Corporate Governance and Standards Committee Report

Report of Audit and Business Improvement Manager

Author: Joan Poole

Tel: 01483 444854

Email: joan.poole@guildford.gov.uk

Lead Councillor responsible: Caroline Reeves

Tel: 07803 204433

Email: caroline.reeves@guildford.gov.uk

Date: 19 September 2019

Potential Impact of EU Exit

Officer Recommendation

The Committee is invited to comment on the potential risks set out in this report and the arrangements for monitoring and managing the potential impact on the Council of the UK leaving the EU on 31 October 2019, or some other date with or without a withdrawal agreement.

Reason for Recommendation:
To enable the Committee to consider the potential risks arising from leaving the EU and the scope of the project plan to mitigate or address the risks

1. Background.

1.1 Following the EU referendum in 2016, the UK was due to leave the EU on 29 March 2019 but, after protracted negotiations, the date was revised to 31 October 2019 to allow more time for negotiations between the EU member states and the UK government. Parliament has recently passed legislation compelling the Prime Minister to try to avoid the UK leaving the EU without a withdrawal agreement by requesting a further extension to the leave date in order to allow more time to seek a satisfactory withdrawal agreement. However, it is still possible for the UK to leave the EU on 31 October with or without a withdrawal agreement.

1.2 Leaving the EU will affect our current trading arrangements and treaties, covering everything from tariffs on supplies and services, to the movement of people, foodstuffs, other goods and data. If there is no overall withdrawal agreement, each element will need to be agreed separately and the UK will trade with the EU on the default terms of the World Trade Organisation (WTO), which will introduce tariffs on a number of goods.

1.3 To a great extent it has been and still is hard to predict the effect of a no deal exit, as there are so many unknowns. A number of sectors have voiced their concerns about the impact of tariffs on their business and the effect of delays at border controls, particularly where firms operate just in time supply chains. For individuals, there are concerns about medical supplies, increases in living costs, possible food shortages (*30 percent of our food comes from the EU*), financial downturn, multinational companies relocating their business either in part or entirely to an EU country and the potential that travel to the EU might be more difficult if extra checks are introduced.

1.4 The scale and uncertainty over what will happen is a national issue, but we need to understand the possible impact on the Council of a no agreement scenario. We convened an officer group, which included senior staff from Finance, Planning, Economic Development, Housing, ICT, Legal Services, Environmental Health and HR. The team looked at:

- the Council's exposure to the different corporate, project and financial risks identified in the report;
- working with local partners to understand how leaving the EU affects their risks and any shared risks;
- the significant policies relevant to the management of these risks (e.g. investment policy) to ensure they are fit for purpose in the new environment;
- the risk assessment on the assumptions used to generate the medium-term financial plan;
- staffing issues following a review of services which could be most affected
- how to monitor the impact and implications of any future agreement between the UK and EU

2. Potential Areas of Risk

2.1 The lack of certainty over what is going to happen has made planning very difficult. We still have no definite way forward, but it is sensible that we look at the potential risks facing the Council and the wider community based on our exit from the EU with no agreement.

2.2 The risks are complex and do not just involve Council services. They range from:

- changes to regulations and regulatory services such as food hygiene, food standards, emission regulations, waste and procurement
- the potential impact of the withdrawal of EU funding streams
- potential impact on delivery of our corporate plan
- potential impact on our Local Plan
- impact on the local economy and partnerships
- impact on residents due to potential financial downturn
- impact on our services due to financial downturn and potential issues with supply chains and rising costs
- non-uk nationals and the impact on our services if they decide to leave *(The Office of National Statistics Report shows that there has been a steady decrease in EU net migration figures since the year ending September 2016 and is at its lowest since 2013.)*

- impact on our services of UK nationals returning to the UK from the European Union
  (It is estimated that in 2017 there were 1.3m UK citizens living in EU countries. In the event of a no deal there is uncertainty about what their EU status will be as currently there are no overall guarantees for UK citizens in EU member states as it is up to individual countries to make that decision).
- the impact of the period of uncertainty and adjustment after the UK leaves
- The impact from changes to legislation may mean that some areas of law are altered either partly or entirely e.g. U.K. employment laws of which many come from European directives. Even in circumstances where there was a no deal exit, the legislation would continue to have effect. It would take further legislation (whether primary or secondary) to amend or abolish it.

2.3 Leaving the EU is not a straightforward process and will take some time to be completely understood due to the levels of integration. As we still do not know the form it will take, it is difficult to make a definitive assessment on the potential economic and service impact on the Council. What is generally considered is that the UK departure will have legal, economic, social and political implications irrespective of the type of agreement reached and the Council needs to identify the risks to our services and communities.

2.4 We need to identify the impact on:

- our financial resilience,
- our funding streams, especially if there is any EU funding through the LEP
- the risks to our corporate plan priorities and major project aspirations,
- the risks on day to day service delivery
- changes to UK employment law (e.g. Working Time Regulations 1998, Agency Worker Regulations 2010) or to government procurement, which is currently subject to EU legislation.
- the impact on the wider community, the economy and business and our ability to attract new inward investment
- the impact on services due to any changes in migration policies particularly important for services with EU nationals on their staff and while there may be protection for existing employees, they may decide to leave due to future uncertainty
- the possible risks of supply chain problems and costs
- fluctuation in demand for some statutory services because of potential economic recession impacting the local economy and housing market e.g. planning and building control
- impact on environmental services which are covered by EU legislation after October 2019 e.g. food safety, air quality, climate change

2.5 We do know that we will be facing a period of uncertainty with potential implications and varying degrees of risk for our service delivery, finances and future plans. The major risks include:

2.6 **Direct EU funding** – one of the most obvious financial risks is the loss of future EU funding. The government has guaranteed all funding from the EU until the end of 2020 regardless of whether it concludes a deal with the EU. The Council does not receive any EU funding and all of the local growth fund funding that we receive from the LEP is from the UK government. The government is proposing to set up a Shared Prosperity Fund to replace the EU funding stream but there is no definitive information on how this will work and when it will be available. However, the loss of EU grants across the UK will increase pressure on any future government funding schemes and we need to identify our sources of funding and assess the impact of any funding changes on our longer-term projects.

2.7 **Inward investment –** it is difficult to judge how our withdrawal from the EU will affect inward investment and how this will affect the town as we try to attract companies to move into the borough. The lack of certainty over the future, particularly with the larger multi-national companies could affect growth and investment decisions in the short term and there is the risk that they may transfer jobs elsewhere or relocate out of the borough, which would potentially have a negative impact on income from investment property rents.

2.8 **Economic Future** - the Bank of England has published the potential economic scenarios if we leave the EU covering the next 5 years. These include the possibility of recession, rising unemployment, a rise in inflation, currency fluctuation and a fall in both commercial and house prices. The figures are speculative due to the level of uncertainty over the final terms of negotiations, but it is prudent that we look at the potential impact of the worst-case scenarios. Any economic downturn and uncertainty can cause budget pressures, which we will have to manage. There could be a knock-on effect on investment and growth and increased pressure on public finances and, therefore, there may be further squeezing of public sector budgets. We also need to be aware of the implications on currency and interest rates, which could affect the financial markets and our investment strategies. This might not only have a potential impact on our financial status but could also affect pension funds.

2.9 Our Treasury Management consultants have advised us that the market already priced in a no deal scenario into the currency and stock exchange markets following the outcome of the referendum vote in 2016 and as a result, a significant downturn is not expected in the short term. Our interest projections are very conservative so we do not anticipate a significant change and we consider that at present there is no indication that the cost of UK government borrowing will rise after withdrawal unless the government has to significantly increase borrowing to balance its budget. We are not anticipating a significant impact on our borrowing costs from the Public Works Loan Board, which would have more of an impact on our medium-term budget position than the loss of investment income. However, although we have these assurances there is a continued risk of volatility in the market, inflationary pressures and the possibility of a recession, which would affect our investment property rental income and our parking income.

2.10 **Business rate income –** with the local retention of business rates, the Council will increasingly depend on its ability to retain and grow rate-paying businesses.

In addition to the inward investment risk already mentioned, the Council could be more financially vulnerable than before.

2.11 **Service pressures –** the unpredictable impact on demand for council services in the event of the UK leaving the EU could be challenging for the Council. We need to scope out where we feel that demand will increase and where there might be a downturn. We will also need to review all of our regulatory services, which are currently governed by EU legislation and identify how we move forward after withdrawal. We have identified services where we employ a number of EU nationals to assess what the risks are to services if those staff decide to leave following our departure from the EU. EU nationals currently make up just over 10% of our workforce and at the moment, there is no suggestion that there will be an immediate risk, but we are monitoring any significant movement.

2.12 The longer-term impact on our residents will depend on a number of factors some of which are outside of our immediate control. There has been a drop in net migration from the EU since 2016 and while this may reduce demand on Council services there are concerns over the potential impact on the NHS and care sectors that rely on staff from the EU for many of their services. Any downturn will put further pressure on a sector that is already stretched and struggling to deliver the level of care required for our ageing elderly population. This will inevitably affect some of our residents who rely on care staff to provide services in their own home and we are working with the NHS and Surrey County Council (SCC) to identify those most at risk.

2.13 **Housing/Homelessness -** an economic downturn will have a significant impact on housing, employment and incomes. This could result in a need to provide more support for tenants struggling with sudden changes in circumstances as well as the risk of potential increases in voids, arrears and bad debt. Homelessness may also increase because of the pressure on housing and the reduction in new developments. In the event of a recession there will be a rise in the number of housing and council tax benefit applications due to the downturn in the economy

2.14 **Housing Development** - ongoing uncertainty could lead to an increase in inflation in materials and labour costs. In addition, according to the Bank of England scenarios, there could be a significant fall in house prices. This combination could put pressure on development projects, and we will need to monitor movements in the market such as delays in development completions that might be early warning signs of problems.

2.15 **ICT and digital** - Over the last few years organisations have increasingly been taking advantage of the relatively cheap and accessible cloud-based data storage and hosting technology. The Council does store data in the cloud but because potentially the UK will leave the EU we need to understand where this data is held and which laws govern its use and access. In the event of a no-deal, the U.K. becomes what is termed a Third Country and as such is no longer a part of the EU's General Data Protection Regulation (GDPR).

2.16 It may be difficult to transfer data from an EEA-based cloud back to the U.K. in the event of a no deal because the cloud providers in the EEA will be subject to

GDPR and there may be restrictions on them. In theory, legislation could make it possible to easily transfer data to a Third Country, which is what the U.K. will become if what is known as an adequacy decision has been reached with the Third Country. This happens when the EU is satisfied that the Third Country's data protection laws are sufficiently strong. While the U.K. would hope to achieve this after a transition period, in the case of a no deal withdrawal this might not be in place in time.

2.17 **Suppliers –** The dossier codenamed Operation Yellow Hammer which was leaked to the press outlined the government's view of the risks to our supply chains in the event of a no deal. It contains details of the potential impact on our supply chains in particular on medicines, food supplies and fuel distribution. Three quarters of our medicines come to the UK through the main Channel crossing between the UK and France and some are particularly vulnerable to severe delays. While some products can be stockpiled, others cannot because of short shelf lives, and It would not be practical to stockpile six months' supplies.

2.18 It is widely reported that following our withdrawal there will be food shortages, especially of fresh foodstuffs and there will be further pressure if prices rise because of the introduction of tariffs. We have looked at our supply chains in particular where problems could affect our vulnerable residents and essential services and we have received assurances from suppliers such as our Meals on Wheels provider that they have contingency plans in place. However, wider problems could arise with increased pressure on food banks and we are working with SCC to identify areas of highest need and how we can co-ordinate resources if needed.

2.19 One of the main areas of risk is the prospect of fuel shortages. This could affect our services especially our refuse fleet, housing repairs and community services. Although we do have our own storage facilities, a national fuel supply chain problem coupled with panic buying could have an impact. In the event of fuel shortages distribution will be based on the priority services and we are looking at contingency plans to mitigate the risk.

2.20 Some of these issues are within our control and we are looking to secure our supply chains in the short term to minimise the risks to our services as much as we can. However, many of these issues have the potential to have an impact on the wider community but are outside our direct control. We are working with other partners such as the NHS, Police and SCC to understand the level of risk and put contingency plans in place. These are ongoing.

The effect of the EU (Withdrawal) Act 2018

2.21 In the event of the UK leaving the EU, the EU (Withdrawal) Act 2018 (EUWA) will come into effect. The Act creates a new category of domestic law i.e. 'retained EU law'. The Act effectively removes the domestic constitutional basis for EU law having effect in the U.K; however, it still provides for the retention of most EU law by "converting" it into a freestanding body of domestic law. The 'retained EU law' will replicate several different sources of EU law as domestic equivalents under three distinct provisions by preserving 1) EU-derived domestic legislation 2) Direct EU legislation and 3) Directly effective rights and other rights.

Therefore, the Act enables the U.K to retain the following legislation, as it existed on exit day:

- EU regulations, decisions and tertiary legislation and elements of the EEA agreement
- Domestic legislation passed to implement EU directives
- Most general principles of EU law
- Most rights and obligations that currently exist in domestic law because of s2(1) European Communities Act 1972
- Relevant case law of the Court of Justice of the European Union

The effect of the European Union (Withdrawal) (No.2) Act 2019

2.22 On 9 September 2019, the European Union (Withdrawal) (No.6) Bill 2017-19 received Royal Assent to become the European Union (Withdrawal) (No. 2) Act 2019.

2.23 The Act may have an effect on the proposed leaving date and includes provisions which:

- Impose a legal obligation on the Prime Minister to request a third extension to the Article 50 period until 23:00 on 31 January 2020. This would be the case, unless, by 19 October 2019, the government has obtained Parliament's consent either to a withdrawal agreement or a no-deal exit.

- Require the Prime Minister to immediately accept a European Council (EC) decision to agree an extension to 23:00 on 31 January 2020. Should the EC propose an alternative end date, the Prime Minister must either accept that extension, or ask the House of Commons to make a decision on its approval. In the event that the House of Commons decide not to pass a motion approving the proposed extension, the Prime Minister can then decide whether to accept or reject the proposal.

- If, by the time an extension period starts, the exit day definition is not changed to reflect the new exit date, the extension still has effect and as such the UK would remain an EU member state throughout the extension period. However, the UK would be in breach of its international obligations to give effect to EU law in domestic law during that period. If exit day is not changed, domestic legislative events would be triggered on the old exit day (as defined in the EUWA 2018) that would be incompatible with the UK's position as a continuing member state during the extension period, such as the repeal of the European Communities Act 1972 and the creation of retained EU law.

3 Financial Implications

3.1 There are no financial implications arising directly from this report. However, any resource implications associated with the implementation of the contingency plan will be subject to necessary reporting and approval processes.

4 Legal Implications

4.1 There are no legal implications arising directly from this report. The report identifies areas of risk and highlights where further work needs to be done to mitigate the risks wherever possible.

5. Human Resource Implications

5.1 There are no human resources implications arising directly from this report, but we will monitor the impact on our services over the next six months.

6 Conclusion

6.1 This report sets out the potential risks and challenges for the Council if we do not reach an agreement with the EU. The current situation is in a state of flux and issues will change depending on whether there is an agreement over the next few weeks. Whatever the outcome of the negotiations we need to be in a position to limit the risks to the Council and to identify new opportunities as and when they arise.

7. Background Papers

None

8. Appendices

None