MIDDLESBROUGH COUNCIL

COUNCIL

19 OCTOBER 2016

IMPLICATIONS OF BRITISH EXIT FROM THE EUROPEAN UNION

THE MAYOR OF MIDDLESBROUGH

PURPOSE OF THE REPORT

1. This report identifies the potential implications for the Tees Valley overall, and for Middlesbrough specifically, of the recent UK Referendum outcome for the withdrawal of British membership of the European Union ('Brexit'), and outlines actions to be taken by the Council and its partners to mitigate potential impacts wherever possible.

2. An earlier version of this report was considered by Executive on 6 September 2016. Further reports will be brought forward in due course, as the Government's plans for Brexit are clarified and potential impacts on the local economy and local authorities in the Tees Valley are better understood.

BACKGROUND

3. On 23 June 2016, the UK voted to leave the European Union. Theresa May, appointed Prime Minister on 13 July following the resignation of David Cameron, has confirmed that the vote for 'Brexit' will be implemented and that a General Election (which could potentially see the Referendum result overturned, if won by a party standing on a 'remain' platform) would not be called.

4. Two new Government departments have been established work alongside the Foreign Office on Brexit:

   - the Department for Exiting the European Union, which will oversee exit negotiations and establish the future relationship between the UK and the EU; and
   - the Department for International Trade, which will promote British trade across the world and seek to establish new trade agreements.

5. *Immediate* unilateral withdrawal from the EU through the repeal of the 1972 European Communities Act has been discounted as a viable option. As such, Brexit will be triggered by the UK invoking Article 50 of the 2007 Treaty on European Union to notify the EU of its withdrawal and oblige the EU to attempt to negotiate a 'withdrawal agreement'.

6. There is no set timetable for triggering Article 50, but once triggered a two-year negotiation period commences. EU Treaties will cease to apply to the UK on the entry

into force of a withdrawal agreement or, if no agreement is concluded, at the end of the two years, unless there is unanimous agreement to extend the negotiating period.

7. Given the likely scope, it is likely that the final deal at the end of any negotiated UK exit from the EU will need to be ratified by EU leaders via a qualified majority vote, a majority in the European Parliament, and by national parliaments across the EU.

8. During the negotiation period, EU laws will still apply to the UK. The UK would continue to participate in other EU business as normal, but it would not participate in internal EU discussions or decisions on its own withdrawal. The UK has stood down from its planned Presidency of the EU in 2017.

9. The House of Parliament's Foreign Affairs Committee, in its recent report *Equipping the Government for Brexit*, identified the 'gross negligence' of the previous Government in commissioning no contingency plans for Brexit, beyond the limited planning by HM Treasury and the Bank of England for the immediate financial aftermath. The Committee concluded that this lack of planning has exacerbated post-referendum uncertainty both within the UK and abroad, and significantly increased the difficulty of the new Government's task.

10. The Prime Minister has recently announced that Article 50 will be triggered before March 2017, and the Department for Exiting the European Union is currently formulating its team and developing its plan for Brexit. There is now an ongoing debate about how much of the negotiation approach will be made public and / or subject to Parliamentary debate, and whether the final 'deal' will be approved by Parliament.

11. The pre-Referendum debate and much of subsequent discussion has focused on the immediate and longer-term economic impacts of Brexit, and parallel issues around immigration. However, there are wider implications from Brexit. For example, EU legislation, whether directly or indirectly, has informed UK law for over 40 years, particularly in respect of social and environmental protections, and post-Brexit the UK will be required to review legislation which has enacted provisions required under EU membership.

12. This report covers:

- initial UK economic impacts and national (macro) mitigation activity;
- potential longer-term implications for the Tees Valley economy;
- actions to be taken by the Tees Valley Combined Authority;
- specific implications for Middlesbrough and the Council's plans; and
- mitigating actions to be taken by this Council.

Initial UK economic impacts and national mitigation activity

13. Pre-Referendum, the Treasury and the Bank of England both highlighted the risks to the UK economy of leaving the EU, including a negative impact on confidence and investment in the UK economy, and a potential further wave of public sector austerity.

14. The Referendum result had an immediate negative impact on the value of Sterling and on financial markets worldwide, and the UK credit rating has since been downgraded by the major ratings agencies, potentially increasing the costs of Government borrowing.

15. At the time of writing (almost two months after the Referendum), both the FTSE 100 and the FTSE 250 have largely recovered their pre-Referendum position, though Sterling remains negatively pressured against the Dollar, bringing inflationary pressure.

16. The great majority of economists believe that Brexit will ultimately result in a contraction in the UK economy, and there have been a number of signals that the UK is heading for, or may already be in, recession (official confirmation of this will not be available until January 2017), including:

    - key lead indicators, including service PMI (manufacturing) new orders and vacancy growth were suggestive of a mild recession, pre-Referendum;
    - almost 50% of FTSE 350 Boards had no post-Brexit plans at May 2016, and reactions to Brexit at home and abroad are crystallising, affecting investment and exports;
    - the CBI's quarterly industrial trends survey in July 2016 showed business confidence falling to its lowest levels since the financial crisis in April 2009;
    - GfK's Consumer Confidence Barometer has fallen more sharply since the Referendum than at any point since 1994 (though other measures of confidence are now improving); and
    - the consumer saving rate was 5.9% prior to the Referendum, with consumer credit growth at around 11% per annum.

17. Since this time, some more positive trends and forecasts have emerged, but the situation is characterised by its unpredictability.

18. In its July 2016 Financial Stability Report, the Bank of England committed to closely monitoring the risks of:

    - further deterioration in investor appetite for UK assets;
    - adjustments in commercial real estate markets tightening credit conditions;
    - increasing numbers of vulnerable households and behaviour of buy-to-let investors;
    - the outlook for the global economy; and
    - reduced and fragile liquidity in core financial markets.

19. The Bank of England has emphasised the fact that the UK banks can now withstand losses twice as large as those endured in the financial crisis of 2008, and has significant monetary and macro-prudential tools available to it to support the economy, including interest rate reductions, quantitative easing and the easing of capital requirements on banks. A package of measures designed to provide additional support to growth and to achieve a sustainable return of inflation to the Bank's 2% target was announced on 4 August 2016, and included a reduction in interest rates to 0.25%.

20. The key target of the previous Government to achieve a budget surplus by 2020 has now been abandoned. In its 2016 Autumn Statement, the Government will determine whether there is a need for an additional fiscal stimulus (tax and spend) to the UK economy. The Chancellor of the Exchequer has already indicated a readiness to re-set Government economic policy to respond to any economic slowdown.

21. It is often stated that 'markets need certainty'. Prior to the Referendum there was much discussion in the media on the impact of Brexit on investment in the UK, with a number of major companies (including key players in the North East, such as Nissan, Hitachi

and Chemoxy International) stating that continued investments would be reviewed in the event of a vote for Leave and the major uncertainty caused by this.

22. In many cases, such decisions are now in delay until the post-Brexit plans are clarified. As such, current economic conditions could well worsen as the approach to Brexit and the potential options for the UK emerge, should these not be perceived as positive.

Potential implications for the Tees Valley economy

23. The most notable impact of Brexit relates to potential loss of access to the Single European Market, initially created through the Single European Act of 1987, which can be defined as '*an area in which there are no functional barriers to the free movement of goods, people, services and capital'*.

24. The table below provides an overview of current options for accessing the Single Market, outside of the negotiation of a customised or free trade agreement:

- membership of the European Free Trade Association (EFTA) – an intergovernmental organisation set up for the promotion of free trade and economic integration to the benefit of its four Member States: Iceland, Liechtenstein, Norway and Switzerland;
- membership of the European Economic Area (EEA) – which unites the EU Member States and three EEA EFTA States (Iceland, Liechtenstein, and Norway) into an Internal Market governed by the same basic rules;
- membership of the European Union Customs Union (EUCU) – which comprises the EU Member States and some of its neighbouring states: Andorra, Monaco, San Marino and Turkey; or
- reliance on World Trade Organisation (WTO) negotiations and tariffs, which would require the UK to individually renegotiate the terms of deals with over 50 countries that it is currently party to as an EU member state.

Option	**Free movement within EU of:**					**Application of EU Law**	**Contribution to EU budget**	**Negotiate external trade agreements**
	Goods	**Agri Goods**	**Services**	**People**	**Capital**			
Status quo	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
EFTA	Yes	No	Partial	No	Yes	No	Partial	Yes
EEA	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
EUCU	Yes	No	No	No	No	No	Partial	Yes
WTO	No	No	No	No	No	No	No	Yes

Source: EU, EFTA, EEA, EUCU and WTO policy guidelines

25. With status quo currently ruled out as an option, the Government will need to pursue whichever option offers the best value to the British economy. The Government's aim will be to secure free access to the Single Market while minimising payments to the EU and concessions to EU law, particularly around the free movement of people. Recent comments from the German and French Government suggest that this will not be possible.

26. The table indicates that any movement away from full membership of the European Union may have impacts on the following issues pertinent to economic development in the Tees Valley:

- funding / investment support;
- regulatory environment;
- exporting;
- Foreign Direct Investment;
- attraction and retention of talent; and
- international knowledge transfer.

Funding / investment support

27. European Structural and Investment Funds (ESIF) support economic development across EU member states and their constituent regions. The Structural funds were developed on the accession of the UK to the then European Economic Community in 1973, with the aim of reducing economic and social inequalities between the nine member states at that time.

28. ESIF comprises five funds: the European Regional Development Fund (ERDF); the European Social Fund (ESF); the Cohesion Fund; the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF). These funds support both capital expenditure and revenue support for innovation, skills, regeneration and growth, and are subject to seven year funding rounds, allowing local authorities to plan for the medium-term, beyond the (currently) annual local government funding settlement, four year comprehensive spending reviews and five year general election cycles.

29. The current total budget for ESIF (2014-20) is £377bn, with the majority of funds allocated to ERDF, ESF and the Cohesion Fund. The majority of funding received by the UK is from ERDF and ESF; no funding is received from the Cohesion Fund.

30. Across 2014-2020 the Tees Valley was to receive £170m of support from ESIF[1], representing the second highest amount of funding (£245) per capita in England, after Cornwall, reflecting its status as a ‘Transition Area’ (i.e. where GDP per capita is between 75 per cent and 90 per cent of the EU average). The programme comprised:

Fund	Amount
ERDF	£94.4m
ESF	£64m
Youth Employment Initiative (YEI)	£10.4m
EAFRD	£1.1m
Total	**£170m**

31. In addition, ERDF and ESF is ‘match-funded’ by £105m from the private and public sector in Tees Valley.

32. Investment is in line with the priorities of the Tees Valley Strategic Economic Plan, with:

- ERDF focused on innovation, ICT, SME competitiveness and Low Carbon;
- ESF focused on skills development, labour market participation and employment;

1 In the form of the single EU Structural and Investment Funds Growth Programme for England, which brings together ERDF, ESF and EAFRD.

- YEI focused on reducing the numbers of 15-29 year olds that are NEET; and
- EAFRD supporting rural SMEs and rural growth.

33. The programme has the following key performance targets to the end of 2023:

- ERDF: 2,356 jobs created and 173 SMEs assisted;
- ESF: 9,510 trained, of whom 4,884 long-term unemployed; and
- YEI: 24,000 unemployed and 10,000 inactive young people assisted.

34. On 13 August 2016, the Chancellor of the Exchequer provided assurance that all structural and investment fund projects (including ERDF and ESF) signed before the Autumn Statement will be fully funded, even when these projects continue beyond the UK's departure from the EU. To date, £24.6m of 2014-20 ESIF has been either spent or committed (£19.8m of this relates to the YEI programme), leaving £145m currently uncommitted.

35. It has also been confirmed that the Treasury will put in place arrangements for assessing whether to guarantee funding for specific structural and investment fund projects that might be signed after the Autumn Statement, but while the UK remains a member of the EU. Further details are to be provided ahead of the 2016 Autumn Statement.

36. This provides some certainty around funding to 2020 and at this stage there is no suggestion that any projects with the 2014-20 programme are under threat. However, (clearly) the UK would not be able to access future ESIF programmes, and no guarantees have yet been made by Government in relation to providing replacement funding equivalent to the current ESIF programme post-2020. This would clearly have a significant impact on the deliverability of the Tees Valley Strategic Economic Plan.

37. The current ESIF programme closely aligns with, and is supported by, other national economic development programmes and funds, including the £400m Northern Powerhouse Investment Fund.

38. The European Investment Bank (EIB) has invested some €42 billion in the UK over the last ten years, including large-scale public sector development projects. Alongside the British Business Bank and Local Enterprise Partnerships in the North West, Yorkshire and the Humber and Tees Valley, is an investor in the Northern Powerhouse Investment Fund.

39. Membership of the EU is not required to access loans from the EIB and the bank has stated that no current loans will be affected by Brexit. However, it is expected that Brexit may lead to greater requirements for guarantees and potentially a more onerous application process for future loans.

Regulatory environment

40. The type of trading relationship the UK ultimately develops with the EU (and other nations) post-Brexit will determine the extent to which existing UK environmental and competition policy could be varied.

41. The Tees Valley economy includes a high concentration of foreign-owned enterprises within heavily environmentally-regulated sectors (such as the process sector), which

primarily service the EU export market. As such, it is unlikely that there would be an appetite for significant variance from EU environmental regulations in these sectors, even if this were to be pursued by Government, post-Brexit.

42. Current EU regulations prevent Government from providing ‘state aid’ (including direct funding, tax relief and exemptions) to companies of over £200,000 in any three-year period. While it is likely that some form of state aid provisions would remain in place post-Brexit (as these are required by EFTA and the WTO, for example), there may be an opportunity for Government to amend UK competition policy to provide additional support (principally related to energy costs, access to international markets and supply chain support) aimed at enhancing the productivity and international competitiveness of strategically important industrial sectors.

43. The Government is currently developing a new UK Industrial Strategy. It is essential that this Strategy recognises the importance of priority sectors within the Tees Valley to national competitiveness, and develops additional support aimed at mitigating constraints to strategically important industrial sectors.

Exporting

44. The EU remains the UK’s most important trading partner. In 2015, 44% of the UK’s goods and services were exported to the EU.

45. The North East exports more goods to the EU than any other region, and is the only English region to have consistently had a substantive goods trade surplus with the EU in recent years.

46. The majority of exports to the EU from the North East are chemicals and cars. These products currently attract the highest tariffs for imports into the EU, meaning that the North East economy could be very negatively affected by any post-Brexit trade deal that does not involve free access to the Single Market. In September 2016, Nissan’s chief executive stated the company may scrap potential new investment in its Sunderland plant if the government refuses to pledge compensation for any tariffs that may be imposed after Brexit.

47. Furthermore, there remains possibility that exports in some sectors (principally the service sector) could be "discriminated against", if freedom of movement across borders is restricted.

Foreign Direct Investment

48. A further significant risk of the Brexit is a reduction in Foreign Direct Investment (FDI). The UK is the number one destination for FDI in Europe, valued highly for access to Europe and a range of other factors, including quality of life, stability, infrastructure and support for entrepreneurs. In 2014/15, 1,988 FDI projects were recorded by UK Trade and Investment, creating 84,063 new jobs and safeguarding 23,055 others[2].

49. Between 2010/11 and 2014/15, 274 projects were recorded in the North East, creating £15,792 new jobs and safeguarding 11,089, with significant increases seen in recent years driven by high-profile investments from Nissan and Hitachi Rail Europe.

2 UKTI Inward Investment Report 2014 to 2015.

50. Ernst and Young's 2015 UK attractiveness survey suggested that while the UK remains the most attractive location in Europe for global investors, a significant majority of investors (72%) view access to the Single Market as important to this attractiveness. Post-Brexit, if access to the Single Market were to be retained without political links to the EU, 31% of respondents stated that this would make the UK less attractive for investment, and 22% that it would make it more so. While Brexit would have some effect (31% freeze or reduction) on investment plans until the end of 2017, 54% of respondents said it would have no impact. Credit Suisse has (separately) stated that 'FDI could easily slow by a half or more (taking c0.5% to 1% off GDP growth)' due to uncertainty in the two-year period between the referendum and Brexit.

51. At the same time, the survey also identified that business requires significant reform to the EU in the areas of competition, tax, labour markets and regulation, and that regional devolution is viewed as a very positive development for the UK economy.

Attraction and retention of talent

52. There is significant pressure to use Brexit to curb inward migration. At present, in-migration by European nationals to the Tees Valley is approximately 1,000 per annum. Curbs on migration may result in reductions in:

- the short to medium-term availability of skilled workers, particularly in the priority sectors of the refreshed Strategic Economic Plan, which over the course of the next ten years will require an additional 25,000 jobs, with 40% of these at NVQ Level 4, many of whom cannot be sourced locally; and
- the number of foreign students applying to study in the Tees Valley, which provide a major source of income for the local economy[3] (particularly via Durham University's Stockton Campus), and other benefits including increased tourism and international awareness of the Tees Valley and locally-produced goods.

53. There is a common perception of high migration into Tees Valley (both from within and outside of the EU). Coupled with the community cohesion issues arising nationally in the immediate aftermath of the Referendum, current and future migrants may have begun to experience a 'chill factor' that could increase difficulties in the attraction and retention of talent.

International knowledge transfer

54. Innovation is central to enhancing local prosperity and the regional innovation ecosystem, in particular universities and 'catapults'[4], and has been largely supported by ESIF but also received revenue support from transnational programmes, such as Horizon 2020, which provides over €80bn of funding for research and innovation across the 2014-20 period.

55. Teesside University has benefited significantly from the European Union. While only 6% of its 18,000 undergraduates in 2014/15 were international (1% from within the EU and 5% from outside), over 76% of its competitive grant research funding comes from the EU.

3 For example, study by Oxford Economics, *The Costs and Benefits of International Students in Sheffield* (January 2013), identified that the net direct economic contribution of international students to sub-regional GDP in that area was £22-25,000 per annum, the equivalent of £120m per annum at that time.

4 Innovation centres connecting UK business with research and academic communities, including within the Tees Valley, the Centre for Process Innovation.

56. The Chancellor’s statement of 13 August 2016 provided assurance that the Treasury will underwrite payments of all awards from the European Commission while the UK remains a member of the EU, even when specific projects continue beyond the UK’s departure from the EU. This provides assurance of funding to 2020, but not beyond this period. However, it should be noted that at present Horizon 2020 is open to both European and non-European partners.

57. The revenue support provided by transnational programmes has been valuable, the real benefit to the UK and regional innovation ecosystem has been access to European-wide innovation platforms (including European Universities, research bodies and SMEs).

58. The development and growth of Digitalcity, and the emergence of the digital and creative sector in the Tees Valley, for example, has been possible due to partners’ access to EU funding, markets and networks.

Actions to be taken by the Tees Valley Combined Authority

59. At its meeting of 24 August 2016, the Tees Valley Combined Authority Board agreed to take the following actions, in conjunction with local partners and Department for International Trade and Investment, to address the potential issues outlined above:

- secure from the Government ring-fenced funding for the Tees Valley comparable in scale and range of support to anticipated ESIF allocations;
- ensure that the emerging British Industrial Strategy recognises the strategic importance to UK competitiveness of Tees Valley’s priority sectors; and develops additional support aimed at mitigating constraints to strategically important industrial sectors;
- consult with local businesses to assess the impact of Brexit on existing trade and identify emerging markets, and identify target markets and develop additional wraparound support for emerging market opportunities;
- establish sector strategies for key industries, developed in collaboration with business, with a particular focus on maintaining and developing the supply chain, to encourage investment in those areas which will most benefit industries in which the Tees Valley has existing strengths;
- implement policies that support an attractive investment climate, in particular investing in adequate new transport infrastructure, investing in sufficient generating capacity to provide affordable power and ensuring the planning regime is fit for purpose;
- work with local industry to assess emerging skills demands and to signpost skills gaps to Government in order to inform subsequent migration targets;
- work with all local Higher and Further Education institutions to ensure that sufficient numbers of foreign students can access further and higher education opportunities in the Tees Valley area;
- in liaison with local authorities and the voluntary and community sector work with the local community and recent and long established migrants to signpost the scope and scale of emerging opportunities and how they can best access them; and
- work with local universities and research bodies to assess current Horizon 2020 and other transnational programme commitments and identify any emerging constraints to future access.

60. These actions respond to the issues and concerns expressed by local authority partners, the Tees Valley Local Enterprise Partnership, and the North East Chamber of Commerce.

Specific implications for Middlesbrough and the Council's plans

61. In addition to the above implications for both the Middlesbrough and the wider Tees Valley economy, there are a number of potential and interrelated impacts from Brexit specific to Middlesbrough. These are as follows:

- the potential local, social impacts of a Brexit-related recession;
- the potential impact on the Council's 2016-20 Strategic Plan; and
- the potential longer-term impacts on devolution and the functions of local government.

Potential social impacts

62. This report flags the prospect of a Brexit-related recession. It is clear that economies within comparatively disadvantaged areas such as Middlesbrough, which are less resilient to shocks and higher living costs, are hit hardest by recession and that this has multiple impacts on the health and wellbeing of local communities.

63. Middlesbrough is the most diverse local authority area in the North East, with 11.8% of its population estimated to be from the Black and Minority Ethnic (BME) community. The immediate aftermath of the Referendum saw a significant increase in hate crime across the UK, though this appears to have been a spike, which is now subsiding.

64. The 2025 Vision for Middlesbrough priorities the reduction of inequalities within Middlesbrough and the value of the town's diversity. Ongoing action planning for the Vision will be reviewed to ensure that the Council is best-placed to address to the potential local, social impacts of a post-Brexit recession.

Potential impacts on the Strategic Plan

65. On 13 July 2016, Council approved a Strategic Plan for the 2016-20 period. This plan positions the Council to effectively support the 2025 Vision for Middlesbrough within the context of ongoing changes to local government funding, with the Government planning to scrap the Revenue Support Grant by 2020, and raising the majority of other revenue locally, including the collective retention of 100% of business rates.

66. Linked to this, the 2016/17 Local Government Finance Settlement, confirmed in February 2016, sets out the grant income local authorities will receive from the Government up to and including the financial year 2019/20, and for the first time offers authorities a four-year funding settlement, provided efficiencies to be achieved across this period are clear.

67. Accordingly, the Strategic Plan assumes the agreement of a four-year funding settlement and is focused on investment, growth and efficiency. As such, there are potential implications from Brexit for the Council's plans.

- **Potential increased demand for public services:** The potential social impacts of Brexit may increase the demand for public services over and above current projections, or require the development of new services. This is unlikely, but would increase the Council's savings requirements. It is proposed that current demand projections are reviewed to ensure that they are resilient to the impact of any potential downturn.

- **Potential changes to current local government funding:** Pre-Referendum, there were signals that a further wave of public sector of austerity may be required. This now appears less likely given the abandonment of the economic targets of the previous Government and signals that economic policy will be 're-set' in the Autumn Statement. The Council has not yet had confirmation from the Government that its plans qualify it for a four-year funding settlement (this may be linked to the Autumn Statement). If this is not granted then the Council will have less flexibility than expected in relation to the use of reserves and some replanning may be required.
- **Potential reduction in planned local revenues:** The future dependency on local revenue generation means that all local authorities will be more exposed to falls tax and rates collection resulting from economic downturns and should plan accordingly. In addition, the Council's plans involve increasing revenues from growing Middlesbrough's economic base. These could be affected by downturns in local property markets.
- **Potential increase in the cost of borrowing for local government and its partners:** As reported, the UK's credit rating has now been downgraded. Those local authorities that hold individual credit ratings (Cornwall, Birmingham, Cornwall, Guildford, Lancashire and Wandsworth) have also been downgraded, and all housing associations rated by Moody's have been placed on a 'negative outlook'. While there was a spike in loans from the Public Works Loan Board in advance of the Referendum, interest rates have not risen significantly post-Brexit and the Council's plans are unaffected. Nevertheless, the Council should continue to explore all capital (and revenue) funding options to deliver and enhance its current plans.
- **Potential downturn in the housing market:** In downgrading the UK credit rating, many credit agencies warned of a correction in the UK's housing market. The RICS July 2016: UK Residential Market Survey reported a further slowing in house price inflation, with near term expectations continuing to signal downward pressure on prices in the coming months. However, twelve month price and sales projections have edged back into positive territory. The MTFP assumes that from 2016/17 to 2019/20 the Council Tax base will increase by 4.2% in total, bringing increased revenues of £2m per annum by 2019/20. Any slow-down in housing growth will affect these assumptions and increase the Council's budget gap. At this stage, there is no indication that the Council's housebuilding plans will be affected by Brexit, though it is likely that housebuilders will take a more cautious approach to development in the short-term. As such, the Council should review its housebuilding plans, developing contingency plans as appropriate to ensure deliverability.
- **Potential downturn in the commercial property market:** The RICS Q2 2016: UK Commercial Property Market Survey reported a sharp fall in investment demand, with London seeing the most profound decline; an increasing share of respondents believing that the market is in an early downturn phase; and twelve month capital value and rental projections moving into negative territory. Clearly, this could have implications for the local commercial property market and impact the Council's MTFP assumptions around commercial property holdings.

Local Government form and functions

68. The direction of travel in local government policy since the 2010 General Election has been towards devolution of powers to local areas.

69. On 23 October 2015, the five Tees Valley leaders and Mayor, and the Chair of the Local Enterprise Partnership signed an “in principle” devolution agreement with the Government and this was subsequently formally approved by each of the councils.

70. The deal is worth £450million over 30 years, equivalent to an additional £15 million per year, and provides for the transfer of significant powers for employment and skills, transport, planning and investment from central government to the Tees Valley. The deal also includes a comprehensive review and redesign of the education, skills and employment support system.

71. A new investment fund will be created to deliver a programme of investment in the region over the 30-year period, which will include a devolved and consolidated transport budget.

72. The Tees Valley will introduce a directly elected city region Mayor who will work alongside the Tees Valley Combined Authority to provide leadership and be directly accountable to the electorate. The first election for a Mayor is set to take place on 4th May 2017.

73. This is the first stage of a two stage process to transform the Combined Authority into a mayoral Combined Authority. The powers of the Mayor are currently the subject of public consultation. There will then be a further decision by the constituent authorities and the Combined Authority about how the Mayor will operate within the mayoral Combined Authority by the end of October 2016. The order will then be laid in Parliament and this second stage of the legislative process will be completed by the end of December 2016.

74. Devolution is part of the wider approach to developing regional economic performance launched under the 2010-15 Coalition Government. The concept of the Northern Powerhouse, for example, comprises improved transport links between major Northern cities and towns and investment in science and innovation, together with devolution agreements.

75. Following the post-Referendum change in Government, there were some concerns that focus on the Northern Powerhouse would be diluted by a new focus on a national industrial strategy. However, in recent weeks the Prime Minister has committed to supporting the proposals. In addition, there are no indications that the new Government intends to step back from devolution.

76. Nevertheless, there remain concerns that the inevitable and overriding focus on Brexit negotiations will bring significant delays to progress on devolution nationally, whether this be agreeing new deals or progressing and extending ongoing deals. One option to resolve this would be for Government to legislate wholesale for devolution, rather than negotiate deals on a case-by-case basis. This option could have significant implications for local government structure.

77. All UK local authority functions are (directly or indirectly) affected by law originating in the European Parliament, as set out below:

- **Procurement:** EU public sector procurement rules require all contracts over €209,000 to be published in the Official Journal of the European Union (OJEU), making them accessible to suppliers from across the EU. There has been some criticism in the past that these rules limit the ability of local authorities to promote local employment. In the medium-term, public procurement rules more generally will remain in place as they have been implemented via UK law.
- **Employment:** EU law has introduced or strengthened a wide range of employment rights and protections in the UK, including the right to a written contract of employment, the Working Time and Health and Safety Framework Directives, equal pay, paid annual leave, maternity rights, and anti-discrimination rights. While there were some proposals in the pre-Referendum debate that health and safety and working time legislation could be amended to support SME competitiveness, the scope for change in employment law will be determined by the UK's future trading relationship with the EU. The Government has since stated that employment rights will not be eroded as a result of Brexit.
- **Human Rights and Equality and Diversity:** While Brexit would not affect the UK's obligations under the European Convention on Human Rights, all of the treaties and the EU Charter of Fundamental Rights would no longer have effect in domestic law on repeal of the European Communities Act 1972. However, many of the protections under EU law have been implemented into UK domestic law by legislation (for example, the Data Protection Act 1998 and various provisions in the Equality Act 2010). There is a longstanding political debate on these issues, centred on a notional UK Bill of Rights.
- **Planning:** While planning is a product of the UK legal system and land use planning is a national matter even within EU membership, the planning system is materially affected by EU law in relation to habitat, air quality, Strategic Environmental Assessment, and so on. Directives in relation to habitats and birds, for example, would not apply of the UK became part of the EEA.
- **Waste management and recycling:** Duties on the collection, transportation, recovery and disposal of waste (with associated targets, and fines) are established by the EU Waste Framework Directive (2008), which has largely been transposed directly into UK law. As such, this legislation will not automatically be affected by Brexit. However, if the UK does not become a member of the EEA post-Brexit, this legislation could be amended or repealed to, for example, relax recycling and / or landfill targets.
- **Trading standards:** As with waste, UK trading standards legislation consists principally of EU directives, such as the Unfair Commercial Practices Directive (2005), transposed into UK law and so this also would not be automatically repealed by Brexit, and is seems unlikely that Government would seek to weaken consumer protection law.
- **Energy efficiency:** Local authorities must manage the energy efficiency of their buildings in line with the Energy Efficiency Directive (2012), transposed into UK law via secondary legislation, which establishes a target to improve efficiency target by 20% by 2020 and requires local authorities to ensure that they purchase energy efficient buildings, products and services. Local authorities have in the past raised concerns that these requirements place additional costs on procurement activity.

78. All primary and secondary legislation, regardless of origin, remains a part of domestic law until it is repealed. The Government has now announced plans for a 'Great Repeal

Bill', which will be prepared in parallel to Brexit negotiations, and when enacted convert all EU legislation into UK law as soon as the UK exits the bloc, giving Parliament the power to then permanently absorb parts of EU legislation into UK law or dispense with elements it does not wish to retain.

79. The future trading relationship with the EU will dictate to what extent EU-derived legislation can be repealed or amended. Existing models for trade agreements with the EU require an EU trading partner to comply with EU law (at least in the areas covered by the trade agreement). Therefore, leaving the EU, and conducting trade through a new trading agreement, would not necessarily result in significant changes to the legislation outlined above.

80. Any review process (what to retain, amend, and remove) will be complex and contested, and given the scale of the endeavour, likely to take place in an evolutionary fashion over many years. This process will bring both risks and opportunities for local government.

81. The Local Government Association has called for local government to be included in negotiations on the terms of Brexit, and for greater powers to be transferred from the EU to local government. While this has been verbally-supported by Government ministers, there has been no formal confirmation at this stage.

Initial mitigation activity

82. On 6 September 2016, Executive agreed the following initial mitigation activity in response to the potential impacts outlined above:

- ensure that ongoing action planning for the 2025 Vision for Middlesbrough is sufficiently robust to address to the potential local, social impacts of a post-Brexit recession;
- review current MTFP demand projections to ensure that they are resilient to the impact of any potential downturn;
- seek clarity from Government on when the Council's four-year funding settlement will be confirmed;
- develop (as part of the ongoing testing of the Council's investment plans) contingency plans to mitigate the impact of any downturn in local property markets and ensure that housebuilding targets are achieved;
- continue to explore all potential capital (and revenue) funding options to ensure that Council delivers and can enhance its current plans for Middlesbrough; and
- engage as appropriate with the Local Government Association's efforts to ensure that local government is involved in Brexit negotiations.

PROPOSALS

83. It is proposed that notes the actions being taken by the Tees Valley Combined Authority and this Council in relation to the issues outlined in the report, and that this matter be further debated in due course, as the Government's plans are clarified and the potential impacts of Brexit are better understood.

Reasons

84. To ensure that the Council is fully prepared for the risks, and able to maximise opportunities arising from, British exit from the European Union.

Options and Risks

85. The Council will continue to review risks (and opportunities) from Brexit on a quarterly basis, and take mitigating actions as appropriate. Actual and potential impacts will be reported in future iterations of the Strategic Plan. The next iteration of the Strategic Plan will be presented to Council on 30 November 2016.

FINANCIAL CONSIDERATIONS

86. There are no direct financial implications arising from the recommendations of this report. Financial implications arising from Brexit will be reflected in future iterations of the Council's Medium-Term Financial Plan, within the Strategic Plan document.

RECOMMENDATIONS

It is recommended that Council:

- Notes and supports the actions being taken by the Tees Valley Combined Authority in respect of the potential impacts on the local economy identified in the report.

- Notes the additional potential implications for Middlesbrough and the Council's plans, and the initial mitigation activity agreed by Executive, as outlined in the report.

- Receives further updates on Brexit and its various implications in due course, as the Government's plans are clarified and the potential impacts of Brexit are better understood.

BACKGROUND PAPERS

None

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