

**Manchester City Council
Report for Resolution**

Report to: Resources and Governance Scrutiny Committee – 21 July 2016
Executive – 27 July 2016

Subject: The Implications of Brexit

Report of: The Chief Executive

Summary

Following the result of the referendum on Britain's membership of the European Union there is considerable uncertainty regarding both the process leading up to withdrawal and the impact that withdrawal will have on the UK economy.

Whilst the medium and long-term impact is difficult to assess at this stage there are some immediate implications that require urgent work over the coming weeks to understand. This report provides an overview of the work underway to ensure that Manchester and Greater Manchester is in a position to mitigate the worst impacts of withdrawal.

Recommendations

The Executive is recommended to:

1. Note the work currently underway to understand the immediate implications for Manchester and Greater Manchester of the decision to withdraw from the European Union.
2. Request that a further report be prepared for consideration at the next meeting of the Executive, providing more detailed analysis of the issues set out in this report and further information regarding Manchester and Greater Manchester's proposed response to those issues.

Wards affected: All

Manchester Strategy outcomes	Summary of the contribution to the strategy
A thriving and sustainable city: supporting a diverse and distinctive economy that creates jobs and opportunities	The decision to withdraw from the European Union had had a negative impact on investor and business confidence. It is critical that Manchester is able to provide support and advice during the challenging and uncertain times ahead and the ability to support businesses to drive productivity, innovate and export will become more important than ever.

<p>A highly skilled city: world class and home grown talent sustaining the city's economic success</p>	<p>Withdrawal from the EU will significantly affect the higher education sector and as such will have a disproportionate impact on cities with a strong university presence such as Manchester. Whilst there will be no short-term change to the status of students and university staff the longer term implications depend on the terms of withdrawal. Ongoing access to transnational research funding is likely to be dependent on the UK's willingness to sign up to the free movement of people.</p>
<p>A progressive and equitable city: making a positive contribution by unlocking the potential of our communities</p>	<p>The potential withdrawal of European funding calls into question the size of the Working Well expansion and the availability of further funding for the Work & Health Programme. ESF funding for significant volumes of general training/employment support is also in doubt. Officers are working with DWP officials to understand the implications of this in more detail.</p>
<p>A liveable and low carbon city: a destination of choice to live, visit, work</p>	<p>A fall in share values and a loss of confidence amongst housing developers means that housing completion rates are likely to decline at a time when current demographic projections indicate that a significant uplift in new housing provision will be required. As part of the process for developing the GM Spatial Framework the GMCA is due to confirm its 'preferred growth option' at the end of August and urgent work is now underway to maximise levels of housing development and investment. The ability of Manchester to continue to attract visitors and workers will be affected by any restriction to the free movement of people. Britain's exit from the EU will have significant social implications and an analysis is underway to provide a better understanding of social inclusion and community cohesion issues within the city.</p>
<p>A connected city: world class infrastructure and connectivity to drive growth</p>	<p>Central to any strategy for creating a stable economic environment will be a re-statement and reinforcement by Government of support for long-standing commitments that are of fundamental importance to the national economy, including investment in critical infrastructure such as HS2 and the Northern Hub.</p>

Full details are in the body of the report, along with any implications for:

- Equal Opportunities Policy
- Risk Management
- Legal Considerations

Financial Consequences – Revenue

None

Financial Consequences – Capital

None

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Background documents (available for public inspection):

None

1. Background and context

- 1.1 In the immediate aftermath of the referendum there is considerable uncertainty regarding both the process leading up to withdrawal and the impact that withdrawal will have on the UK economy.
- 1.2 It will be some time before the position becomes clear, particularly as the formal process for triggering withdrawal has not yet happened. At the time of writing there is as yet no indication regarding when the new Government is likely to trigger Article 50. Political uncertainty is compounded further by calls for a second Scottish independence referendum to protect Scotland's position within the EU and a leadership contest in the Labour party.
- 1.3 The 2016 Autumn Statement is likely to be the point at which the new Government signals whether it will be promoting any changes in fiscal or economic management strategies, and whether it remains committed to re-balancing the national economy and to the Northern Powerhouse. Government has indicated that it is awaiting the publication of official forecasts in advance of the Autumn Statement before considering additional tax rises or spending cuts.
- 1.4 A platform for negotiating our future relationship with the European Union has yet to be established but it is likely that there will be a protracted period of transition. The precise implications for access to markets and for labour movement and availability will depend on the terms of withdrawal that the British government is able to negotiate.
- 1.5 The impact on cities will depend in part on their economic make-up. Those UK cities reliant on the production of physical goods (such as cars) are likely to become less competitive if tariffs and quotas are imposed on goods for export into the EU, although the impact of such tariffs and quotas may be mitigated by a depreciation in Sterling. Restrictions on the free movement of people could have a negative impact on those cities with strengths in Research and Development and in Intellectual Property, as the ability to attract and retain highly trained talent is critical to success, although those cities that have already established global strengths in such sectors should remain strong. Restrictions on hiring EU citizens may also likely to have a negative impact on cities with a significant service sector, although the decision to leave the EU may improve the attractiveness of UK cities to some financial institutions as the UK would not be subject to Solvency II, EU legislation that the sector has fought hard against which codifies and harmonises EU insurance regulations, primarily concerning the amount of capital that EU insurance companies must hold to reduce the risk of insolvency.
- 1.6 Brexit will also significantly affect the higher education sector, and as such will have a disproportionate impact on those cities with a strong university presence such as Manchester. The decision to leave the EU will affect European students who study at UK universities and exercise significant spending power within the cities in which they live; it may affect the ability of UK universities to attract European researchers and students to contribute to

universities' research and development strengths, and it will affect the EU funding currently available to UK academic institutions.

- 1.7 Whilst in the short-term there will be no change in the immigration status of current EU students, no change in the immigration or employment status for EU nationals currently employed by universities, no change to the fee status of EU students, and no change to existing EU-funded grants or collaborative projects with other EU institutions it is impossible to predict the precise consequences of Brexit on the higher education sector until the terms of withdrawal become clear.
- 1.8 Whilst the medium and long-term impact of Britain's withdrawal from the EU is difficult to assess at this stage, there are some immediate implications that require urgent work over the coming weeks to understand. It is clear that access to ERDF and ESF funding will end and that continued access to transnational funding will depend on the terms that Britain negotiates with Europe. There will be significant confusion and disruption amongst supported parties as a result of withdrawal at the mid-point of the current programme, and it is unlikely that funds will be available to draw down in full. It is also clear that Britain's decision to leave the European Union is already having a negative impact on investor and business confidence and we need to understand as a matter of urgency how this fall in confidence will affect behaviour in the short to medium term.
- 1.9 Government has a clear role to play in building economic stability and establishing a climate of confidence at both national and international level. Central to any strategy for creating a stable economic environment will be re-stating and reinforcing support for long-standing commitments that are of fundamental importance to the long-term success of the economy, including investment in critical infrastructure such as HS2 and the Northern Hub and investment to support globally-leading areas of excellence such as advanced materials and health research.
- 1.10 However, local leaders also have a critical role to play in building market confidence and this briefing note identifies the work required over the coming weeks to ensure that Manchester and Greater Manchester is in a position to mitigate the worst impacts of withdrawal.
- 1.11 The issues highlighted above indicate the fundamental importance of places outside London and the South East having a seat at the table in overseeing the framework for withdrawal, and once this is established for overseeing the detailed negotiations. The UK Core Cities Network has already made this requirement known.

2. European funding

- 2.1 European Structural and Investment Funds are vested through multi-year agreements at sub-regional level, with the current round covering the period from 2014 to 2020.

- 2.2 Greater Manchester currently receives funding from the European Regional Development Fund (ERDF) and European Social Fund (ESF) as well as from Transnational Funds. GM's indicative allocation over the 2014-2020 period was £176m of ERDF and £145m of ESF. This funding has to be matched with a minimum of 50% 'non-EU' funding creating a programme of nearly £650m. EU funding is also often used to lever in additional public and private sector funding. Although the allocation of funding is made to GM, the regional centre, with a concentration of higher education and businesses is a significant beneficiary of this funding.
- 2.3 To date only £19m of ERDF funding has been contracted (including £5m to the Graphene Engineering and Innovation Centre) together with a further £17m of ESF funding due to significant delays in the UK Government and EU agreeing the Operational Programmes. A significant proportion of GM's EU funding was due to be contracted under two Financial Instruments – an extension of the Evergreen fund (£60m plus £10m of grant) and the Northern Powerhouse Investment Fund (£32m). A further £8m of ESF funding was due to be contracted to support the current Working Well expansion, with the potential of c. £20m to follow in 2018-2020 to support the Work & Health Programme.
- 2.4 CLG and DWP have both now stated verbally that existing EU funding contracts will be honoured, that they will progress further applications as normal, but at this stage they will not be signing any new EU funding contracts. Although this does not leave Greater Manchester with any existing liabilities that cannot be covered, it does have implications for the ability to deliver against a number of the priorities set out in the Greater Manchester Strategy and in the recently published Manchester Strategy.
- 2.5 In the immediate term it calls into the size of the Working Well expansion and, for the 2018-2020 period, the availability of further funding for the Work & Health Programme. ESF funding for significant volumes of general training/employment support which are currently in the process of being commissioned are also in doubt. This is of particular significance for the ambition to establish Manchester as a progressive and equitable city by expanding our programmes for people with complex and multiple problems, and by helping people to find work, stay in work and progress in work.
- 2.6 The withdrawal of European funding will also have significant implications for the availability of funding through Financial Instruments and further funding for business support services delivered through the Growth Hub for the 2018-2020 period. These issues are explored in further detail below.
- 2.7 The GMCA has an existing Transnational funding contract via ELENA (£2m for Low Carbon Development) which would appear to be secure. However GM has plans to access significant transnational programme to support Transport and Health Innovation. Depending on the 'BREXIT deal' GM may still have access to these funds as, for example, is the case for Norway but it will be some time before this can be determined.

- 2.8 As noted above, universities will be heavily affected should the EU funding currently available to academic institutions be withdrawn. GM universities are reliant on research funding via the Horizon transnational programme, with an allocation of over £165 million to support world-class science and to remove the barriers to innovation, making it easier for the public and private sectors to work together and deliver innovation. Any ongoing access to EU grant funding is likely to be contingent on the UK's willingness to sign up to the free movement of people.

3. Investment

- 3.1 Urgent work is required to understand the potential implications of Brexit on the investment appetite of institutional investors and banks, and both the MCC Strategic Development Team and the GM Core Investment Team is liaising closely with private equity houses and banks to develop further intelligence in this regard. However early conversations and analysis already suggest that investors are nervous at this point, particularly those in the North American markets. Such investors have and are due to bring substantial investment to Manchester and GM and it is critical that we act quickly to offer reassurance and demonstrate that we are 'open for business'. Failure to do so may place the development of key strategic sites at risk.
- 3.2 A clear way to provide that reassurance is to invest our own funding in key developments, giving those investors the confidence to continue with their plans, especially in relation to commercial property developments.
- 3.3 However, as highlighted above it is now possible that we will not be able to access the ERDF funding required to extend the Evergreen Fund as planned. Even if EU funding were available until 2018 this may not give sufficient time to create and implement a meaningful fund. It is also possible that the Northern Powerhouse Investment Fund, supported by the British Business Bank will be in the same position.
- 3.4 It is imperative that we are able to respond to increasing demand for 'pari passu' or part-funded debt if we are to shore up confidence in the investment market, and continue to drive business growth and diversification through this difficult period. Urgent work is now underway to identify the resources required to respond to this demand.

4. Driving productivity

- 4.1 It is also clear that there is huge uncertainty and varying degrees of concern amongst Manchester's existing business community. The Manchester Growth Company is liaising closely with companies located within GM, including large companies and SMEs as well as inward investors, to understand those concerns and to provide information, reassurance and support in the immediate term. A 'sounding board' will be established to develop a greater understanding of the impact of Brexit on GM firms, and to understand how behaviours are changing in the light of the referendum result.

- 4.2 Initial intelligence suggests that it is likely that, in the immediate term, the majority of businesses will 'do nothing' and will wait to see how the political process of withdrawal unfolds and what terms are agreed in the negotiations. There are indications that businesses are taking decisions to pause or hold investment actions whilst the immediate situation stabilises. Of particular interest will be intentions and actions of overseas investors and focus will be given to engaging with these companies. It is critical that GM is able to provide support and advice during the challenging and uncertain times ahead. The ability to support businesses to drive productivity and innovate becomes more important than ever. Based on the intelligence gathered and analysis produced through engagement with businesses as outlined above, bespoke packages of support and specialised resources will be developed to ensure that GM business remain confident enough to continue to invest and diversify.

5. Housing

- 5.1 Greater Manchester is due to confirm its "preferred growth option" in a report to the GMCA at the end of July including a "full objectively assessed" estimate of housing need, based on a robust analysis of population projections, migration levels and household formation rates. Further work has been commissioned from Oxford Economics to understand the potential impact that withdrawal from the European Union will have on GM population projections. Initial analysis has demonstrated that the GM population is still expected to increase broadly in line with the Accelerated Growth Scenario, one of the 'strategic growth options' that the GMCA consulted on at the end of 2015.
- 5.2 Whilst the precise level of growth that we should be planning for has yet to be determined, current projections indicate that a significant uplift in the provision of new housing will be required if we are to meet housing requirements over the coming decades. However, initial intelligence indicates that share values amongst housing developers have fallen by 40-45% since the announcement of the referendum result. Housing completion rates had recently reached 5-6,000 units per annum, from a low of 3-4,000 units per annum, but development rates will almost certainly decline again in light of the economic uncertainty we are facing. Urgent work is now required to examine options to maximise levels of housing development and investment.

6. Social inclusion

- 6.1 It is clear that Britain's exit from the EU will have significant social as well as economic implications. Again, it is too early to understand the likely impact in any detail but initial analysis of voting patterns across the country show that there are correlations between specific characteristics and voters' propensity to vote Leave as demonstrated by the Lord Ashcroft report issued shortly after the referendumⁱ. Urban city centres such as Manchester voted to remain in the EU but the degree of support for Remain decreases almost in direct proportion with the distance from the centre. This voting pattern correlates with the socio-demographic profile of city residents spatially, with educational attainment and earnings declining as the distance from the city centre widens. More than two thirds of those in receipt of state pensions voted Leave, as did two thirds of

- council and housing association tenants. The referendum has exposed significant divisions in opinion across age groups, socio-economic classes, education levels and other classifications.
- 6.2 Within the city an analysis of referendum results at ward level will be undertaken to further understand voting patterns. Combined with local intelligence regarding socio-characteristics and demographic change this analysis will enable a better understanding to be developed of social inclusion and community cohesion issues.
- 6.3 We will continue to respond robustly to any immediate cases of racism, hate crime and risks to community cohesion. Manchester has a history of providing strong leadership to promote common interests over potential divisions. It will now be important to build on this and to strengthen our means of listening and responding to residents.
- 6.4 At Greater Manchester level detailed analysis is underway to evaluate the different interventions that may be required to address such issues. The 'Deep Dive' study, led by New Economy, with independent quality assurance provided by Deloitte and Ekosgen, will be a key source of evidence for the Greater Manchester Spatial Framework and a refreshed Greater Manchester Strategy. The study has analysed economic issues and opportunities across the GM to better understand how all parts of the conurbation can have a strong and positive economic function to support future growth and to maximise the ability of all residents to share in its benefits. With input from all ten GM local authorities the work has provided an understanding of the spatial implications of, and barriers to, growth by comprehensively analysing demand and supply side factors. Phase 2 of the work, which is due to report initial findings in August, takes this analysis to the lowest spatial scale possible to develop our understanding of the implications of these factors at a local level.
- 6.5 It is also clear that the work of the RSA's Inclusive Growth Commission, chaired by Stephanie Flanders, will be extremely important. The Commission has issued an open call for evidence in relation to three research themes of:
- more inclusive, productive labour markets;
 - dynamic, resilient places; and
 - creating system change.
- 6.6 Greater Manchester has already agreed to make a significant input to the Commission and a clear plan of work is under development to ensure that GM's understanding of these issues, and the evidence and analysis that we submit to the Commission, is as strong as possible.
- 6.7 Given the importance of the issues under consideration, especially in the aftermath of the referendum, we will also be urging the Commission to bring forward an interim analysis in September, in advance of the final report due in March 2017.

7. Next steps

- 7.1 A further briefing will be prepared for consideration by the Executive at their next meeting that provides more detailed analysis of the issues set out in this note and sets out Manchester and Greater Manchester's proposed response to those issues.
- 7.2 That analysis will then be brought together with the work already underway to implement the recently published Manchester Strategy to form the basis of an economic and fiscal management strategy to ensure that the priorities of Our Manchester can be delivered, despite the uncertain political, economic and fiscal climate we are now operating in.

ⁱ Lord Ashcroft Polls, 2016, 'EU Referendum 'How Did You Vote' Poll', <http://lordashcroftpolls.com/wp-content/uploads/2016/06/How-th-UK-voted-Full-tables-1.pdf>