

# Property market disruption impacting estate agent profitability

## Get in e-state

Estate agents are facing an unprecedented set of challenges. Long-running structural changes in the market have combined with prolonged political and economic uncertainty and a raft of legislative changes, generating headwinds for agents of all scales. Rethinking their strategies, operational processes and business models will be a priority for many agents to retain competitiveness and profitability in an increasingly disrupted market.

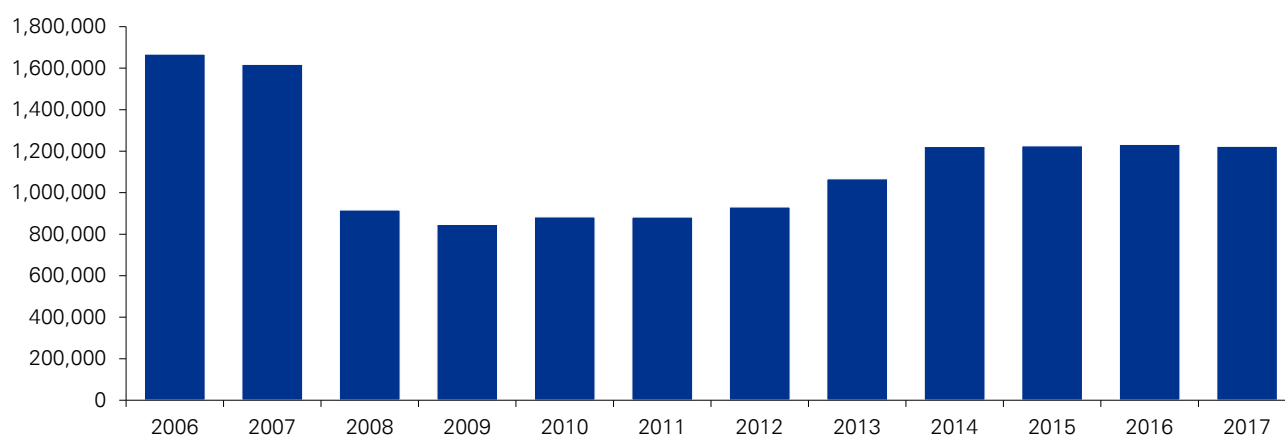
## Transaction volumes slide, but only back to pre-2016 levels

Although the latest ONS data shows average sales prices across the UK have increased 3.5% over the year, this figure obscures wide national variations - most notably in London where prices declined by 0.3%<sup>1</sup>.

Yet for estate agents taking a fee from each sale, it's volume, rather than value, which has the biggest impact on their bottom line. And on this measure, the newspaper headlines look rather downbeat. HMRC data for October 2018 saw completed transaction grow a slight 1.3% on a seasonally-adjusted basis against the same month a year ago<sup>2</sup>. Some tightening mortgage criteria, broader economic uncertainty and a general concern around affordability are all contributory factors.

Whilst that all sounds precipitous, looking a little further back provides some noteworthy context. As widely reported, the sector has experienced huge sales volatility in recent years - driven largely by changes in stamp duty affecting buy-to-let landlords and international investors. Indeed, after a notable spike prior to stamp duty reform, the national market is broadly returning to around 100,000 transactions per month (seasonally adjusted), which has been broadly flat for the past few years. So, what's going on?

## UK Residential Transactions, 2006-2017



Source: Office for National Statistics/HMRC data.

Data made available under Open Government Licence for Public Sector Information (OGL). Further information available here: <https://www.nationalarchives.gov.uk/doc/open-government-licence/version/3/>

<sup>1</sup> Office for National Statistics / UK Land Registry, UK House Price Index Summary (August 2018)

<https://www.gov.uk/government/publications/uk-house-price-index-summary-september-2018/uk-house-price-index-summary-september-2018>

<sup>2</sup> Office for National Statistics / HMRC, Monthly property transactions completed in the UK with a value of £40,000 or above (October 2018) <https://www.gov.uk/government/statistics/monthly-property-transactions-completed-in-the-uk-with-value-40000-or-above>

## Structural issues are squeezing margins

We see that the stress in the sector is largely a result of structural changes that have been incrementally eroding margins for several years, the drop in sales completions exacerbating issues that have hitherto remained latent.

Traditional estate agents are, at their most basic, shops for houses. As such, many of the issues impacting the retail sector (minimum wage legislation, declining footfalls and increased overheads) are similarly affecting High Street agents' cost bases.

And, like retail, they are also being shaken by the internet revolution - properties previously advertised only in shop windows or in newspaper ads now appear on specialist web portals. This initial shift to online worked with the established players' operating models rather than against them, driving footfall to retail branches. Yet the relatively recent arrival of online-only and hybrid estate agents seek to cut out High Street operators altogether whilst getting the client to do much of the sales work. Though still commanding only 8% of the market, these new entrants have grown their market share by over 30% year-on-year. Potential consolidation in the online agency space could create some sizable nationwide rivals to the established players.

The upshot is a significant and ongoing squeeze on revenue as traditional agencies aggressively compete with each other on price in order to sustain a property book large enough to keep prospective buyers coming through the doors and cashflow sufficient to cover their overheads. This is particularly acute where new branches have been opened speculatively or based on instinct, creating localised pockets of extreme oversupply. One industry source estimates that whilst in 2011 three-quarters of sellers paid more than 1% in agency fees, by 2017 this had fallen to one-third<sup>3</sup>. In a market where house prices are failing to rise materially and fixed costs continue to climb, a shrinking slice of an unchanging pie can only erode the bottom line.

## New legislation will apply further pressure on margins and sales

Agencies, particularly in London, generate a significant proportion of income from assured shorthold tenancies. New legislation, expected to come into effect in 2019, will prevent agents from charging up-front 'one-off' fees to new tenants, which can total hundreds of pounds per letting.

Whether agents will be able to recover the lost income from the landlord in such a competitive market remains doubtful. Add in ongoing economic uncertainty and it's clear that market pressures will remain for the foreseeable future.

## So how can we help?

### Making data-driven decisions

In such an unpredictable environment, agents need to be rethinking their strategies, operating and business models holistically – tinkering around the edges or looking at issues in isolation may be insufficient in order to retain relevance. Identifying and critically assessing revenue and cost drivers at a granular level is essential in order to make data-driven strategic and operational decisions.

Estate agents need to assess, as part of their strategic review, whether their own 'estate' remains fit-for-purpose. This includes evaluating their branch network against a range of indices - catchment area sizes, sales mix, neighbourhood demographics, local competition, and so on.

This in itself may drive questions that could transform the whole operating model – if the majority of their trade is now coming from online than from passing trade, does an agency need to retain expensive High Street locations in order to retain a local presence? Would a franchise model provide greater flexibility and reduce exposure?

We have an established track record in working with clients to identify and support implementation of cost reduction and revenue optimisation opportunities. We have access to a range of market-leading data tools that can analyse and visualise current performance against a range of metrics and support evidence-based decision-making.

### Adapting to new technologies

There's few industries as old as selling property, and yet even here technology is already transforming how agents operate day-to-day.

<sup>3</sup> Property Industry Eye, <http://www.propertyindustryeye.com/average-estate-agents-fee-sinks-to-1-with-more-falls-forecast/September 2017>

The advancement of AI and Machine Learning that can accurately and reliably undertake valuations with little or no human input is likely to erode existing revenue streams. Similarly, web-based platforms can already automate many of the manual credit checking, referencing and approval processes involved in shorthand assured property lettings.

Those who can incorporate such innovations into their operating model will benefit from long-term efficiencies and keep one step ahead of the competition. We are recognised leaders in the PropTech space and can advise on how to implement effectively new technologies to ensure your overall proposition remains distinctive.

If you are interested in our offering, please contact us.



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