of development finance for housing.

2. What preparations is the real estate finance market making for a No-deal Brexit?

We have seen the SME sector rush to secure historically cheap funding from high street banks. This area of the economy has been resilient to date and it seems SMEs are taking a very much business as usual approach. We see lenders continuing to have an appetite to support the SME sector.

As there is such a lack of clarity on what the post-Brexit world will look like we haven't seen our clients make radical preparations. We have seen larger corporates and investment funds investigate their funding options and then sit on their options as they wait for clarity on Brexit. I'm sure that the larger investors are waiting to see what value will be in the market after October and it may be they will need higher equity stakes post-Brexit.

One difference between now and the 2008 financial crash is that the banks are far better capitalised. This will give the banks flexibility to react to Brexit once the dust settles.

3. Are there any additional clauses, or other documentary changes, that should be made in preparation for a No-deal Brexit?

We have experience of using a Brexit clause in property contracts. This gave our clients the opportunity to terminate property contracts which we first saw in 2016 in the event the leave campaign won the referendum. We have seen this more in the investment sector as opposed to the development sector. We have seen developers not commencing schemes rather than start a scheme where any party requires a Brexit clause.

4. Is the prospect of a No-deal Brexit changing the way deals are structured e.g. different mix of lending or borrower entities or loan tranches?

We haven't seen anything specific other than a slowdown in the volume of transactions.

I feel possibly lenders will look to structure deals with more of an equity return (e.g. exit fees, equity participation, etc) if, as a result of a No-deal Brexit, the transactions are perceived to be more risky. In terms of pricing, it is unlikely this will move significantly as we see liquidity in the market as still being strong.

5. Are there any other issues, legal or practical, that real estate finance lawyers and market participants should be aware of?

Whatever type of Brexit takes place I expect that the Bank of England will keep the interest rate at the current level or reduce it. This will give investors and developers breathing space during an expected difficult short term post-Brexit period without suffering a significant shock and avoiding the need for investors to participate in a fire sale of their assets. It will also allow developers to proceed with schemes that they have been holding back on starting provided that their purchasers or tenants remain committed to those schemes.

I would also expect to see a rise in bridging finance, either in the traditional sense or new banking products coming to the market, to help the real estate market ride out any short term turbulence in the market in the event of a No-deal Brexit.

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