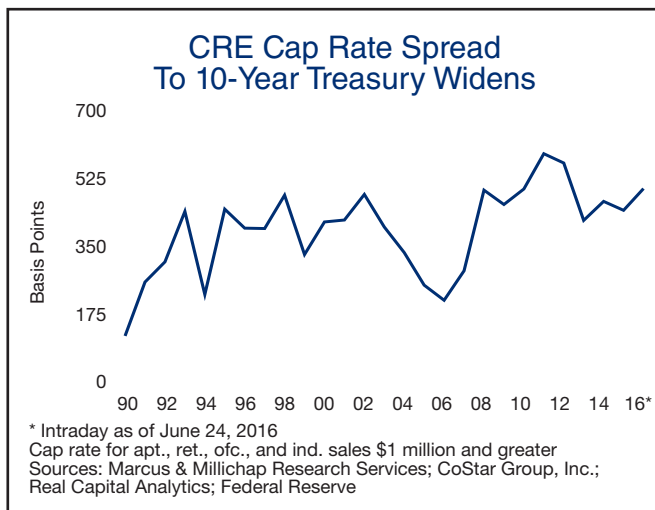


SPECIAL RESEARCH BRIEF: BREXIT

British Surprise with EU Exit Vote – Uncertainty Poses Headwind;  
Falling Interest Rates a Silver Lining for Commercial Real Estate

- Contrary to polls and predictions, citizens of the United Kingdom voted to leave the European Union, creating uncertainty that induced a sharp decline in global equity markets. The British currency fell dramatically, boosting the value of the U.S. dollar, and the quick re-deployment of capital to safer assets pushed U.S. Treasury rates to their lowest levels since 2012. Despite the short-term volatility resulting from this unanticipated outcome of the British vote, the risk to the U.S. economy should be limited.
- The U.K. receives only 3.9 percent of U.S. exports, so even a modest British recession resulting from the departure would minimally impact the U.S. economy. Granted, the broader EU takes in about 15 percent of U.S. exports, but the U.K. exit is unlikely to spark a substantive economic decline across the remaining 27 members of the union. Another potential hazard stems from the concentration of banking services in London with deep ties across the globe. However, central banks worldwide stepped in to backstop liquidity and reassure markets that banking systems will remain operational. In addition, U.S. banks recently passed their stress tests, providing assurances that they have sufficient liquidity to navigate choppy financial waters.
- Following its meeting earlier this month, the Fed cited risks associated with the Brexit vote as a contributing factor in its decision not to raise rates at that time. With the outcome of the British vote decided, the potential for a July increase has been virtually erased, and the probability of a September hike has fallen significantly. In conjunction with the decline in Treasury rates and reassurances of liquidity, commercial real estate investors could benefit from low lending costs. Although lender spreads generally widened in the aftermath of the Brexit vote, interest rates remain highly favorable for investors.
- The greatest downside risk remains that falling equity markets could create sufficient fear that investors begin a sell-off, similar to what happened at the beginning of the year. These contagion-related fear-induced risks could weaken business and consumer confidence, slowing the economy and creating downside potential for the economy.
- The Brexit will likely have little impact on short-term commercial real estate performance as few demand drivers will be influenced. Apartment demand in the second quarter appears quite robust, with positive demographics and long-run hiring momentum supporting the sector. The outlook for office and retail properties is more mixed, depending on how consumers and businesses perceive the news. Should confidence falter, demand for these property types could soften modestly, but restrained construction will remain an important factor supporting the performance of these asset types. Industrial properties are positioned to benefit from the Brexit as the strengthening dollar could lift imports of foreign goods, though potential downsides exist for U.S. manufacturers that export.
- While the Brexit decision has elevated short-term uncertainty that will likely translate into greater investor caution, it could also potentially boost commercial real estate sales in the mid to long term. Downward pressure on interest rates will benefit investors, while the appeal of hard assets with favorable yields could draw additional capital to the sector. The depth and duration of volatility surrounding the event will significantly influence the ramifications for investment real estate. However, barring an unanticipated major economic setback or consequences stemming from the Brexit, the prospects of significant downside risk are limited.



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