Global Hospitality & Leisure

NEWSLETTER

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Brexit: What Does It Mean for the Hospitality and Leisure Industry?

On 23 June 2016, UK voters decided to leave the EU. The full impact of this decision is unclear but businesses and potential investors in the UK and overseas face a prolonged period of economic uncertainty, and in the short-term at least, will act with a greater degree of caution. The decision to leave the EU is expected to affect the UK economy, but it will have specific effects on the UK hospitality and leisure industry, which has been estimated to generate revenues of over £200 billion a year, given its sensitivity to consumer spending and business confidence.

The Process of Leaving the EU

The formal process of leaving the EU is set out in Article 50 Treaty on European Union. Once triggered, Article 50 provides a two-year window to negotiate an exit from the EU. Article 50, however, only provides for the negotiation of a withdrawal arrangement and not a deal on the future relationship between the UK and the EU. There is a degree of uncertainty as to how to progress the negotiations given that there is no precedent for triggering Article 50. It would make sense from the UK's perspective for the UK to not trigger Article 50 until there is some clarity as to the future relationship with the EU.

Changes in the UK Government, including Theresa May succeeding David Cameron as Prime Minster, have intensified the economic uncertainty. To provide greater economic certainty it is important that the UK Government outlines its plan and strategy for withdrawal, including the timetable, as quickly as possible. The most significant legal point which requires clarification is the future relationship between the UK and the EU post-withdrawal, with several models proposed, including:

- EEA membership;
- A series of bilateral agreements; and
- A single free trade area agreement.

Economic Impact

When markets opened after the referendum result was announced on the morning of 24 June 2016, the potential impact of Brexit on the UK economy was clear. The pound sterling fell to levels not seen in 30 years and the FTSE 100 fell by over 8%, before both regained some ground prior to markets closing. Since 24 June 2016, the FTSE 100 has overtaken its pre-referendum levels, reaching its highest level for 14 months on 16 August 2016. However, the value of the pound has remained weak against currencies such as the Euro, US dollar and Hong Kong dollar, leading to fears over rising inflation due to the increased cost of imports. In addition, several rating agencies downgraded the UK's credit rating soon after the result was announced.

As a response to the potential effects of Brexit, to sustain economic growth and employment in the UK, the Bank of England introduced a significant package of stimulus measures in August 2016, the measures included:

- A cut in the Bank of England interest rate from 0.5% to a record low of 0.25%;
- The purchase of up to £10 billion of UK corporate bonds;
- A £60 billion expansion of the asset purchase scheme for UK government bonds; and
- A new Term Funding Scheme to provide funding for banks.

Alongside this stimulus package, the Bank of England has allowed banks to use some of their capital buffer to extend credit to current and prospective customers. Together, these measures are designed to lower the cost of borrowing for consumers and businesses and create demand in the economy by ensuring that banks are able to continue lending at competitive rates. The Bank of England has said that it is prepared to extend these measures in the future if required.

Despite warnings of job losses and reduced consumer spending as a result of Brexit, the Office for National Statistics released figures showing that in the UK the number of people claiming unemployment benefits in July 2016 fell by 8,600 (suggesting unemployment has fallen), and consumer spending increased 1.4% from June 2016 to July 2016. These figures suggest that the short-term implications of Brexit have not been as substantial as first feared. Nevertheless, the effect of a weak pound on prices is still expected to lead to reduced spending, placing pressure on economic growth and employment. In the medium-term, the Bank of England expects to see a rise in unemployment, with little growth in GDP in the second half of 2016.

Negative Impact of Brexit on the Hospitality and Leisure Industry

The hospitality and leisure industry is particularly susceptible to the effects of Brexit as it relies heavily on consumer spending and business confidence. The initial industry response to the referendum result was negative, with the share price of a number of hospitality and leisure companies falling.

The short- to medium-term outlook for the hospitality and leisure industry is somewhat uncertain. The predicted increase in inflation and unemployment may negatively impact some domestic consumer demand as domestic consumers will have less disposable income to spend on luxuries such as eating out and leisure hotels.

Amid economic uncertainty, corporate demand is also likely to fall as a result of a reduction in business travel budgets. Additionally, depending on the outcome of negotiations with the EU, some financial services firms currently located in the UK may be required to transfer some operations into the EU to take advantage of the EU financial services passport. Some firms have already indicated that they will relocate certain operations. The result of firms relocating is a reduction in corporate demand for hospitality and leisure, particularly travel and hotels, as fewer people visit the UK on business.

In the short-term there may also be a reduction in capital investment in the hospitality and leisure industry, with investors anxious about investing large sums in an uncertain market. The economic reaction to Brexit may be a particular problem for foreign investment in real estate, which requires significant funding, especially given the sensitivity of property prices. The concern over investing in the wider UK real estate market was highlighted when various real estate funds prevented investors withdrawing funds immediately after the referendum, amid fears that property prices may fall. Three months on, their position appears to be softening and the redemption fears reducing.

As a result of leaving the EU, it is likely that the UK will no longer be subject to the free movement of people (one of the four EU freedoms). With 67% of visitors to the UK coming from the EU this may have

a material effect on the UK hospitality and leisure industry. However, it is unlikely that the UK will place significant barriers on EU citizens travelling to the UK on holiday. The industry relies heavily on EU labour and may find it hard to find replacements if the UK Government places restrictions on EU citizens working in the UK.

Opportunities for the Hospitality and Leisure Industry as a Result of Brexit

Brexit may result in short-term challenges for the UK hospitality and leisure industry, however it is likely to provide long-term opportunities for investors. This will be the case particularly as the strategy and timetable for EU withdrawal become clearer.

As stated above, one of the impacts of Brexit has been the fall in the value of the pound. While this will result in increased prices for domestic consumers, it may also provide a significant boost to tourism from overseas. The weak pound makes travelling to the UK cheaper and will encourage overseas tourists to visit its extensive cultural, sporting and historical attractions. In addition, the value of the pound has made trips abroad more expensive for UK residents, increasing the number of "staycations", as witnessed in the aftermath of the 2008 financial crisis. Although the number of overseas and domestic tourists may increase as a result of Brexit, this may not fully cover the cost to the industry of reduced domestic consumer spending and corporate demand.

The decrease in the value of the pound and the potential fall in the value of UK real estate also provides the opportunity for increased investment from overseas in the UK hospitality and leisure industry, particularly in assets such as hotels. This combination gives overseas investors an opportunity to find good value long-term investments, especially if the investor is not already overexposed to these UK investments. As the UK's strategy and timetable for leaving the EU becomes clearer and the economic outlook becomes more certain, investors from overseas may take advantage of cheaper investments and an increase in UK demand from both overseas and domestic tourists. If the Bank of England's stimulus package is successful it will ensure that funding is still available for investors looking to take advantage of the opportunities provided by Brexit.

The Future

Despite anxiety over the UK economy, the Chancellor, Philip Hammond, has reiterated that the UK remains "open for business". Economic uncertainty remains, however the UK hospitality and leisure industry may present opportunities for investors, particularly investors from overseas, when the markets settle and businesses make firm decisions on their approach. Withdrawal from the EU will by no means be swift, and we are unlikely to know the full consequences for a number of years. However investors should have plans in place to mitigate Brexit risks and take advantage of the opportunities it may present.