



INDUSTRY UPDATE

QUARTER 4
YEAR 2019

Property Services

Despite continued economic uncertainty, many pockets of the property market are performing well, with strong growth prospects and M&A activity set for the future.

The property market has seen a significant decline in activity in recent years, largely due to the political and economic uncertainty rife in the UK. However, the UK economy rebounded in August thanks to a strong service sector, and many pockets of the property market are showing strong performance.



Overview

The property industry can broadly be divided into four occupier markers; retail, office, industrial and residential, with each sector facing a unique set of challenges.

Retail property sales have performed surprisingly well in 2019 with consecutive increased sales. However, the consumer retail outlook is bleak, with Brexit inflating the cost of goods and an increasing number of failed retailers, the market is likely to suffer going forward.

Office vacancy rates in London fell below 5% for the first time in two years, owing to a shortage of grade A space, a high take up and the continued growth of service offices, a trend which can be seen across the country.

Industrial property sales are consistently low, however, MCSI's quarterly index reported rental growth of 3%

in Q2 of 2019. This is down from 4.6% in 2018, but still indicative of strong demand for prime industrial properties.

Residential property transactions are estimated to account for 36.4% of industry revenue. Affordability is key in the residential market and has given rise to several trends, including an increase in privately rented households, build-to-rent accommodation and a huge disparity in house prices and transaction numbers in different parts of the country.

Aiding the property market are a range of professional property service providers, supplying clients with additional services needed to lease or purchase a property. This includes services such as estate agents, conveyancers and mortgage brokers.

	2019	2020	2021	2022	2023	5 y CAGR
UK House Price Forecast	1.5%	4.0%	3.0%	2.5%	3.0%	14.8%
North West	3.0%	6.0%	4.0%	3.0%	4.0%	21.6%
Yorkshire and Humberside	2.5%	5.5%	4.0%	3.0%	4.0%	20.5%
Wales	2.0%	5.5%	4.0%	3.0%	3.5%	19.3%
Midlands	3.0%	5.0%	3.5%	3.0%	3.5%	19.3%
Scotland	2.5%	5.0%	3.5%	2.5%	3.5%	18.2%
North East	2.0%	5.0%	3.5%	2.5%	3.5%	17.6%
South West	0.5%	3.5%	2.5%	2.5%	3.0%	12.6%
South East	0.0%	2.0%	2.5%	2.0%	2.5%	9.3%
London	-2.0%	0.0%	2.5%	1.5%	2.5%	4.5%

Estate agents

Overview

The three major players in the market are Countrywide PLC (5.1%), Connells Ltd (3.6%) and Savills PLC (3.1%). Savills is the most acquisitive of the three, acquiring eight firms in the past five years, including most recently, Meller Braggins in October 2018 for an undisclosed fee.



The UK Estate Agent industry is estimated to be worth approximately £11.1 billion, with a Compound Annual Growth Rate (CAGR) of 1.0% per annum between 2014 and 2019. During this period, although the industry has grown, revenue has been volatile. The EU referendum caused a huge amount of uncertainty in recent years and demand has fallen. The growth of online property services has also put pressure on the industry and led to a saturation of the market.

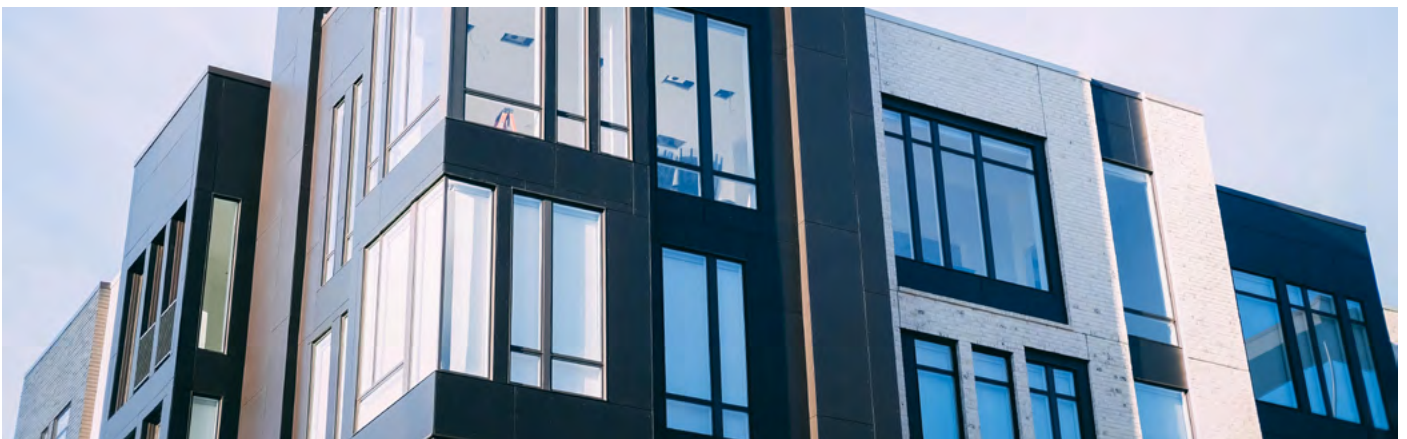
M&A

Profitability analysis reveals the disparity between the most profitable companies and the average estate agency. The top 656 companies in the market, as at January 2019, benefitted from an average net profit margin of 8.6%. In contrast, the remaining industry average was less than 1.7% margin, with many companies making a loss. These top firms are highly attractive to investors and M&A activity continues to flourish, with 72 deals completed in the past 12 months in the UK. There has been particularly strong Private Equity (PE) interest in the sector, with 56% of these deals being backed by PE Houses.

Company	Investor	Amount
BestBid	Hambro Perks	£0.5m
Vesta (UK)	Marchmont Ventures	£0.5m
Bunk	Pirus Capital	£0.85m
Flatfair	Unicorn Asset Management	£1.3m
Home Made	VentureFriends	£2m
GetAgent	Channel Four Television	£2.2m
Flatfair	Adevinta	£8.4m
YOPA Property	DMG ventures	£16m
Purplebricks	Axel Springer	£43m
YOPA Property	Balderton Capital	£120m

Risks

The estate agency landscape has changed greatly in the last decade, particularly with the arrival of online agencies such as Purple Bricks, which is now the fastest growing operator. Online estate agents attained a 7.2% share of all exchanges in the market in 2018 and this figure continues to increase. Online estate agents in the UK are quickly growing in popularity because they can help home-sellers save a small fortune. Traditional estate agent's fees are around 1.5% plus VAT; equating to £4,500 for the average house sold at £250,000. This contrasts with the online estate agent's fees of less than £1,000. It is therefore paramount for traditional estate agents to offer outstanding customer service and expertise to ensure they are providing clients with a valuable service.



Personal touch is still valued in the age of internet

52%

of buyers visited the estate agent branch

43%

of sellers visited the estate agent branch

87%

say that professionalism and rapport with branch staff is important in choosing an agent

90%

say that performance of the estate agent is important

Outlook

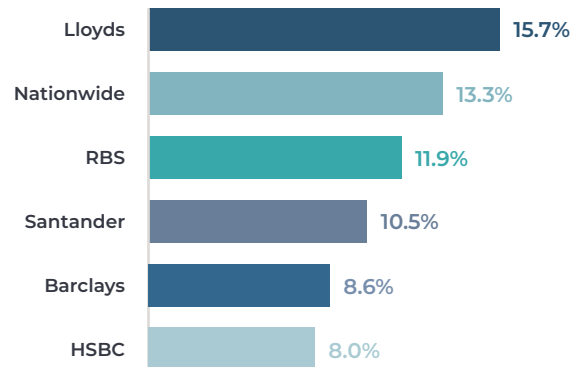
The deal secured with the European Union will play a large role in revenue growth of the property industry going forward. Revenue in the estate agent industry is forecast to expand at a CAGR of 4.5% over the next five years, generating an additional £17.2 billion. The initial years of the coming period are likely to be characterised by growing demand for lettings, as the house price-to-income ratio continues to increase in the residential market. However, in the commercial market, business capital expenditure is forecast to rise due to low financing costs and strong global growth. This is expected to support demand for commercial property going forward, creating a further opportunity for the industry.

Mortgage broking

Overview

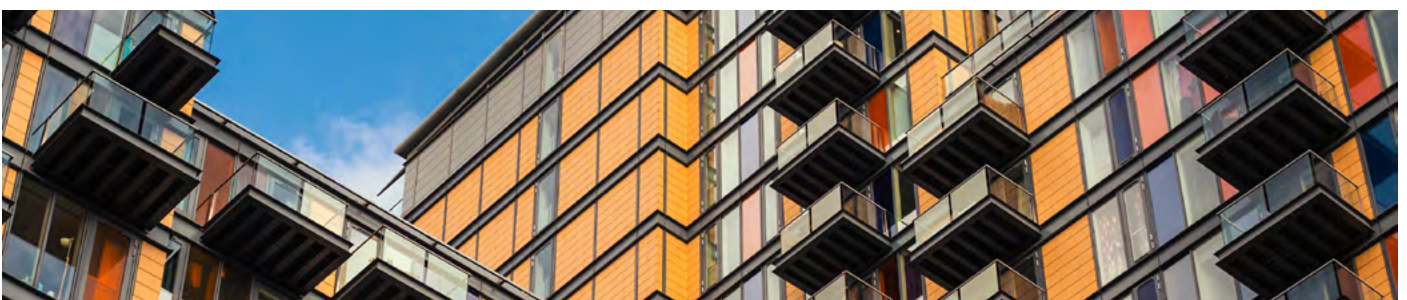
The 'big six' high street banks continue to dominate the mortgage market in the UK, as they accounted for nearly 70% of all mortgage lending in 2018.

The FT lending league tables showed Lloyds remained the largest lender with £42.5 billion worth of gross lending and 15.7% market share, followed by Nationwide (13.3%), RBS (11.9%), Santander (10.5%), Barclays (8.6%) and HSBC (8%).



Intermediaries' (brokers') share of mortgage distribution by value is over 60%, with brokers arranging mortgages valued at over £25 billion. Despite these impressive statistics, the number of mortgages arranged through brokers is still only half the level prior to the financial crisis in 2008. Nevertheless, the widening range of lenders, growing complexity in the range of mortgage features and regulatory changes, make the support and advice of brokers increasingly in demand.

Mortgage rate





M&A

M&A activity in the broking industry is low, with only five deals completed in the past 12 months in the UK, most of which were online mortgage platforms. However, with the industry being relatively niche and with a limited number of players, there has always been little M&A activity.

Company	Investor	Amount
Sterling Rock Financial	Financial Advice Centre	-
Habito	Augmentum	£5m
firstmortgage.co.uk	Mortgage Advice Bureau	£14.6m
Mojo Mortgages	Epiphany Capital	£7m
Charles Cameron & Associates	Lonsdale Capital Partners	-

Risks

Rising competition in the mortgage market is prompting banks and building societies to turn to riskier lending. Mortgage deals where banks are willing to lend more than 95% of a property's value has increased 60% in the last two years, the highest increase since the financial crisis. This is the effect of the price wars and increased competition faced in the industry today. Riskier lending is a danger to the entire property industry and could potentially cause another mortgage crisis.

Outlook

As with many of the property service sectors, technology is having a profound impact on the outlook of brokerage. Application-to-offer timescales have been reduced to a matter of minutes by many lenders, making it easy for brokers to help compare and analyse the best deals for clients. Fintech firms including Trussle, Habito and Burrow are also changing the broking landscape, offering free online mortgage brokering services to consumers. Many are using artificial intelligence to help prospective borrowers search for products based on answers provided to a series of questions. The rise of this online service is likely to take over from the traditional mortgage broking service provided by financial advisers. However, many consumers still favour the advice of a consultant to help explain the complex features of various mortgages.

Conveyancing

Overview

Conveyancing is one of the most common legal services people use in their lifetime, with more than one million homes bought and sold every year in the UK. The conveyancing market is very fragmented, with no single firm dominating the industry. The market leader holds less than 2% market share and the top 20 firms combined occupy less than 10%.





The conveyancing and lending industry are closely linked in the property purchase process. There are around 100 mortgage lenders in the UK, each of which has a set of specific requirements that a conveyancer must fulfil in order to represent the lender. Customers must instruct a solicitor from the lenders approved panel, else they will be faced with paying two sets of legal fees. This results in approved solicitors dominating the market, with lending panels having a huge influence on the marketplace. Lender panels have a detailed set of criteria, including number of purchase completions, professional indemnity insurance limit, accreditations and number of Partners. These requirements are unattainable for many smaller and emerging conveyancers, resulting in a monopolistic market.

M&A

Market analysis reveals that many of the smaller conveyancing firms are being acquired by the dominant players. 20 deals have completed in the conveyancing space in the past 12 months in the UK, five of which were acquired by top ten firms. In the same period, over 100 deals were completed in the larger legal sector and over £800 million of capital invested. This figure includes three investments from the Business Growth Fund, which is actively investing in legal firms across a variety of specialisms.

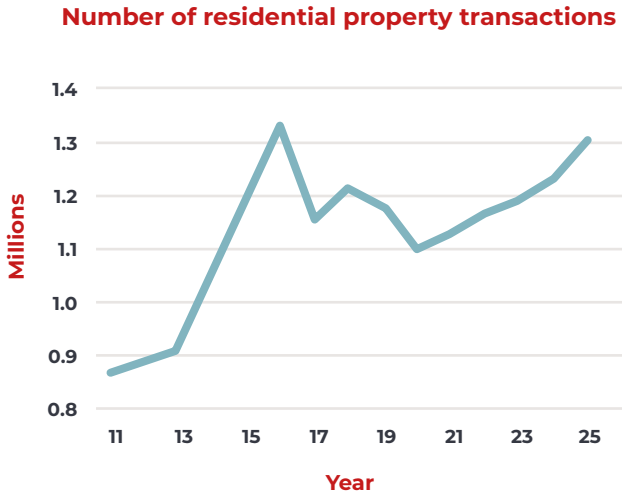
Company	Investor	Amount
Elevate Services	Kayne Anderson	£19.5m
NetDocuments	Cove Hill Partners	£231m
O'Neill Patient Solicitors	Inflexion Private Equity	-
Chapman IP	Murgitroyd Group	£6.6m
Plexus Law	Access Capital Partners	£362m
Duff & Phelps	Business Growth Fund	£10.5m
MyHomeMove	Palamon Capital Partners	-
Peppermint Technology	Scottish Equity Partners	£7m
Amicus Resolution	Par Equity	£0.7m
Apperio	Business Growth Fund	£7.4m

Risks

According to the SRA, there are concerns about the conduct of some solicitors and the quality of service they are providing, with a high proportion of insurance claims and complaints to the Legal Ombudsman relating to conveyancing. There are also increasing risks for conveyancing clients, as technological problems such as cybercrime and mortgage fraud increase. More than 52% of people rely on recommendations when choosing a solicitor, so it is of utmost importance for companies to keep their integrity and reputation intact.

Outlook

Technology will play a huge part in the conveyancing process going forward, especially when it comes to communication. Consumers are demanding a more convenient, online platform with pre-populated forms and digital document readers, making the process easier and quicker for all parties. Increased regulation surrounding transparency of fees will also come into effect over the next few years, which is expected to increase consumer confidence and satisfaction. Conveyancing relies on the property market, particularly the number of transactions completed. The number of property transactions is projected to rise by a CAGR of 6% from 2018 – 2022 and it is expected that the conveyancing market will increase with it.



Conclusion

Despite the unique trends and challenges faced by each of the property service industries, there are many overriding similarities in the market. The EU referendum and the uncertainty that surrounds Brexit, has muted demand and increased volatility industry wide. Technology is also a common denominator and revolutionising the market. It is up to existing firms to embrace the change going forward if they want to compete with emerging technology companies and keep up with the evolving market.

The outlook for the property industry is bright, as the date for Britain’s departure from the EU draws nearer, industry experts expect confidence to rise and transaction numbers to increase significantly over the coming years. This will have a positive impact on all the property service establishments, as they rely on the stability and demand of the property market.

Gerald Edelman services

We have significant experience in and deliver a range of services to those in the property sector, including:

- ▶ Business development and strategy
- ▶ M&A and deal advisory
- ▶ Tax planning and advice including VAT, SDLT & CIS
- ▶ Asset finance and leasing solutions
- ▶ HR advisory



Contact Us

To speak to one of our experts in **property services** contact:



Deval Patel

PARTNER

- ☎ +44 (0)20 8492 5642
- ☎ +44 (0)7768 823 875
- ✉ dpatel@geraldedelman.com



Hiten Patel

PARTNER

- ☎ +44 (0)20 7299 1444
- ☎ +44 (0)7788 920 364
- ✉ hpatel@geraldedelman.com

73 Cornhill
London
EC3V 3QQ


1238 High Road
London
N20 0LH



+44 (0)20 7299 1400
hello@geraldedelman.com



+44 (0)20 8492 5600
hello@geraldedelman.com



 73 Cornhill
London
EC3V 3QQ

 1238 High Road
London
N20 0LH

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 hello@geraldedelman.com

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