

Homebuilding in the UK

A market study

September 2008

OFT1020

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1 EXECUTIVE SUMMARY

- 1.1 A well functioning new homebuilding market in the UK is crucial - both for the thousands of homebuyers who buy a new home every year and for the health of the wider UK economy. Despite the recent downturn in the general property market and in the market for new homes, the homebuilding industry in the UK remains large. During 2007 just under 194,000 new homes were built in the UK, representing sales of around £45 billion.
- 1.2 Before 2007, the homebuilding industry enjoyed a period of significant growth, characterised by the increasing price of land and homes, and fuelled by strong underlying demand and the ability of homebuyers to borrow many times their earnings relatively cheaply. But this steady rise in the price of homes did not appear to be matched by a steady increase in the number of homes being built by homebuilders. As a result, some commentators questioned whether there might be competition problems in the industry.
- 1.3 We launched this study into the state of competition and the effectiveness of consumer protection in the homebuilding industry just before activity in the wider property market and the new homebuilding industry began to slow, and then enter a severe downturn. In 2008 we saw major reductions in the share price of listed homebuilders and a sharp decline in the number of homes being built and sold. So we were able to observe at first hand the realisation of many of the risks that homebuilders face, and must accommodate in their business models, even in better times.
- 1.4 Our study was launched partly in response to the suggestion that competition problems might lie behind the sluggish response to rising prices, and partly in response to the 2004 Barker review. This expressed concerns about the level of consumer satisfaction with new homes and recommended that the industry should increase levels of homebuyer satisfaction by developing a code of conduct. Later, the Callcutt review recommended that, subject to a two year notice period and special arrangements for new entrants and small firms, the Government and

public agencies should cease dealings with any homebuilding firm which did not meet a predetermined standard of customer satisfaction.

- 1.5 This report presents the Office of Fair Trading's assessment of competition in the delivery of new homes. The results from our survey of new homebuyers, our mystery shopping exercise and many interviews with individual homebuilders are central to our competition assessment – a well functioning market for new homes should deliver homes which are fit for purpose and are finished to a level expected by the homebuyer.

Key findings

- 1.6 Our study found little evidence of competition problems with the delivery of new homes in the UK. The evidence points towards a conclusion that homebuilders in the UK compete for sales against each other and existing homes – that is, while some homebuyers may wish to buy only a new home, many consider buying either a new or existing home, and so the price of existing homes and the price of new homes constrain each other.
- 1.7 We found no evidence that individual homebuilders have persistent or widespread market power or that they are able to restrict supply or inflate prices. On rare occasions an individual homebuilder may find that it is temporarily the sole provider of a particular type of housing in a local market, but these examples appear to be scarce and account for a small fraction of the total supply of new homes.
- 1.8 Having a stock of land helps a homebuilder cope with fluctuations in the housing market and also helps to reduce its exposure to risk resulting from the planning system. We have not found any evidence that homebuilders have the ability to anti-competitively hoard land or own a large amount of land with planning permission on which they have not started to build. Apart from the homebuilding firms, the available information suggests that the largest 'landbank' may be that held by the public sector. Homebuilders are, to some extent, constrained by the availability of suitable land. If the Government and devolved administrations wish to ease this constraint going forward then one potential way of doing this would be to make more public sector land,

which is suitable for development, more readily available to homebuilders.

- 1.9 Small homebuilders and individuals building their own homes will build on smaller sites which the larger homebuilders will not take on. Without the smaller homebuilders and self build some sites would simply remain undeveloped. The UK lags behind other countries in the number of self build projects. In terms of ensuring that land which is already available for homebuilding is used efficiently and output maximised, it is important to maintain a vibrant small and self build sector.
- 1.10 While the homebuilding industry largely has a clean bill of health in terms of competition, this does not mean that there are no problems at all. Many homebuyers experience some faults with a new home, many of which are quickly fixed, but some homebuyers experience significant detriment, distress and inconvenience that comes with major, or many, faults in a new home.
- 1.11 In a competitive market, all other things being equal, a product that delivers a higher level of customer satisfaction will be expected to outsell a product with lower customer satisfaction. This outcome can only be expected, however, when consumers are readily able to discern how good the product is before they purchase it. Homebuyers are not able to accurately assess the quality of a new home in advance of purchase and the – perhaps overwhelming – importance of price and location means that homebuilders may not compete as fiercely as they might on some aspects of quality and customer service.
- 1.12 While overall financial consumer detriment from faults, poor customer service and moving in delays is relatively low compared to the size of the industry, it is not insignificant in absolute terms. We have not, however, attempted to put a financial figure on distress and inconvenience which for some homebuyers at least will be considerable. Buying a home is, of course, the biggest investment that many people will ever make and when things do go wrong, homebuyers quite literally live with the results. Many homebuyers will experience a relatively low level of annoyance waiting for small faults to be fixed. But some homebuyers, in addition to financial detriment from the loss of facility, will experience

considerable distress living – sometimes for long periods – with faulty plumbing, heating and the failure of other functional items.

- 1.13 The sales process for a new home also is not without problems – we have concerns around reservation fees, the clarity of information provided to homebuyers, and we consider some of the terms and conditions in many contracts used across the industry may potentially be unfair.
- 1.14 Looking to the future, new regulations and standards such as the Code for Sustainable Homes may bring with them new challenges for homebuilders – in particular for smaller firms who may struggle, without assistance, to meet the requirements and to implement new technological solutions. In addition, it may be the case that as homebuilders adapt to the new standards there will be a transition period in which snagging and faults with new homes increase rather than decrease.
- 1.15 The recent downturn in the housing market coupled with the impact of the 'credit crunch' is likely to result in a significant reduction in the number of homes built in the short term and a reduction in capacity of the homebuilding industry. The likelihood is that once the market begins to improve there will be a substantial time lag before there is sufficient capacity in the industry to once again build homes at 2007 rates.

Key recommendations

- 1.16 We published much of our evidence and background reports in advance of this final report to allow our stakeholders to comment on, and contribute to, our findings. During the course of this study, the industry acknowledged the concerns that we raised around problems with the finishing of some new homes and aspects of the sales process.
- 1.17 The following organisations have said that they are now committed to the introduction of a code of conduct which meets the consumer protection concerns raised in this report:
 - Construction Employers Federation (NI)

- Council of Mortgage Lenders
- Federation of Master Builders
- Home Builders Federation
- House Builders Association
- Homes for Scotland
- LABC New Home Warranty
- National House Building Council
- Premier Guarantee
- Retirement Housing Group (of The Home Builders Federation)
- Zurich Building Guarantee

1.18 Four years ago the Barker review called on the industry to develop a code of conduct and seek OFT approval for that code. Part of the driver for this report was the absence of any code resulting from the Barker review. So, despite welcoming and supporting the efforts of the industry, it is still appropriate for us to make a recommendation that should kick in automatically in the event that the industry fails to meet any one of four agreed milestones on the way to its proposed deadline of a fully operational code by March 2010.

1.19 In the event that the industry fails to make adequate progress, or fails to deliver an effective solution to the concerns raised in this report, we recommend immediate further intervention in the form of a statutory redress mechanism for new homebuyers funded by a levy on the industry. The redress scheme should be capable of awarding redress and compensation for any failings in the sales process, shortcomings in contracts, delays or faults. To help offset the asymmetry of information between homebuyer and homebuilder which leads to the inability of the prospective buyer to choose the highest quality homebuilder, the results of the redress scheme – in terms of the number and outcomes of

complaints made against individual homebuilders – should be made public.

- 1.20 In order to aid capital constrained small homebuilders, we recommend that consideration should be given to the timing of the payment for the proposed community infrastructure levy (CIL) for small homebuilders. Since profits are only realised at the end of the project, and the CIL paid at the beginning, this is likely to place extra pressure on small homebuilders.
- 1.21 Similarly, if the CIL is extended to self build developments, we would recommend that in order to ease development funding pressure by reducing the up-front pre-mortgage costs faced by self builders, the CIL should be paid at the end, rather than the beginning, of a project.
- 1.22 To facilitate the technological advances required by the Code for Sustainable Homes, it is important to help small homebuilders and self builders make use of off-the-peg solutions for meeting the various code levels. Currently the majority of the products available come from abroad and small homebuilders and those undertaking self build projects may not have the required contacts or knowledge to explore these solutions. We recommend that Government and the Welsh Assembly Government should consider the need to assist small homebuilders and individuals building their own homes so that they can access the necessary technologies to overcome the zero carbon challenge.
- 1.23 Again with a view to maximising output, we would recommend that local authorities should consider the possibility that group self build could deliver a healthy proportion of new housing. Local authorities should be encouraged to make publicly owned land available to an 'enabler' who will control the overall design of the site, divide it into suitable plots and plan necessary infrastructure allowing people building their own homes to develop these plots.

Thank you

- 1.24 As part of this study, we have consulted many consumer groups, industry professionals, trade and professional bodies, Government departments and the devolved administrations in Northern Ireland,

Scotland and Wales. We have surveyed homebuyers and interviewed many individuals, housing associations and landlords buying new homes as part of their business. We have mystery shopped, sent questionnaires to 7,000 UK homebuilders, asked the top 10 firms to fill in detailed surveys, commissioned an academic study into warranties and expert reports on business models and financing.

- 1.25 A list of organisations and individuals to whom we are grateful for their contributions and willingness to assist the OFT's team in its work can be found in Annexe A to this report.

2 INTRODUCTION

2.1 The Barker Review¹ of Housing Supply's Final Report in March 2004² (Barker review) was one of the main drivers for this study. The Barker review concluded that the industry must increase levels of customer satisfaction and develop a code of conduct for new home sales. In particular, the Barker review recommended that:

'The HBF [Home Builders Federation] should develop a strategy to increase the proportion of house buyers who would recommend their housebuilder from 46 per cent to at least 75 per cent by 2007.

Over the same period, levels of customer satisfaction with service quality should rise from 65 per cent to at least 85 per cent...'

2.2 The Barker review also called upon the Home Builders Federation (HBF) to develop a code of conduct in full compliance with the framework provided by the OFT's Consumer Codes Approval Scheme (CCAS) and said that this code of conduct should require fair contracts complying with the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs). The Barker review stated that if progress was unsatisfactory, or if consumer satisfaction levels did not rise substantially within three years, the OFT should conduct a wide-ranging review of whether the market for new homebuilding was working well for consumers.

2.3 Following the Barker review's recommendations, we monitored the homebuilding sector and, in the absence of any apparently effective industry code, in June 2007 concluded that a wide - ranging market study was appropriate.

¹ This was set up by the Government to look at the reasons for the lack of supply and low responsiveness of housing in the UK.

² www.hm-treasury.gov.uk/media/E/3/barker_review_report_494.pdf

- 2.4 While we had been monitoring the industry, we had further noted the concerns of various commentators regarding why homebuilders were not building more homes even when house prices were rising sharply.³
- 2.5 We were also aware of polarised views on landbanking and were alive to the belief in certain circles that homebuilders were hoarding land with planning permission, rather than building on it, in order to profit from rising land prices.⁴

Impact of other reviews

- 2.6 In establishing the parameters for this study, we worked closely with the Callcutt review⁵ both to avoid duplication of effort and to feed its findings into our study. We also worked closely with the National Audit Office (NAO) which is conducting a study into the planning regime.⁶ In order to avoid an overlap with the NAO, we refined the scope of our study to omit any detailed examination of the planning regime, limiting our work in this area to the impact of features of the planning regime which may have a strong link to our analysis of competition.⁷

³ See, for example, Hometrack, Housing Intelligence, June 2007, Where is the first rung of the housing ladder? Challenges and risks of a longstanding imbalance in housing supply. Available at:

www.hometrack.co.uk/documents/Publications/HI%20May%202007%20First%20rung%20of%20the%20housing%20ladder.pdf

⁴ See, for example, *Opening up the Debate Exploring housing land supply myths*, a report based evidence given to the Callcutt review prepared by the Royal Town Planning Institute (RTPI) which can be found at www.callcuttreview.co.uk/downloads/royaltownplanninginstitute.doc, evidence to the Barker review submitted by the Chartered Institute of Housing which can be found at www.cih.org/display.php?db=policies&id=425 and certain views expressed in *Affordability and the Supply of Housing* which can be found at www.parliament.the-stationery-office.com/pa/cm200506/cmselect/cmodpm/703/703-i.pdf

⁵ The Callcutt Review of Housebuilding Delivery published its report on 22 November 2007. See www.communities.gov.uk/documents/housing/pdf/callcuttreview.pdf

⁶ www.nao.org.uk/publications/workinprogress/home_planning.htm

⁷ www.oft.gov.uk/advice_and_resources/resource_base/market-studies/current/home1

Methodology

2.7 Market studies involve detailed examinations of markets, practices and regulation to explore whether the needs of consumers in a particular market are being well served.⁸ They are exploratory studies to gain the best possible understanding of how markets are working. Possible outcomes of a market study include:

- giving the market a clean bill of health
- publishing information to help consumers
- encouraging firms to take voluntary action
- encouraging an industry code of practice
- making recommendations to the Government or sector regulators
- investigation and enforcement action against companies suspected of breaching consumer or competition law
- a market investigation reference to the Competition Commission.

2.8 If a study reveals the need for further investigation or action under any of the OFT's enforcement powers, the OFT will act accordingly, subject to its administrative priorities.

2.9 When we launched this study, we invited written submissions from interested parties and these proved crucial in highlighting the key issues for the study to consider. Throughout this study we consulted widely with a broad range of homebuilders, academics and other industry professionals, key trade and professional organisations and government. A full list of consultees and contributors can be found at Annexe A.

⁸ www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft519.pdf,
www.offt.gov.uk/advice_and_resources/small_businesses/competing/studies

2.10 Contacts and discussions with stakeholders continued to play a major role as the study progressed. In particular, we published much of our evidence and background reports well in advance of final publication of this report.⁹ These background reports were supplemented by other discrete reviews and information gathering exercises. The principal reports and reviews which we prepared or commissioned are outlined below.

Consumer survey

2.11 This was a face to face survey of 1052 new build homeowners in Great Britain looking at their experience of buying a new home. A draft of the results of this survey was published on our website in June 2008.¹⁰ The final report can be found at Annexe B.

Mystery shop

2.12 This commissioned work comprised some 615 mystery visits or 'shops' carried out at new build developments throughout the United Kingdom. A draft of the results of the mystery shop was published on our website in July 2008.¹¹ The final report can be found at Annexe C.

Homebuilders' survey

2.13 This survey was undertaken in November 2007 to help test various hypotheses from the study. Paper questionnaires were posted to a sample of 7,000 UK homebuilders covering small, medium, large homebuilding businesses. The final report can be found at Annexe D. In addition, in January 2008 the top 10 homebuilders (by volume) were sent detailed follow up questions.

⁹ See www.offt.gov.uk/advice_and_resources/resource_base/market-studies/current/home1

¹⁰ www.offt.gov.uk/advice_and_resources/resource_base/market-studies/current/home1

¹¹ www.offt.gov.uk/advice_and_resources/resource_base/market-studies/current/home1

Finance study

2.14 This commissioned work was done by KPMG and sought to provide an overview of the financing issues and any associated constraints which may face homebuilders. It also looked at whether there was a commercial rationale for 'landbanking.' A draft of this report was published on our website in June 2008.¹² The final version of this report can be found at Annexe E.

Case studies

2.15 We conducted a series of case studies with homebuilders across the UK. These case studies are set out at Annexe F. The aim of these case studies was to assist us in further understanding the issues faced in the homebuilding sector and to feed this knowledge into the wider study. In choosing the case studies, as well as ensuring a regional and national split, we also sought to use examples from as many differing types of homebuilding site as possible.

2.16 We are particularly grateful to the homebuilders who assisted with these case studies and their willingness to participate in the process is very much appreciated. The case studies were conducted between February and May 2008 with the following homebuilders and at the following sites:

- Fairgrove Homes, Grange Gardens, Loscoe, Derbyshire
- Fairview New Homes, Delta Apartments, Aylesbury
- English Partnerships Development, Upton, Northampton
- Redrow, The Vision Project, Devonport, Plymouth
- J & K Builders, Camber Sands, East Sussex
- Carvill Group, Woodbrook Development, County Down

¹² www.offt.gov.uk/advice_and_resources/resource_base/market-studies/current/home1

- Jason Orme, self build, Bewdley, Worcestershire
- Crest Nicholson, The Atrium, Camberley, Surrey
- Mactaggart and Mickel, The Drum, Bo'ness
- East Shore Village, Seaham, County Durham
- Anwyl Construction, Ty Newydd, Wrexham
- George Wimpey, The Bridge, Dartford, Kent
- St James Parade, Cyfartha Mews, Merthyr Tydfil
- Danny Ward, Cuthberts Maltings, Diss, Norfolk.

Review of the legal framework and review of alternative dispute resolution (ADR)

2.17 This is a review of the framework of key laws, instruments and regulations that apply to the construction, marketing and sale of new homes in the UK. It also highlights the available remedies and avenues of redress open to homebuyers. This review can be found at Annexe G. In conjunction with this, we also reviewed ADR available to new build homebuyers. This review can be found at Annexe H.

Review of regulation

2.18 We conducted a review of regulation relevant to homebuilding. Details of this review can be found at Annexe I.

Warranties

2.19 We commissioned a report from Professor Sommerville of Glasgow Caledonian University. The report provides his view of the main aspects of the UK new home warranty market and includes an examination of the homebuyer's understanding of warranties and why, and to what extent, homebuyers regard them as important. It also provides his view

of a range of international warranty regimes and provisions (Canada, Japan, France, Australia and the USA) together with a discussion of how they compare with those in the UK. A draft of this report was placed on our website in July 2008.¹³ This report can be found at Annexe J.

Review of the homebuying process

2.20 We conducted a brief review of the key stages of the homebuying process. Details of this can be found at Annexe K.

Comparison of consumer satisfaction surveys

2.21 We undertook an analysis of comparators with customer satisfaction levels in other sectors. Details can be found at Annexe L

2.22 In addition, we considered individual complaints from homebuyers submitted to us during the course of the study, looked at relevant advertising and carried out structured interviews with buy to let investors, representatives of housing associations, self build homebuyers and individual tradesmen.

Consultation with stakeholders

2.23 In June and July 2008, we consulted with our key stakeholders seeking views and comments on our provisional findings. As part of this process, we discussed with the industry the possibility of the industry establishing a code of conduct. As described above in the Executive Summary, the homebuilding industry has decided to set up and administer a code of conduct. Copies of letters from the representative organisations in the homebuilding industry indicating their intention to set up a code of conduct can be found at Annexe M.

¹³ www.offt.gov.uk/advice_and_resources/resource_base/market-studies/current/home1

Format of the report

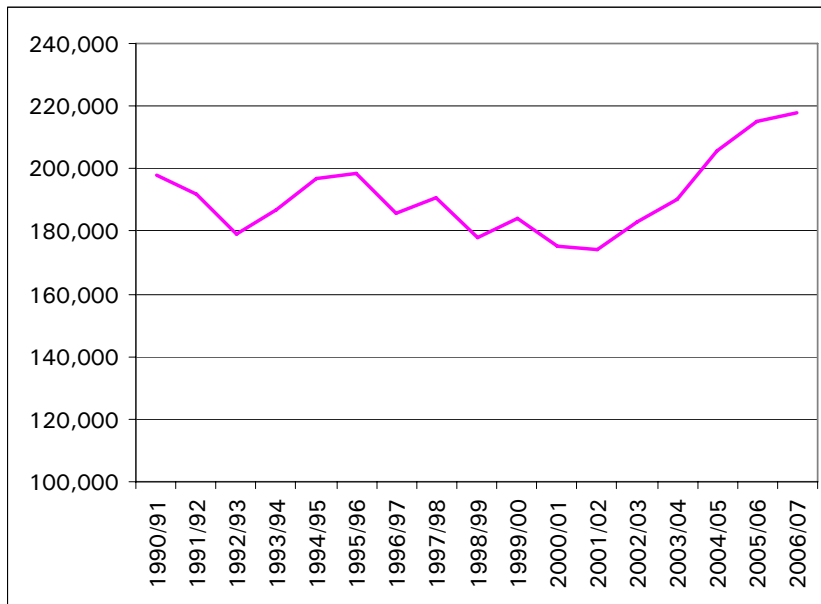
- 2.24 The report on this market study begins by providing an overview of the homebuilding industry. This examines the size and structure of the industry and then provides a short history of the housing market and the various cycles it has experienced from the end of the Second World War to current times.
- 2.25 Chapter 4 then moves on to look at competition in the industry. It covers market definition, market concentration at a national and local level and barriers to entry and expansion. It also examines vertical integration, switching costs and information asymmetries. Finally it asks whether the market delivers a good outcome for homebuyers.
- 2.26 Chapter 5 discusses land supply and landbanking. It first looks at the availability, ownership and pricing of land in the UK. It then addresses the issues of whether insufficient amounts of residential land are released by landowners even when land values are high and whether homebuilders do not build on permissioned land but instead hoard it in landbanks so as to restrict output.
- 2.27 Chapter 6 addresses the issue of consumer protection. It discusses the results of our mystery shopping exercise and consumer survey which we used to examine the homebuyer's experience of the sales process for a new home. It then proceeds to analyse the methods of redress open to homebuyers when things do go wrong and scrutinises the general level of consumer protection which currently exists for homebuyers purchasing new homes.
- 2.28 Chapter 7 then sets out our suggested remedies to address the problems we have discovered and examined in the previous Chapters.
- 2.29 The report concludes with Chapter 8 which discusses the prospects for the industry going forward.
- 2.30 The details in this report are checked as accurate to 1 September 2008.

3 OVERVIEW OF THE HOMEBUILDING INDUSTRY

Size and structure of the industry

3.1 During 2007 about 194,000 private dwellings were started in the UK¹⁴ and in the first quarter of 2007 the average price of a new home in the UK was just over £232,000¹⁵ implying the value of the private new homes market was about £45 billion. It is likely that output and prices for 2007/08 will be lower as a result of a sharp deterioration in market conditions.

Chart 3.1: Permanent dwellings completed, United Kingdom



Source: CLG live table 209.

3.2 The UK homebuilding market consists of a relatively small number of large homebuilders building most new homes and a large number of smaller homebuilders. In 2006 the top 10 homebuilders built 44 per cent of all new homes and the top 25 homebuilders built 54 per cent. The 75

¹⁴ CLG live table 209.

¹⁵ CLG live table 507.

largest firms supplied about 63 per cent of output¹⁶ and roughly a quarter of supply is accounted for by a long 'tail' of about 5,000 firms.¹⁷

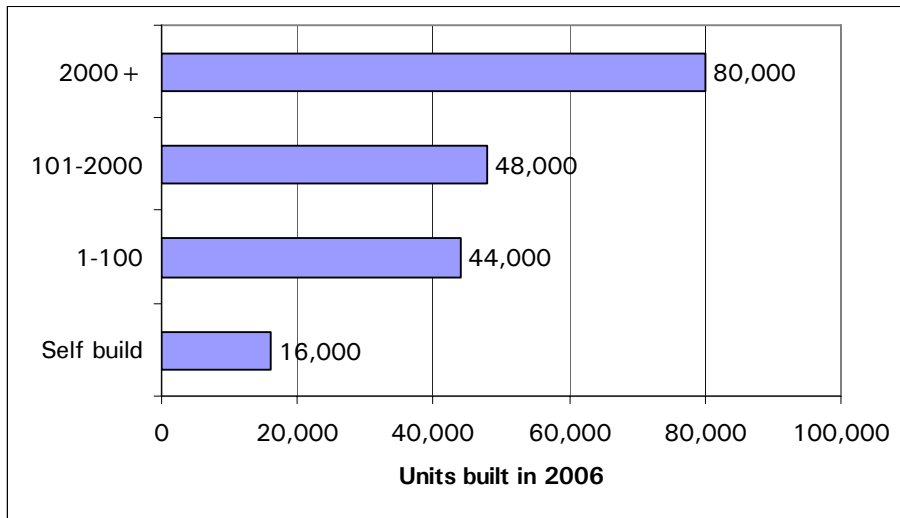
3.3 NHBC figures (see Chart 3.2) indicate that in 2006, homebuilders building more than 2,000 homes a year produced 43 per cent of total private homebuilding output, homebuilders building between 101 and 2,000 homes a year were responsible for 26 per cent and those building up to 100 homes a year built 23 per cent of homes. We estimate that self built homes provided nearly 9 per cent of private new home supply in that year.¹⁸

¹⁶ Source: *Housing Market Intelligence Report 2007*.

¹⁷ Source NHBC. It should be noted that the ONS figures database lists 26,500 private contractors whose main business is homebuilding compared with approximately 6,000 registered with the NHBC to build homes in 2006. The ONS will include many smaller contractors who rarely build complete homes and whose 'homebuilding' tends to be building extensions, conservatories etc. It should also be noted that NHBC covers about 80 per cent of the market.

¹⁸ It is extremely difficult to get accurate data about how many self built homes are produced each year. Throughout this report we have worked on the assumption that about 16,000 self built homes are constructed each year. Our calculation is set out in Annexe R.

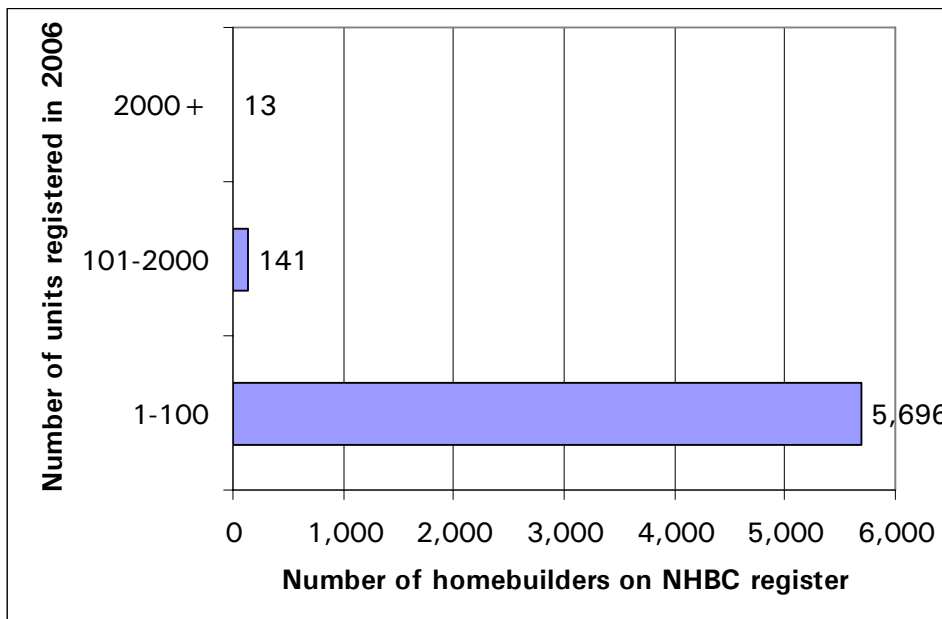
Chart 3.2: Total number of homes built by size of homebuilder, 2006



Source: Table 13, NHBC, *New Housebuilding Statistics 2007* and OFT estimates.

3.4 In 2006 there were 154 homebuilders who were building more than 101 homes a year. There were 5,850 homebuilders who registered with NHBC in 2006, 5,696 of them built fewer than 100 homes that year.

Chart 3.3: Number of homebuilders by size, 2006



Source: NHBC.

3.5 Table 3.1 shows the top 10 homebuilders by turnover in 2006.

Table 3.1: Top 10 homebuilders, ranked by turnover, 2006

Company	Units built	Percentage of total private housing output (193,720 homes)
Taylor Wimpey	21,910	11
Persimmon	16,701	9
Barratt	14,601	8
Bellway	7,117	4
Berkeley Group	3,001	2
Redrow	4,735	2
Miller	3,960	2
Crest Nicholson	2,946	2
Gladedale	3,854	2
Bovis	3,123	2

Source: Housing Market Intelligence Report 2007 and CLG live table 211.

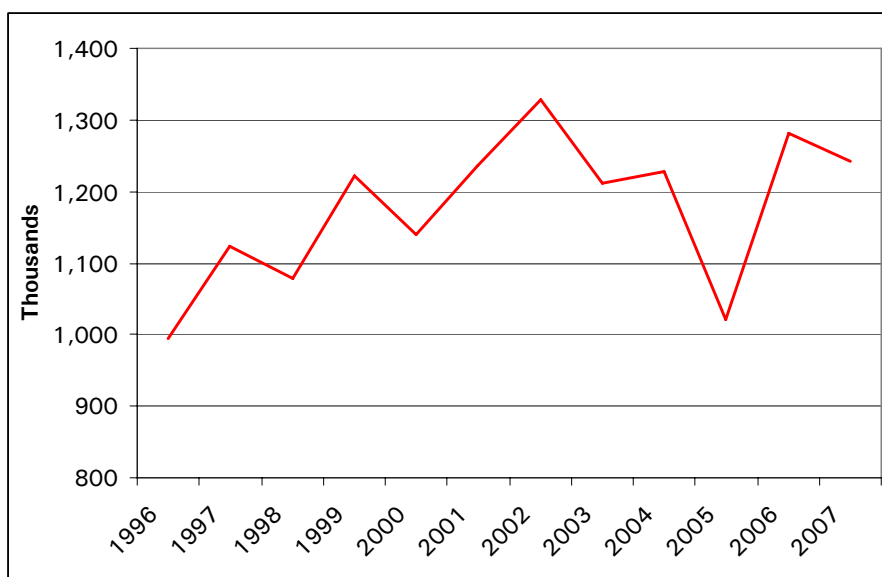
New and existing homes

3.6 In total, including new and existing homes, there were 1.8 million residential sales in 2007 in the UK, a fall of about one per cent from the 2006 level but a rise of 15 per cent from 2005.¹⁹

¹⁹HMRC, 2008, *Property transactions in the United Kingdom*, July 2008. Available at: www.hmrc.gov.uk/stats/survey_of_prop/menu.htm

3.7 Data on property transactions in the whole of the UK is surprisingly limited but detailed information is available for England and Wales as shown in Chart 3.4. There were nearly 1.3 million property sales in England and Wales in 2007.

Chart 3.4: Residential property transactions in England and Wales, 1996 to 2007



Source: CLG live table 584.

3.8 In 2006 the number of new homes completed was equal to about 10 per cent of the total number of residential homes sold in the UK.²⁰ This ratio was slightly higher in England and Wales at about 12 per cent²¹ and has remained fairly steady over the past 10 years. The figures provide a snapshot of the homebuilding industry's contribution to the overall number of homes but of course it is important to note that the housing market and the homebuilding industry, are cyclical, and the next section

²⁰ Calculation based on 192,000 private enterprise dwellings completed in 2006/07 (Source: CLG live table 209) and 1,848,000 property transactions in the UK (Source: HMRC).

²¹ Calculation based on 154,670 private enterprise dwellings completed in 2006/07 (Source: CLG live table 209) and 1,308,816 property transactions in England and Wales (Source: CLG live table 584).

of this chapter looks at the ups and downs of the market since the Second World War.

Housing market history²²

- 3.9 Since the end of the Second World War there have been three housing booms, the mid 1950s to the early 1970s, the early 1980s to the early 1990s and the late 1990s to the late 2000s. When this study began in June 2007 UK house prices had been rising for 10 years. In 2007 the housing market started to slow and today house prices are falling.²³
- 3.10 After the end of the Second World War there was a significant increase in the number of homes built. Regulatory controls on new development were gradually relaxed and the number of new homes built privately each year rose almost continuously from 28,000 in 1949 to a peak in 1968 when 226,000 homes were built.²⁴ Between 1969 and 1973 an average 190,000 homes were built each year. During this time nominal house prices rose by 114 per cent,²⁵ and annual house price inflation peaked at just over 42 per cent in Q4 1972.
- 3.11 In the following analysis we have used Nationwide house price data and CLG completions data. We used Nationwide data because it offers data on both real and nominal house prices. CLG completions data was chosen because it offered the widest data set in terms of geography and time.

²² We are especially grateful to Fred Wellings for his assistance in compiling this history. Readers interested in a comprehensive history of UK homebuilders should see: Wellings, Fred, 2006, *British Housebuilders, History & Analysis*, Blackwell Publishing Ltd which we reference extensively here.

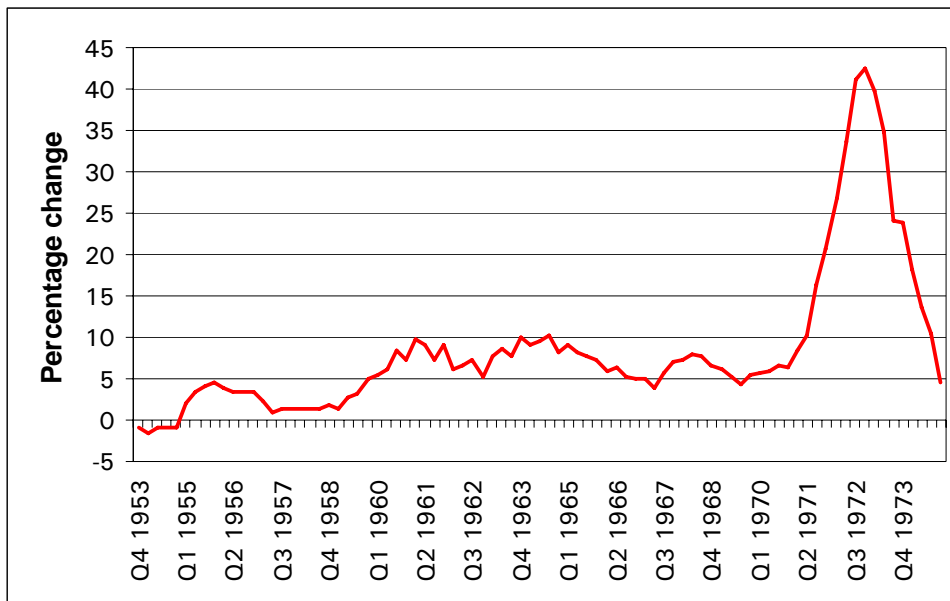
²³ See www.nationwide.co.uk/hpi/historical/Aug_2008.pdf

²⁴ This is the highest number of homes built in a single year since the series started being recorded in 1949.

²⁵ Nationwide series 'UK house prices since 1952'. Available at: www.nationwide.co.uk/hpi/downloads/UK_house_price_since_1952.xls

3.12 In 1974 the housing market collapsed, private housing completions fell by 24 per cent²⁶ and the number of new homes started, a sign of homebuilder confidence, fell by half.²⁷ Wellings²⁸ lists a range of factors which contributed to the housing market collapse. He explains that the mortgage lending rate was raised from 7.5 per cent to 11.5 per cent between June and July 1973. The Arab-Israeli war started in October 1973 which led to a rise in oil prices and the mortgage lending rate reached 13 per cent in November. In November and December two secondary banks, London & County and Cedar Holdings, had to be rescued. During 1974 the FT Index fell 55 per cent.

Chart 3.5: Annual nominal house price inflation, UK, Q4 1953 – Q4 1974



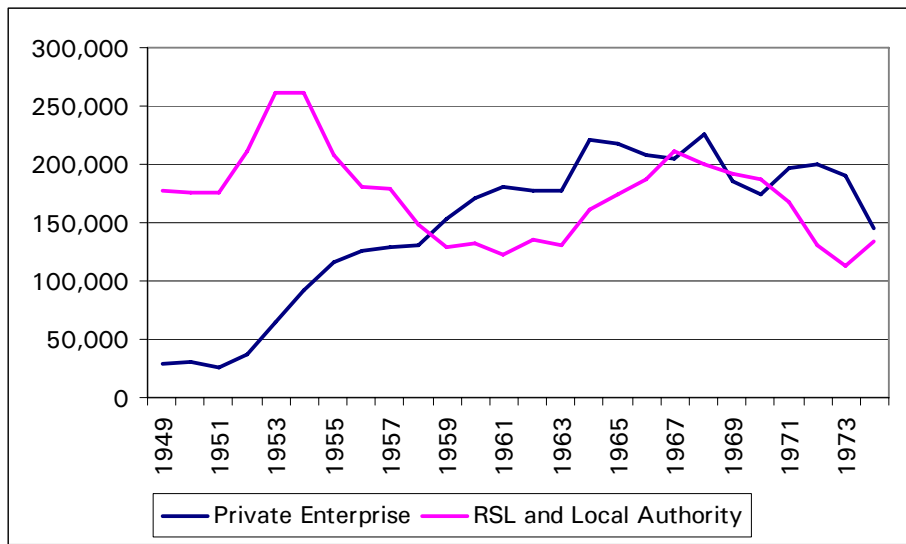
Source: Nationwide.

²⁶ CLG live table 241.

²⁷ Para 3, p83, Wellings, Fred, *British Housebuilders, History & Analysis*, Blackwell Publishing 2006.

²⁸ Ibid.

Chart 3.6: Housing completions, UK, 1949 – 1974



Source: CLG live table 241.

- 3.13 As can be seen in Chart 3.5, nominal annual house price inflation fell from 42.4 per cent in Q4 1972 to 4.5 per cent in Q4 1974. Although house prices were rising in nominal terms they were falling in real terms because the underlying inflation rate was rising more quickly than house prices.²⁹
- 3.14 According to Wellings the market collapse in 1974 and the slow decline over the rest of the decade precipitated long term change in the homebuilding industry. Some secondary banks that provided funding for homebuilders collapsed and left the homebuilders without financial support leading to a number of insolvencies. Wellings writes that the incident that sent 'shock waves through the industry'³⁰ was the failure

²⁹ The annual retail price index (RPI) averaged 7.7 per cent in Q4 1972 and rose to an average of 18.2 per cent in Q4 1974.

³⁰ Para 1, p85, Wellings, Fred, op. cit.

of Bovis who were the fourth largest homebuilder at the time.³¹ A number of other firms also failed.³²

3.15 From 1974 until the early 1980s private homebuilding remained fairly constant and although nominal house prices were rising because of the high inflation rate they were falling in real terms.³³ Towards the end of the decade house prices started to pick up and annual nominal house price inflation approached 30 per cent throughout 1979.³⁴

3.16 In 1979 a new Conservative government led by Margaret Thatcher was elected. During its time in office this government introduced significant institutional and political reform. Baddeley³⁵ splits the policy reform into three types:

- financial changes accompanying deregulation
- fiscal changes, including changes affecting the incentives to buy a home, and
- changes affecting the supply of alternatives to owner-occupation.

³¹ Bovis was rescued by P&O.

³² For more details of firms who failed during the mid-1970s see p85, Wellings, Fred, op. cit.

³³ In real terms house prices fell by about 40 per cent between 1973 and 1977. Source: Muellbauer, J & Murphy, A, 1997, Booms and busts in the UK housing markets, *The Economic Journal*, Vol. 107, p1701 – 1727.

³⁴ We have used data about nominal house prices from 1952 to 1974 and real house prices from 1975 onwards because we were unable to find data about real house prices before 1975.

³⁵ Baddeley, M, 2005, *Housing bubbles, herds and frenzies: evidence from British housing markets*, CEPP policy brief no. 02/05, University of Cambridge.

- 3.17 One policy was to increase the level of home ownership. This policy led to a rise in the demand for homes to buy.³⁶
- 3.18 High interest rates from the end of 1979 to mid-1980 led to a fall in nominal house price inflation. At the same time house price inflation was falling so was output. In 1980 the number of new homes started fell by 31 per cent,³⁷ with housing completions at just 119,000 in 1981, the lowest level since 1955.³⁸
- 3.19 The slowdown proved short lived and, with the exception of 1985, the number of private completions grew about 10 per cent a year from 1982 to 1988 (see Chart 3.8)³⁹ By the end of 1988 nominal house price inflation was close to 30 per cent and continued at this level for the first half of 1989.⁴⁰ Between Q1 1981 and Q4 1988 nominal house prices rose by 115 per cent.

³⁶ This policy was successful, in the 1950s 30 per cent of households owned their own home and 52 per cent rented. By 1997 the proportion of owner-occupiers had risen to 67 per cent and eight per cent of households rented. Source: Baddeley, M, 2005, *Housing bubbles, herds and frenzies: evidence from British housing markets*, CEPP policy brief no. 02/05, University of Cambridge.

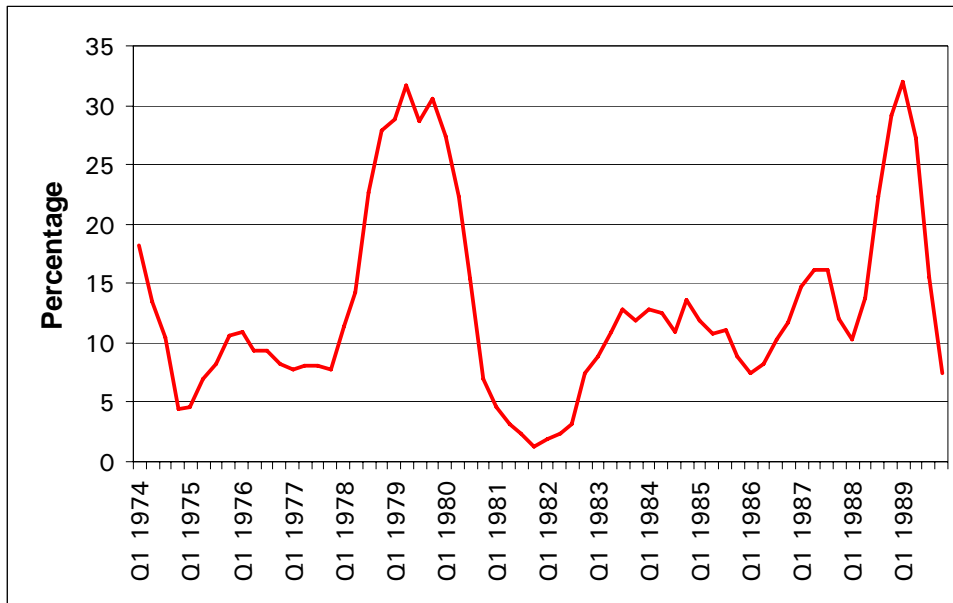
³⁷ Para 1, p84 Wellings, Fred, op. cit.

³⁸ CLG live table 241.

³⁹ CLG live table 241.

⁴⁰ Nationwide series 'UK house prices since 1952. Available at:
www.nationwide.co.uk/hpi/downloads/UK_house_price_since_1952.xls

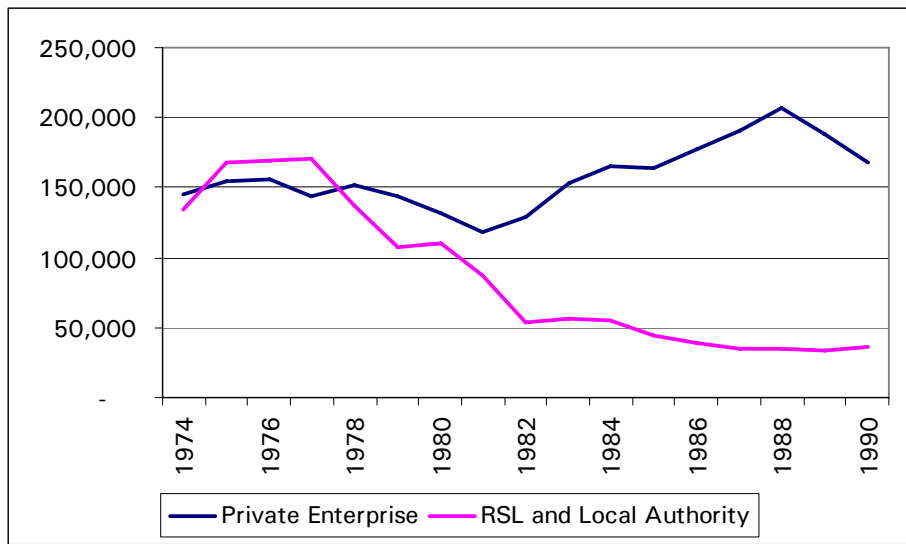
Chart 3.7: Annual nominal house price inflation, UK, Q1 1974 – Q4 1989



Source: Nationwide.

3.20 From 1981 to 1988 private housing completions rose by 75 per cent, see Chart 3.8. Due to a change of government policy the number of Registered Social Landlords (RSLs) (see Glossary) and local authority homes being built fell from 1977 onwards. The total number of new homes built, that is those built by private homebuilders, RSL and local authorities rose by 17 per cent from 1981 to 1988.

Chart 3.8: Housing completions, 1974 – 1990



Source: CLG live table 241.

3.21 Wellings writes that the rise in volumes and house prices made the end of the 1980s nearly as profitable as the early 1970s for homebuilders. Between 1986 and 1988 the trading profits of the top five homebuilders trebled.⁴¹

3.22 Muellbauer and Murphy⁴² identify some of the factors that contributed to the house price boom of the 1980s:

- initial debt levels were very low, as were real house prices
- income growth after the early 1980s recession was strong, as were income growth expectations

⁴¹ Para 3, p87 Wellings, Fred, op. cit.

⁴² Muellbauer, J & Murphy, A, 1997, Booms and busts in the UK housing markets, *The Economic Journal*, Vol. 107, p1701 – 1727.

- wealth income ratios grew and the 'spendability' of illiquid assets (such as housing) was increased - equity withdrawal became more popular in the 1980s⁴³
- demographic trends – stronger population growth in homebuying age group
- the supply of homes grew more slowly with the construction of social housing falling to a small fraction of 1970s levels (see Chart 3.8), and
- between 1987 and 1988 interest rates fell and the proposed abolition of property taxes in favour of the Poll Tax gave a further boost to valuations.

3.23 The sharply rising housing market in 1988 was, in part, caused by the stock market crash of October 1987, during which the FTSE lost 25 per cent of its value in one week. As a result, interest rates were cut to the lowest level for a decade.⁴⁴ During the first half of 1988 the Chancellor gave six months notice of his intention to abolish double mortgage tax relief.⁴⁵ The combination of this advance warning and low interest rates led to heightened activity in the housing market and real annual house price inflation was close to 30 per cent from Q4 1988 to Q2 1989.⁴⁶

⁴³ Meen, G, 2005, On the economics of the Barker review of housing supply, *Housing Studies*, Vol. 20, No. 6, p949 – 971.

⁴⁴ The base rate was cut to 7.5 per cent in May 1988. p.94, Wellings, op.cit.

⁴⁵ p.94, *ibid.*

⁴⁶ p.94, *ibid.*

- 3.24 In 1989 house prices collapsed again. Muellbauer and Murphy⁴⁷ conclude that the housing bust of the early 1990s was due to a reversal of most of the factors listed above which accounted for the boom of the 1980s.
- 3.25 As a result of higher spending in the wake of the interest rate cuts inflation started to rise⁴⁸ and the Bank of England raised interest rates sharply to try and stop the rise.⁴⁹
- 3.26 The housing market crash of the late 1980s and early 1990s had a severe effect on the UK economy which slipped into recession. Baddeley notes that by the late 1980s the 'triggers for the recessionary phase were already in place'.⁵⁰ Rising unemployment during the 1980s and early 1990s decreased job security and very high levels of personal debt meant that the chances of default and repossession rose.⁵¹
- 3.27 Between Q4 1988 and Q1 1993 house prices across the UK fell by 12 per cent in nominal terms.⁵² There was regional variation in the level of price falls: nominal house prices in the South East fell by 31 per cent.⁵³ This fall in nominal prices meant that many homeowners now experienced negative equity. They owned homes that were worth less than they paid for them. Between 1980 and 1991 the number of

⁴⁷ Muellbauer, J & Murphy, A, 1997, Booms and busts in the UK housing markets, *The Economic Journal*, Vol. 107, p1701 – 1727.

⁴⁸ In Q1 1988 RPI averaged 3.4 per cent, in Q4 this average had risen to 6.5 per cent.

⁴⁹ The Bank of England interest rate was raised to try and control inflation, the base rate increased from 7.5 per cent in May 1988 to 15 per cent in October 1989, a level it was to maintain for the next twelve months. Source: p94, Wellings, op.cit.

⁵⁰ Baddeley, M, 2005, Housing bubbles, herds and frenzies: evidence from British housing markets, CEPP policy brief no. 02/05, University of Cambridge.

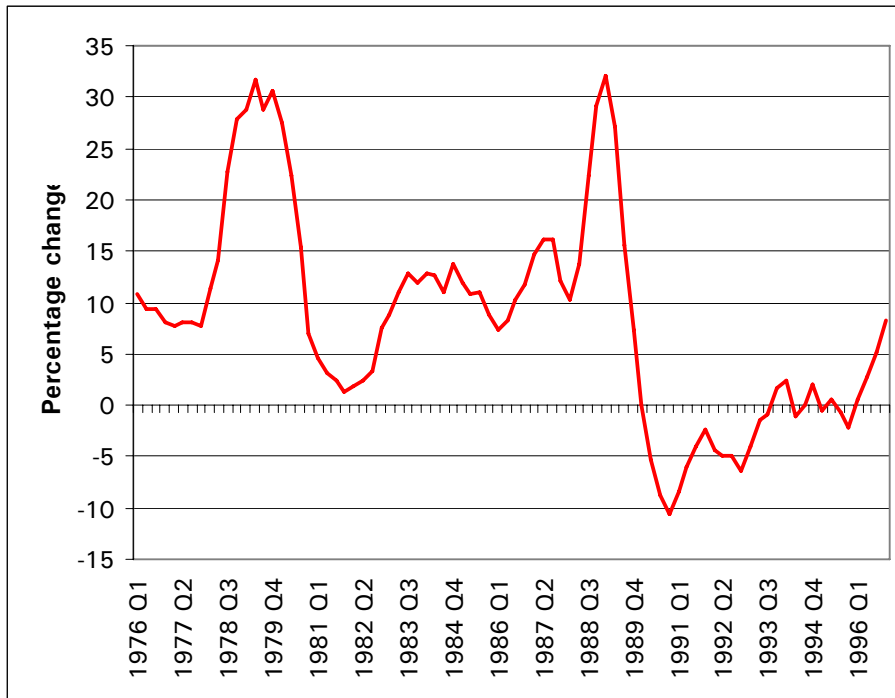
⁵¹ Ibid.

⁵² Nationwide series 'UK house prices since 1952. Available at: www.nationwide.co.uk/hpi/downloads/UK_house_price_since_1952.xls

⁵³ Para 2, p95 Wellings, Fred, op. cit.

repossessions rose by about 150 per cent.⁵⁴ House prices did not stop falling until Q2 1996 (see Chart 3.9).

Chart 3.9: Nominal house price inflation, UK, Q1 1976 – Q4 1996



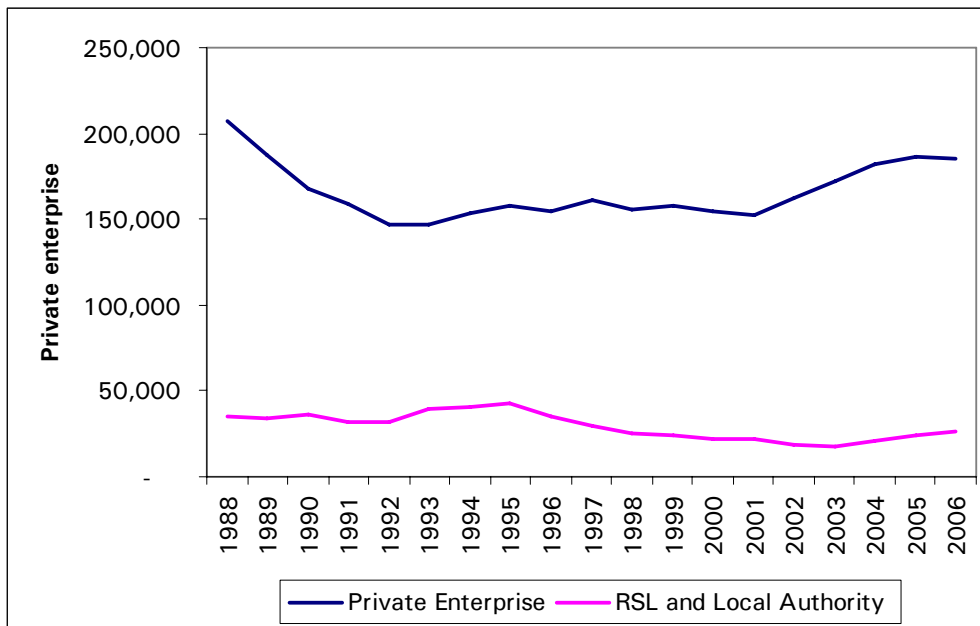
Source: Nationwide.

3.28 As can be seen in Chart 3.10 between 1988 and 1992 annual private enterprise housing completions fell by 29 per cent, from 207,000 to 147,000. Meen⁵⁵ finds evidence of a structural change in the market post-1990 with the number of new homes started much lower than any of the mathematical models of the industry had predicted. The models of house prices and transactions used by Meen broke down in the early 1990s.

⁵⁴ Baddeley, M, 2005, Housing bubbles, herds and frenzies: evidence from British housing markets, CEPP policy brief no. 02/05, University of Cambridge.

⁵⁵ Meen, G, 2005, On the economics of the Barker review of housing supply, *Housing Studies*, Vol. 20, No. 6, p949 – 971.

Chart 3.10: Annual housing completions, UK, 1988 – 2006



Source: CLG live table 241.

3.29 As Wellings observes, another difference between the slowdown in the early 1970s and the early 1990s was that the changes to the industry were financial rather than physical.⁵⁶ In the 1970s, the failure of a number of secondary banks caused problems for a number of homebuilders as it left them without finance. During the 1990s, banks were far more supportive so there were far fewer immediate insolvencies among homebuilders.⁵⁷ This is not to say that homebuilders were not affected by the housing market problems, land prices still fell sharply and total land write-offs were about £2.5bn.⁵⁸

3.30 One consequence of the three housing cycles in the UK since the Second World War is that the homebuilding industry has become far

⁵⁶ p93 and p99, Wellings, op. cit.

⁵⁷ p95, Ibid.

⁵⁸ Para 1, p93, Ibid.

more concentrated. In 1973 the top 10 homebuilders were responsible for 18 per cent of total output.⁵⁹ In 2007 the top 10 homebuilders built 44 per cent of total output.⁶⁰ It remains to be seen whether the current market downturn triggers another round of rationalisation and concentration in the industry.

- 3.31 As Wellings recounts, by the mid-1990s, the land write-offs had been made, house prices had stabilised and confidence in the market was returning.⁶¹ During the 1990s private housing completions averaged 156,000 units a year.⁶² By early 1997 annual nominal house price inflation was above 10 per cent. From 1997 house prices rose continuously until 2007 although the rate of growth slowed from early 2003.
- 3.32 Between 1993 and 2001 the average real gain in house prices was £35,985, however during this same period 4.1 per cent of owner-occupiers experienced a fall in real house prices.⁶³ Between Q1 1997 and Q4 2007 nominal house prices rose 230 per cent. Nominal house prices fell four per cent year on year in Q2 2008 (see Chart 3.11).

⁵⁹ Table 5.1, p82, *ibid.*

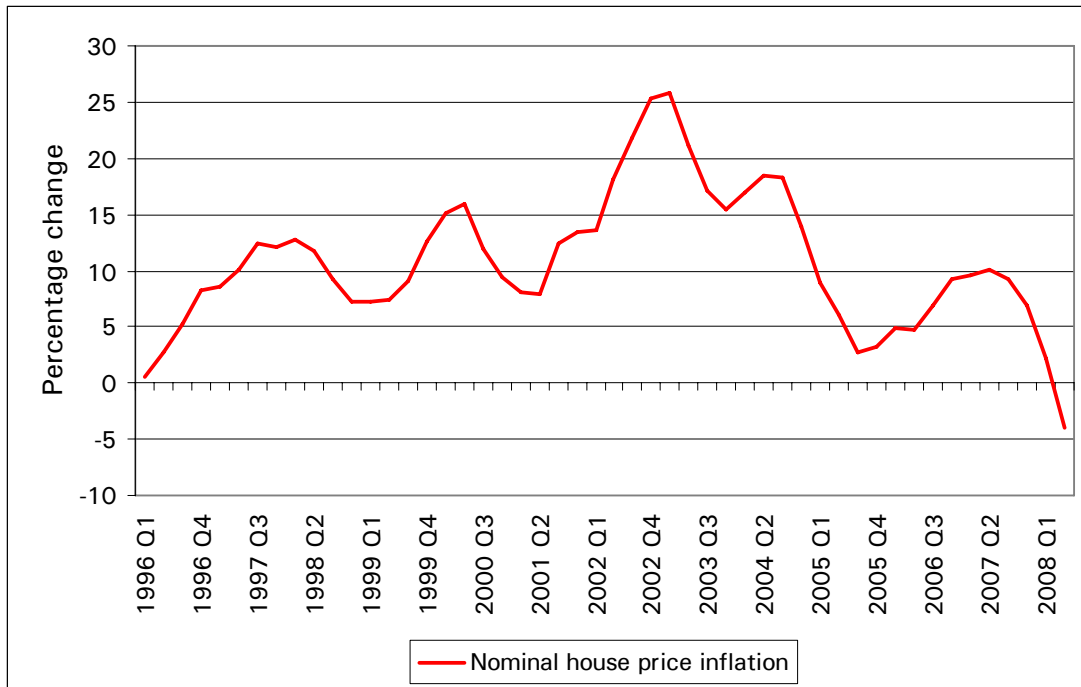
⁶⁰ Housing Market Intelligence Report 2007 and CLG live table 209.

⁶¹ p.99, Wellings, *op. cit.*

⁶² CLG live table 241.

⁶³ Disney, R, Henley, A & Jevons, D, 2003, *House price shocks, negative equity & household consumption in the UK.*

Chart 3.11: Real and nominal house price inflation, Q1 1996 – Q2 2008



Source: Nationwide.

The 'credit crunch' and the 2007/08 housing market downturn⁶⁴

3.33 When we started this study in June 2007 the housing market was strong after 10 years of rising prices although many commentators, and indeed some homebuilders, warned that a slowdown was inevitable.⁶⁵ Despite these warnings most homebuyers and homebuilders did not expect the downturn to be anything like as severe as it has become, in part because the last time house prices were falling was in the mid

⁶⁴ This section is correct as of 1 September 2008.

⁶⁵ See for example the predictions made by Capital Economics in 2007 at: www.capitaleconomics.com/clientarea/articles/hma300107.pdf

1990s and as one commentator put it 'housing market cycles last eleven years, while our memories last nine.'⁶⁶

- 3.34 In June 2007 problems started to emerge in the US housing market as the number of defaults on sub-prime mortgages started to rise. This fed through to financial markets via residential mortgage backed securities (RMBS) (see Glossary).⁶⁷
- 3.35 This collapse and the problems in the US housing market caused a sudden and significant re-pricing of risk. This re-pricing of risk caused asset prices to drop sharply⁶⁸ leading to a severe rationing of funds in the money market and, in turn, the mortgage securitisation market effectively seized up. A number of US hedge funds collapsed sending shock waves through the entire global financial system.⁶⁹ The market volatility quickly spread from US markets to the UK.
- 3.36 Of all European banks, the UK-based Northern Rock was probably the most reliant on the wholesale money markets for funding.⁷⁰ Because of

⁶⁶ Davis, E, 2008 *Are we stupid?* BBC News, [internet], 19 March 2008. Available at: www.bbc.co.uk/blogs/thereporters/evandavis/

⁶⁷ A type of mortgage-backed security composed of a wide array of different non-commercial mortgage debts. It securitises the mortgage payments of non-commercial real estate. Different residential mortgages with varying credit ratings are pooled together and sold in tranches to investors looking to diversify their portfolios or hedge against certain types of risks. (Source: www.investorwords.com/6642/Residential_Mortgage_Backled_Security.html). Holders of a RMBS receive interest and principal payments that come from the holders of the residential debt.

⁶⁸ See chart 2.2, p15, Crosby, J, 2008, *Mortgage finance: interim analysis*, report commissioned by HM Treasury. Available at: www.hm-treasury.gov.uk/media/3/E/crosby290708.pdf

⁶⁹ Pitman, M, 2007, Bear Stearns fund collapse sends shock through CDOs (Update 2), *Bloomberg* [internet], 21 June 2007. Available at: www.bloomberg.com/apps/news?pid=20601087&sid=ai_5WXEe7Bpw&refer=home

⁷⁰ Less than a third of its funding came from customer accounts, which was lower than most other major UK banks. Source: figure 11, p20, Charles Rivers Associates (CRA), 2008, *Market study: The impact on competition of the restructuring plan for Northern Rock*, Prepared on the instructions of the solicitors for HM Treasury (Slaughter & May).

this, when the securitisation market seized up Northern Rock subsequently began to experience extreme liquidity difficulties, causing it to become unable to raise money to finance its business. Eventually Northern Rock was taken into temporary public ownership in February 2008.⁷¹ The effect of this was profound; Northern Rock was the third largest mortgage lender in the UK in 2006. The fact a bank this size could fail so quickly made other banks extremely nervous about participating in the wholesale money markets. The amount of inter-bank lending in particular dropped sharply as banks became concerned about the chances of another bank failure.⁷²

3.37 The problems in the wholesale money market had a direct impact on both homebuilders and homebuyers. The seizing up of the mortgage securitisation market had serious implications for the mortgage market. In 2006 RMBS and covered bonds⁷³ (see Glossary) equated to about two-thirds of net mortgage lending.⁷⁴ The fact that the trading of RMBS effectively ceased prompted worries about how the problems in the mortgage market, specifically the fall in mortgage availability, would

⁷¹ www.hm-treasury.gov.uk/newsroom_and_speeches/press/2008/press_16_08.cfm

⁷² At the time of writing, 1 September 2008, no other banks have failed but a number have been forced to make rights issues at a significant discount because they are unable to secure funding through wholesale markets. See www.thisismoney.co.uk/news/columnists/article.html?in_article_id=442122&in_page_id=19&in_author_id=1822 for more information.

⁷³ Covered bonds are debt instruments secured by a cover pool of mortgage loans (property as collateral) or public-sector debt to which investors have a preferential claim in the event of default. While the nature of this preferential claim, as well as other safety features (asset eligibility and coverage, bankruptcy-remoteness and regulation) depends on the specific framework under which a covered bond is issued, it is the safety aspect that is common to all covered bonds. Source: <http://ecbc.hypo.org/Content/Default.asp?PageID=311>

⁷⁴ Crosby, J, 2008, *Mortgage finance: interim analysis*, report commissioned by HM Treasury.

affect homebuilders. As a result, the shares in publicly quoted homebuilders fell.⁷⁵

- 3.38 Homebuyers were affected as the availability of mortgages fell and any mortgages that were offered often had tighter lending criteria, such as the need for a larger deposit.⁷⁶
- 3.39 The restriction of mortgage availability led to a sharp slowdown in the housing market with the number of transactions in England and Wales falling by 18 per cent in Q4 2007.⁷⁷ This fall in transactions led to a fall in house prices, real house prices fell by eight per cent in the year to Q2 2008.⁷⁸

⁷⁵ Flanagan, M, 2007, Northern Rock 'crisis' hits house builders, *The Scotsman* [internet], 15 September 2007. Available at:
<http://business.scotsman.com/mortgageandpropertynews/Northern-Rock-crisis-hits-house.3327285.jp>

⁷⁶ John, P, 2008, Paula John: Market News, *Independent Online* [internet], 3 September 2008. Available at: www.independent.co.uk/life-style/house-and-home/property/paula-john-market-news-916886.html

⁷⁷ 18 per cent fall compared with the number of transactions in Q3 2007 in England and Wales. Source: CLG live table 584.

⁷⁸ UK prices, Nationwide series 'UK house prices since 1952. Available at:
www.nationwide.co.uk/hpi/downloads/UK_house_price_since_1952.xls

- 3.40 This slowing of the housing market has hit homebuilders very hard. Most of the top 10 homebuilders have made redundancies⁷⁹ and many have stopped work on some sites.⁸⁰
- 3.41 Redundancies mean that skills are being lost from the industry. During the course of this study we have been told by homebuilders that workers who are made redundant during a downturn do not all return to homebuilding, or return quickly, when output starts to expand again. This lost capacity acts as a supply constraint when the market starts to rise again.
- 3.42 Land prices are more volatile than house prices and the slowdown in the housing market has caused many homebuilders to announce very large writedowns on their landbanks (as well as writedowns on other items).⁸¹
- 3.43 The lack of sales and large writedowns has meant that some homebuilders have had to renegotiate their banking agreements. Some

⁷⁹ See for example: Conway, E and Monaghan, A, 2008, Crest Nicholson cuts staff as gloom deepens, *Telegraph online* [internet], 18 May 2008. Available at: www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/16/cncrest116.xml and Monaghan, A and Griffiths, K, 2008, Taylor Wimpey to close a third of its offices as housing slowdown bites, *Telegraph online* [internet], 20 May 2008. Available at: www.telegraph.co.uk/money/main.jhtml?xml=/money/2008/05/20/cnjobs120.xml

⁸⁰ See for example: Wearden, G, 2008, Britain's biggest homebuilder halts new projects, *Guardian unlimited* [internet], 24 April 2008. Available at: www.guardian.co.uk/business/2008/apr/24/persimmon.construction

⁸¹ See for example: Costello, M, 2008, Taylor Wimpey hit by £1.5bn property writedowns, *Times online* [internet], 27 August 2008. Available at: http://business.timesonline.co.uk/tol/business/industry_sectors/construction_and_property/article4617165.ece

homebuilders have warned that they may breach their banking covenants, (see Glossary) although so far this has not happened.⁸²

- 3.44 Comparing the situation during the early and mid-1970s with the present day there are a number of similarities. The availability of mortgages has declined, mortgage interest rates are higher than they have been for a long time.⁸³ There has also been a sharp rise in oil prices⁸⁴ although these have slipped back during the last few months.⁸⁵ During both previous housing market downturns, in the early 1970s and late 1980s, the downturn in the housing market coincided with a slowdown in economic activity across the UK. The Bank of England now predicts that UK GDP growth will be broadly flat over the forthcoming year.⁸⁶
- 3.45 This time what started as a problem in the US housing market has spread to the UK via the financial markets and had an impact on the UK housing market and the wider economy. Economic growth has slowed down; GDP did not grow at all in Q2 2008 (on a quarterly basis) although compared with Q2 2007 it was 1.4 per cent higher.⁸⁷

⁸² Pignal, S, 2008, Builders move quickly to adapt to new market, *FT.com* [internet], 11 August 2008. Available at: www.ft.com/cms/s/0/a88596d2-67bd-11dd-8d3b-0000779fd18c.dwp_uuid=18a58248-385b-11dd-8aed-0000779fd2ac.html

⁸³ The average mortgage rate in June 2008 was 6.65 per cent, the highest since October 2000 (source: Bank of England), the number of mortgage approvals in June 2008 was 36,000, the lowest level since records begin in 1993 (source: Bank of England).

⁸⁴ The price of Brent crude oil rose by 84 per cent between May 2007 and May 2008. (Source: BERR).

⁸⁵ Milner, M and Clark, A, 2008, Energy: Fall in oil price comes with a warning, *Guardian Unlimited* [internet], 13 August 2008. Available at: www.guardian.co.uk/business/2008/aug/13/oil.energy

⁸⁶ See Chapter 5, August 2008 Inflation Report, Bank of England, available at: www.bankofengland.co.uk/publications/inflationreport/ir08aug.pdf

⁸⁷ Office of National Statistics.

- 3.46 At this point in time it is impossible to know for certain how long the current market conditions will continue and whether it will get any worse before things start to improve. Commentators are divided between those who think market conditions will deteriorate further⁸⁸ and those who think house prices will start to rise by the end of next year due to the current low levels of new homebuilding.⁸⁹
- 3.47 One thing is for certain, the profits of the large homebuilders have fallen very quickly and sharply⁹⁰ and it is likely that many small homebuilders will now be concentrating on refurbishment and maintenance.
- 3.48 We now move on to consider the conditions of competition in the industry and the implications of those conditions for homebuyers.

⁸⁸ Stewart, H and Brett, A, 2008, Things will get worse: you can bet the house on it, *Guardian unlimited* [internet], 17 August 2008. Available at: www.guardian.co.uk/business/2008/aug/17/housingmarket.property1

⁸⁹ Research by Centre for Economic and Business Research (CEBR) cited in Gilmore, G, 2008, Gloom over service sector fuels fears of recession, *Times online* [internet], 5 August 2008. http://business.timesonline.co.uk/tol/business/industry_sectors/construction_and_property/article4460954.ece

⁹⁰ For example Taylor Wimpey's profits for the first half of the year fell by 96%. See Builder profits come tumbling down, *Sky.com* [internet], 27 August 2008. Available at: <http://news.sky.com/skynews/Home/Business/Housebuilder-Taylor-Wimpey-Announces-A-96-Drop-In-First-Half-Profits/Article/200808415087567?f=rss>

4 COMPETITION IN THE HOMEBUILDING INDUSTRY

4.1 Any analysis of competition usually begins with a market definition - this is normally a process which allows us to state, both in terms of products and geographically, what is included in the 'market' under consideration. For the purposes of this report market definition allows us to examine the competitive constraints operating on the supply of new homes. Once we have defined a market, we look at the competitive pressures in that defined market which, in this report, includes a consideration of the following features:

- market definition
- market concentration at a national and local level
- barriers to entry and expansion
- vertical integration
- switching costs
- information asymmetries
- does the market deliver a good outcome for homebuyers?

Market definition

4.2 A full market definition for the homebuilding industry would need to consider such questions as whether new homes are in the same market as existing homes (that is, do homebuilders compete against the sale of existing homes), whether the market is national or consists of many local markets, and whether separate markets exist for smaller and larger homes.

4.3 The data which would be required to present a complete market definition for homes in the UK is extensive, not readily available in the UK in a useable form and impractical to collect for this study. Nevertheless, many of the factors listed above can be examined to

provide an indicative market definition and we do so in the next sections.

- 4.4 The usual technique for defining markets in competition analysis is to use a so-called 'SSNIP test'.⁹¹ The SSNIP test hypothesises what would happen to the sales and profitability of a given product if its price were to increase above competitive levels by 5-10 per cent for one year. If such an increase does not result in an off-setting reduction in sales and a fall in profitability due to consumers switching to rival products, the product in question is said to be in a market in its own right. By contrast if sales and profitability fall because the price increase encourages consumers to purchase alternative products, then those alternative products are said to be in the same market and the market definition is widened to include them.⁹²
- 4.5 In circumstances where it is either impractical or impossible to define a market precisely it is normal practice to define a market narrowly (including the smallest number of substitute products and the most limited geographic area that is sensible) and to ask the question whether, on this narrowly defined market, there are any competition problems.⁹³

Housing markets are local

- 4.6 We consider it unnecessary to repeat here the work done by others, or to pre-empt the work currently being undertaken by Local Planning Authorities (LPAs) in defining Housing Market Areas (HMAs). Most researchers who have considered housing markets have concluded that they are, in some sense, local markets. We concur with this view.

⁹¹ Strictly, a Small but Significant Non-transitory Increment in Price test (SSNIP test).

⁹² For more details on how the OFT considers market definition see, 'Market Definition', OFT Guideline 403.

⁹³ This follows the approach used by the OFT in its examination of mergers in the homebuilding industry.

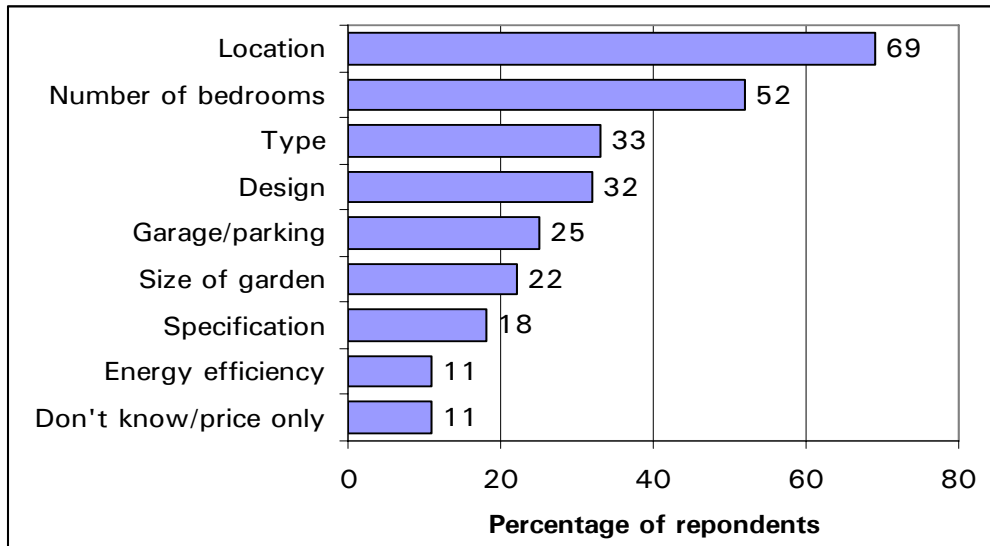
- 4.7 The Barker review suggested that homebuilders compete in local housing markets.⁹⁴ We agree with this conclusion. Although firms monitor the state of the national housing market, it seems likely that it is the level of local demand⁹⁵ and the existence of local competitors that influence whether or not a site is taken forward for development and the speed at which it is built out. Equally, the long lead times in the housing industry mean that the level of supply-side substitution that is possible is likely to be very limited. In short, although prices might be rising in one area of the country it is unlikely that homebuilders operating in other areas will be able to move into that area particularly quickly.
- 4.8 Homebuyers also consider the location of a home to be of prime importance. In research carried out by the NHBC Foundation homebuyers were asked what features they considered when they purchased their new home. Chart 4.1 shows the spontaneous responses; location was cited by 69 per cent of all respondents as important.⁹⁶

⁹⁴ Page 5, Barker, K, 2003, Review of housing supply, interim report – analysis, HM Treasury.

⁹⁵ Eight out of nine respondents to our data request sent to the top 10 homebuilders said that rising demand in local area and/or knowledge of local economic conditions were included in the top three factors which influenced expansion into a new area.

⁹⁶ When interpreting data we have looked at the evidence as whole rather than rely on a single piece of data. Chart 4.1 is broadly indicative of homebuyers' priorities but tells us little about how they respond to changes in price for example.

Chart 4.1: Proportion of people mentioning different features when asked what they considered when purchasing their new home⁹⁷



Source: p20, Zero carbon: what does it mean to homeowners and housebuilders, NHBC Foundation, April 2008.

4.9 When buying a home, homebuyers report having a fixed idea of the location in which they would like to buy. Our consumer survey (see Annexe B) showed that nearly two-thirds of survey respondents (62 per cent) said that the furthest property that they had considered buying when looking for their current home was less than 11 miles away from the one they bought. This is unsurprising: choices regarding the location of a home are likely to be constrained geographically by a wide range of factors such as proximity to work, schools, family and friends.

4.10 Since it is impractical to define a series of local housing markets for the whole of the UK for the purposes of this study, it is sensible to consider whether any well defined pre-existing boundaries, in particular LPA boundaries, present a meaningful approximation to local housing markets.

⁹⁷ The survey asked homebuyers which features they considered when purchasing a new home, not necessarily a new build property. The survey group did not include any buy-to-let investors.

4.11 It is our view, having considered the available evidence, that it is not unreasonable to use LPA areas as a proxy for local housing markets. The available comparisons between LPAs and other housing market area definitions indicate that, while there are significant differences between them, they are not so extreme as to render LPAs meaningless as a proxy measure (see Annexe N for a discussion of the relationship between LPAs and other measures of housing market areas). While this is a far from perfect alternative, it allows us to consider housing supply at a local level as planning data is readily available for each LPA. For the avoidance of doubt, we do not consider that LPAs are actually local housing markets; future work based on better data will almost certainly draw different boundaries.

Homes of different sizes are in the same market

4.12 The supply of new homes is highly heterogeneous. New homes come in different sizes and different architectural styles. This creates substantial differences between new homes even within the same local market. It is therefore important to consider whether these differences create separate markets for different types of new home.

4.13 In our view they do not. While it is obviously the case that a five bedroom home with a large garden in an edge of town setting is clearly very different to a studio flat in a town centre this alone does not indicate that the products are in separate markets.

4.14 The reason for this is so-called 'chains of substitution'. The concept of a chain of substitution is based on the logic that between a studio flat and a five bedroom house are a large number of other homes of varying sizes of greater or lesser similarity. So, a one bedroom flat might be a good substitute for a studio flat, such that if the price of studio flats were to rise 5-10 per cent then some would-be studio homebuyers might consider buying a one bedroom flat instead. Likewise, for some homebuyers, a large one bedroom home might be a good substitute for a two bedroom home as might a small three bedroom home. A 5-10 per cent increase in the price of two bedroom homes might encourage some homebuyers to trade up (or down) to three (or one) bedroom homes and so on.

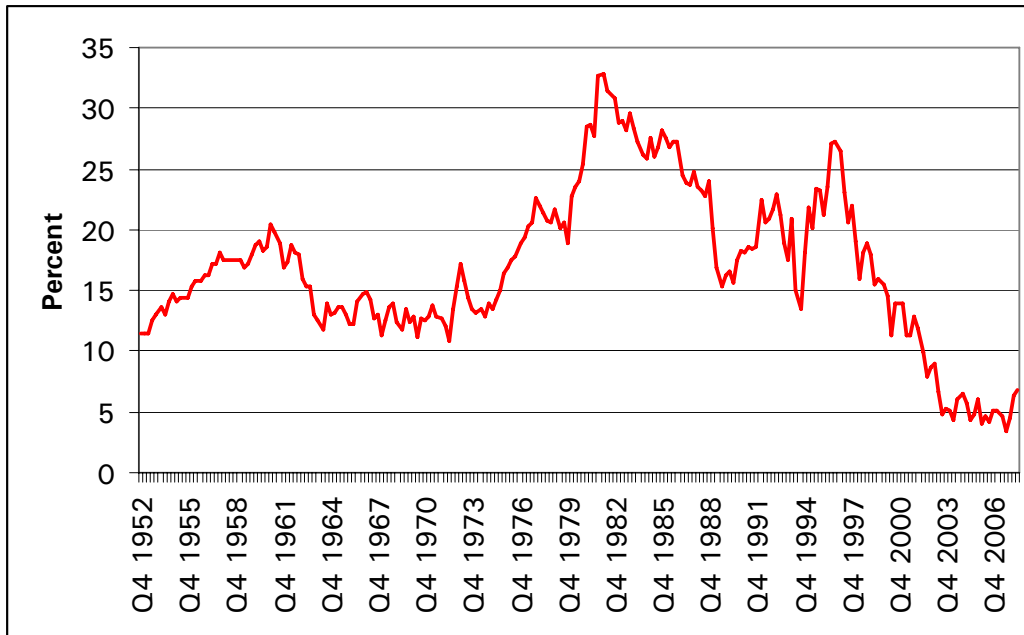
- 4.15 In this way there is a chain of substitution between the smallest properties and the largest. Moreover, because the differences between different properties can be very small (there may be only minor differences in floor space, for example, between a large studio and a small one bedroom home) it is unlikely there are any breaks in the chain.
- 4.16 Indeed the very difficulty of defining an 'average' two bedroom home, for example, (there really is no such thing) further serves to reinforce the conclusion that it is not meaningful to think of the housing market as being subdivided by size of homes.

New homes partially constrained by the existing stock of homes

- 4.17 It has long been established that new build homes trade at a premium to existing homes (see Chart 4.2). This may suggest that the age of a home, and in particular whether it is brand new, influences a homebuyer's perception of its quality.⁹⁸ In our consumer survey (see Annexe B) more than half the respondents said that one of the reasons they chose to buy a new build home was because no redecorating or work would be needed (56 per cent). One in five said one of the reasons they bought a new home was because of better energy efficiency than in an existing home (19 per cent). These facts suggest that the new build premium might include the value generated by an expectation of higher quality in a new home.

⁹⁸ We use the term 'quality' here to include all aspects of quality. The perception of higher quality in new build homes could be a reflection of the expected lower maintenance costs.

Chart 4.2: Size of the new build premium, Q4 1952 – Q2 2008



Source: Nationwide.

4.18 However, some researchers suggest that the new build premium does not necessarily indicate that homebuyers consider new build homes to be of higher quality. In their RICS research paper⁹⁹ Golland and Thrower suggest that the new build premium falls when the housing market is rising. They argue that the new build premium is likely to be influenced by a range of factors including the age of the existing housing stock in the local area and the density of the development. Furthermore, the new build premium does not take account of any incentives offered to the homebuyer by the homebuilder, such as paying the stamp duty or accepting part-exchange of a pre existing home. Consequently, Golland and Thrower conclude that the new build premium is not a true reflection of the value the homebuyer places on the new home.

⁹⁹ *Whose house is it anyway? The valuation process and the market for new homes* Andrew Golland and Steven Thrower, De Montfort University, RICS Research. [www.rics.org/Practiceareas/Property/Residential/Market/whose house is it anyway 19990101.htm](http://www.rics.org/Practiceareas/Property/Residential/Market/whose_house_is_it_anyway_19990101.htm)

- 4.19 Nevertheless, the observation that a new build premium exists, combined with the observation that some homebuyers consider new homes to have a better specification than existing homes, has led to the view amongst some commentators that new build homes are in a separate market from the existing housing stock.¹⁰⁰
- 4.20 The extent to which homebuyers view new and existing homes to be substitutes was examined in our consumer survey. Half of all homebuyers of new homes interviewed responded that they had considered existing homes that had already been lived in as well as brand new homes (51 per cent). For homebuyers who were 65 or over, the proportion who had considered existing as well as new homes was lower. One third (33 per cent) of those aged 65 or over had considered existing as well as brand new homes, compared to just over half (55 per cent) of homebuyers under 65.¹⁰¹ Some homebuilders who participated in the case studies held the belief that a fair proportion of their customers focused entirely on new build properties (For example, see the Woodbrook development case study at Annexe F and the observations made by the Carvill Group to the effect that it considers most of its homebuyers only consider new build properties.)
- 4.21 The fact that our consumer survey shows that half of the respondents considered an existing home before buying a new build home does not necessarily mean that they *do* consider existing and new homes as substitutes for one another. It is impossible to know what their choice of home (new build or existing) would be if the homebuilder raised the price of new build homes by 5-10 per cent.
- 4.22 Nevertheless, it is clear that there are significant differences in some homebuyers' perceptions between new homes and existing homes which, whether they are responsible for the new build premium or not, may make the existing housing stock an imperfect substitute for a new

¹⁰⁰ See, for example: Watkins, C, 1999, Property valuation and the structure of urban housing markets, *Journal of Property Investment & Finance*, Vol.17, No.2, p 157 – 175.

¹⁰¹ Figures taken from the weighted results of the consumer survey, Q5.

home. That, of course, is not to say that existing homes impose no constraint on the price of new homes at all but rather that the closest constraint may come from other new homes with the existing housing stock a close second.

- 4.23 Although, throughout our interview programme for this study homebuilders have told us that they believe that significant price competition is exerted by existing homes over new homes, it is impossible to know what effect a price rise in new build homes would have on the profits for homebuilders in practice.
- 4.24 Nevertheless, the evidence outlined above and evidence¹⁰² gathered during the course of the study leads us to believe that a high level of price competition, exerted by existing homes over new homes, is a key characteristic of the market for new build homes. While we are unable to reach a definitive conclusion that new homes are in the same market as existing homes, such a conclusion is consistent with our observations of industry practice.
- 4.25 For example, the practice of site splitting (see Glossary) is consistent with a finding that new homebuilders compete with the existing housing stock as much as with each other since if competition was primarily between new homes then site splitting would intensify competition and perhaps be unattractive to homebuilders.¹⁰³ Similarly, much of the marketing literature of new homebuilders compares the benefits of new build compared to an existing home.

¹⁰² Interview programme with homebuilders.

¹⁰³ When a site is split usually the homebuilders will be marketing slightly different products, for example in East Shore Village (see the discussion at Annexe F) there were three homebuilders each one building a different type of house. Although the homebuilders are in competition with each other to sell their homes having more than one homebuilder on a site helped attract more potential homebuyers so although there was increased competition there were more potential customers to compete for. One RSL/homebuilder we spoke to gave the analogy of a shopping centre, although the shops are competing with each other for the same customers the fact there are a number of shops attracts more consumers than one shop would on its own.

- 4.26 Consequently, it is our view that even where a single homebuilder supplies a significant proportion of new homes in a local market, the ability of this homebuilder to influence prices will be limited.
- 4.27 There are two exceptions when this general rule may not apply:
- when the type of the existing housing stock being put onto the market is substantially different from the type of new build homes, and
 - when the amount of the existing housing stock being put onto the market is small relative to the number of new build properties being supplied.¹⁰⁴
- 4.28 We examine these exceptional cases in our consideration of market concentration later in this study.

Conclusion

- 4.29 It appears highly likely that, within a certain budget, homebuyers overwhelmingly consider location to be the most important factor when buying a home and their choices of location are generally limited by jobs, schools, family ties and transport links. It seems unlikely that homebuilders can quickly switch resources from one area to another in response to rising prices. For these reasons, we agree with other studies that housing markets are local.
- 4.30 We consider that it is highly likely that the market can be characterised by a chain of substitution between the smallest homes and the largest such that all homes of all sizes are effectively in the same economic market.

¹⁰⁴ The industry may be characterised by a certain amount of swing capacity, existing homes coming on to the market as result of increases in the price of new homes leading to increased demand for existing homes. If swing capacity is large this would weaken any homebuilders' market power. In the scenario outlined here swing capacity would be small.

- 4.31 While there is no definitive evidence available, we agree with Golland and Thrower's conclusion (see discussion at paragraph 4.18) that the new build premium is unlikely to be a true representation of the value homebuyers place on a new home.
- 4.32 We do not have sufficient evidence to prove that new and existing homes are in the same market (although we strongly suspect that this is the case) so, to err on the side of caution, we conducted our analysis of market concentration by taking into account the fact that new build homes may be in a separate market. In the next section we discuss the fact that even when we only consider the supply of new homes - without existing homes - there appears to be little evidence of any problems with competition in local markets.
- 4.33 For the purposes of this study, we have used LPA boundaries as a proxy for HMAs. This choice of boundary allows us to obtain data on development activity on a firm by firm basis. We are confident that a LPA boundary is unlikely to deviate so far from the 'true' boundaries of HMAs as to invalidate our subsequent analysis (see Annexe N for further details of this analysis).

Market shares and concentration

- 4.34 Once the relevant product and geographic markets have been defined, the next step in a competition analysis is to consider whether the suppliers of those products, in those geographic areas, have any market power which could distort competition. Market shares of firms, both in absolute terms and relative to each other, can give an indication of the extent of a firm's market power.
- 4.35 Market power can be thought of as the ability to profitably sustain prices above competitive levels or restrict output or quality below competitive levels.¹⁰⁵ It was put to us in the early stages of this study that homebuilders may have market power which enables them to restrict output and drive up prices.

¹⁰⁵ For further details see 'Assessment of market power', OFT Guideline 415.

How homebuilders set prices

- 4.36 As discussed in the market definition section, we believe that the evidence gathered during the course of the study points to a conclusion that a high level of price competition, exerted by existing homes over new homes, is a key characteristic of the market for new build homes.
- 4.37 If the price of a new home is largely dictated by the price of similar existing properties, it can be approximated by the price of a similar existing home in the local market plus a new build premium (see paragraphs 4.17 – 4.28). When deciding what to bid for a piece of land a homebuilder will use the expected prices¹⁰⁶ in the market to calculate the gross development value (GDV) of a prospective project. The GDV determines the price a homebuilder can afford to pay for the land (see Annexe O which discusses how development land is valued). This means that the homebuilder will build at a rate which will satisfy the demand in the local market at or above the existing price levels.
- 4.38 It is important to observe that this means that if homebuilders wish to sell homes more quickly, they can do so, but they have to reduce prices to achieve faster sales. This is not usually a profitable strategy, in the sense that faster sales and hence lower interest costs do not offset the reduction in price. The KPMG report at paragraph 2.21, Annexe E sets out an illustrative numerical example.
- 4.39 If the price of homes was to fall below the homebuilder's estimated GDV, then the calculations the homebuilder had used to decide the land price would be wrong and the homebuilder would either have to accept a reduced margin or make a loss. If the homebuilder repeatedly overestimated the GDV it would consistently make a loss. This encourages homebuilders not to use GDVs substantially above the

¹⁰⁶ The expected price will be heavily influenced by the recent selling prices of similar properties. The expected price will also be influenced by the homebuilder's opinion about the state of the future market. For example if the market was rising strongly it is likely that the homebuilder will look at prevailing prices and then add on the expected market appreciation to calculate the gross development value.

market price of similar homes. By the same logic, fierce competition for land deters homebuilders from revising their assessment of GDV downwards so that they can sell homes at lower prices. That is, if a homebuilder decided to adopt a price cutting approach where it decided to sell its homes cheaply and so attempt to sell more homes then it would be unable to buy any land. A lower GDV means a lower bid for land and inevitably a homebuilder attempting to offer cheaper homes will be outbid for land by a homebuilder selling homes at the prevailing market price.

- 4.40 It is for this reason that build out rates, or absorption rates as they are known (see Glossary), are dictated by local market conditions and not by the maximum technical speed at which homes can be built. Homebuilders deliver new homes as fast as they can sell them, not as fast as they can build them.¹⁰⁷
- 4.41 Of course, the ability to influence prices by adjusting output defines a homebuilder as a price setter rather than a price taker and indeed this is true. Homebuilders do set their own prices rather than blindly adhering to the average market price for new homes. It is important, however, to understand the environment in which they do this.
- 4.42 First, homes are heterogeneous; no two homes are identical. Achieving the best price for a home involves matching the home with the homebuyer who values it most highly, this can take time. Second, it is usually more profitable to wait to sell a home than to cut the price to sell it quickly (see the analysis at paragraph 2.21 of the KPMG report at Annexe E for a numerical example). Third, if a homebuilder builds out a site rapidly it is not allowed to build more homes simply because it can sell them, rather it needs planning permission to expand output and this has long lead times and is unpredictable. Finally, competition for land

¹⁰⁷ This can be seen in current market conditions where homebuilders are halting construction on sites because they are unable to sell the ones they have already built. See for example Jameson, A, 2008, Persimmon stops new site building as sales fall, *Times Online* [internet]. 24 April. Available at: http://business.timesonline.co.uk/tol/business/industry_sectors/construction_and_property/article3805018.ece

dissuades homebuilders from attempting to sell homes for less than they might achieve as in order to do so a homebuilder would need to bid less for land and would almost certainly be outbid by a rival homebuilder planning to sell homes for the maximum amount.

- 4.43 It is our view, therefore, that although homebuilders clearly have some price setting power, they are still significantly constrained by the price of the existing housing stock.
- 4.44 Since housing markets are local markets, not national markets, the degree of competition from other new homebuilders and existing stock, is, of course, likely to vary from area to area. While generally we expect new homebuilders to be constrained by competition from the existing housing stock, it is possible that in a local market with high levels of concentration in new build and where new build properties also make up a large share of the total housing stock for sale, that an individual homebuilder may have some market power. The next section examines the degree of concentration in local markets.

Market shares

- 4.45 On a national basis, concentration in the industry is low by comparison with that in many other consumer goods manufacturing industries. In 2006, the single largest firm supplied 11 per cent of the market and the top ten firms supplied 44 per cent of total supply. The 75 largest firms (all of whom produce 100 units a year or more) supplied about 63 per cent of output¹⁰⁸ and roughly a quarter of supply was accounted for by a long 'tail' of about 5,000 firms.¹⁰⁹
- 4.46 Analysing concentration at a national level is not necessarily relevant for assessing market power, since it is likely that economic markets are much smaller local markets so the remainder of this chapter sets out this evidence examining whether there are local areas where a single firm

¹⁰⁸ Source: Housing Market Intelligence Report 2007.

¹⁰⁹ Source NHBC. It should be noted that NHBC covers about 80 per cent of the market.

might have persistent or temporary price setting powers. The dataset used for the analysis is information on a large majority of UK planning approvals granted between 1996 and 2007 on development sites of at least 10 units.¹¹⁰ A full description of the data and how it was used in this analysis is given in Annexe P.

Local markets with single firm dominance

4.47 Table 4.1 shows the number of LPAs where a single firm was given permission to build over 50 per cent of the private housing units in that LPA.¹¹¹ The data was analysed in seven different three-year rolling periods, from 1998–2000 to 2004–2006. This data suggests that in each of the three-year periods, approximately 10 per cent of all UK LPAs granted permission to a single firm to build 50 per cent or more of their private new build homes. This pattern is repeated in England, Wales, Scotland and Northern Ireland individually.¹¹²

¹¹⁰ About a third of the approvals in the dataset, mostly more recent ones, had no entry in the column of data for which firm was building on the site. In these cases it was not possible to tell who had built (or would build) on the sites and so they were left empty and counted separately. These rows of data will be referred to as 'blanks'.

¹¹¹ Note that the dataset did not contain any data for sites which had less than 10 units and the dataset is not complete. As smaller sites are more likely to be handled by smaller homebuilders this is likely to overestimate concentration.

¹¹² There are 438 LPAs in the UK: 355 in England, 32 in Scotland, 25 in Wales and 26 in Northern Ireland.

Table 4.1: Number of local authorities where a single firm was granted permission to build more than 50 per cent of units

No. LPAs where single firm got permission to build > 50% units					
Period	UK	England	Wales	Scotland	N Ireland
1998 to 2000	50	44	3	1	2
1999 to 2001	43	37	2	3	1
2000 to 2002	45	37	2	3	3
2001 to 2003	42	37	2	3	0
2002 to 2004	37	30	2	4	1
2003 to 2005	41	37	1	3	0
2004 to 2006	29	24	0	4	1

Source: Emap Glenigan.

4.48 Looking in more detail at these areas where a single homebuilder obtained a high proportion of planning permissions, it appears that this 'concentration' is usually the result of the homebuilder gaining control over a single large site or a small number of large sites. It does not appear to be the case that concentration in these areas is a result of a single firm gaining control over a large number of sites, and by so doing, maintaining a persistently high market share.

4.49 Table 4.2 shows the mean number of units per approval in 'concentrated' and 'non-concentrated' areas.¹¹³ As can be seen in the table the mean number of units per approval in concentrated areas is higher than the mean in non-concentrated areas showing that concentration is a result of differing site sizes.

¹¹³ We are using the term 'concentrated' to refer to an LPA where one homebuilder have more than 50 per cent of approvals over the given time period.

Table 4.2: Mean number of units per planning approval

Period	Non-concentrated	Concentrated
1998 to 2000	39	48
1999 to 2001	39	48
2000 to 2002	40	65
2001 to 2003	41	63
2002 to 2004	42	70
2003 to 2005	43	65
2004 to 2006	45	66

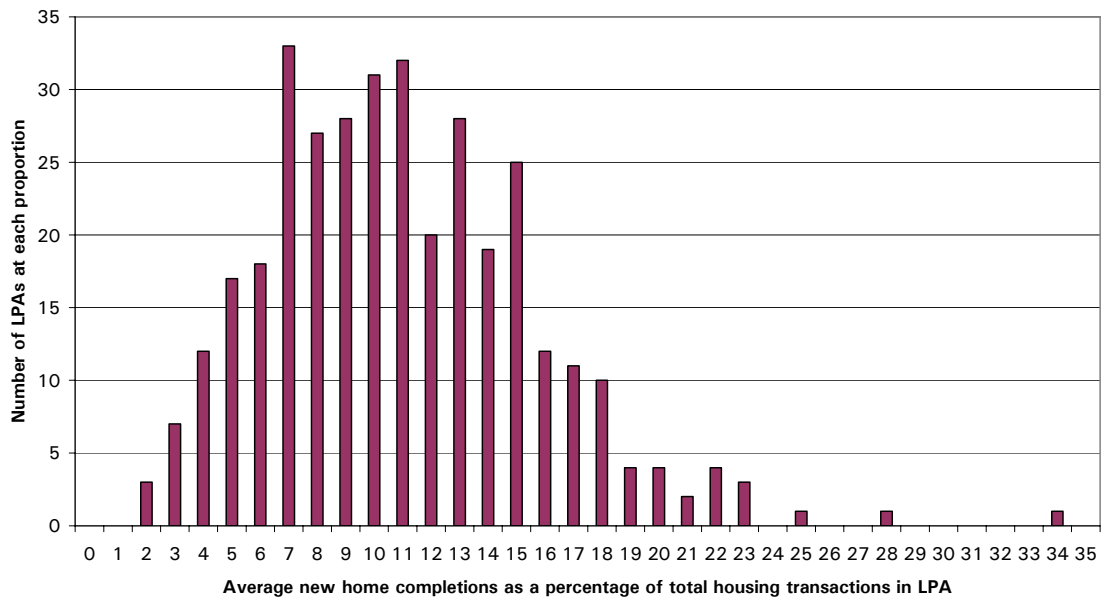
Source: Emap Glenigan.

- 4.50 Another key observation is that the areas identified as 'concentrated' in Table 4.1 do not stay the same from year to year. Firms do not seem to gain more than a very temporary high share of the supply of new homes, often as a result of having been given permission to build on a single large site. There were only five local authorities in the UK where a single homebuilder parent company had permission to build more than 50 per cent of all the units, approved in the period 1997 to 2007. In all five cases, the situation is as a result of a single homebuilder having permission for some especially large sites (see Annexe Q for a detailed discussion of each case.)
- 4.51 The importance of this analysis is that the areas identified in Table 4.1 are only 'concentrated' as a result of the planning system. As long as there are areas where the number of sites going through the planning system is limited, and these sites vary in size, there will in some situations, be a single homebuilder which holds a temporarily large proportion of supply.

4.52 The analysis so far has erred on the side of caution and calculated concentration assuming that new homes are in a separate market to the existing stock of homes. For completeness, we have also considered how the inclusion of the existing stock in the market affects concentration.

4.53 Chart 4.3 shows new home completions as a percentage of total housing transactions, calculated as an average over a five year period. There is substantial variation between LPAs ranging from two to 34 per cent of the total.

Chart 4.3: Average value of new build completions as a percentage of total housing transactions in each LPA, UK 2001 – 2006



Source: CLG Live Table 253 (completions) and 584 (total transactions).

4.54 Even if it were the case, which it is not, that the highest proportion of new build completions relative to total housing transactions for the period 2001-06 (34 per cent) were to be in the same LPA as the highest proportion of new build output accounted for by a single firm over the period 1998-2006 (65 per cent) then the market share of the largest homebuilder would be only 22 per cent. The figure of 22 per cent falls

well below the usual threshold at which the OFT would consider a firm to be dominant.¹¹⁴

- 4.55 So while, in theory, it is possible that there could be local markets with high levels of concentration in new homes and where new homes also make up a large share of the total housing stock for sale, the data suggests this is not the case in practice.
- 4.56 We are not persuaded that new homes are in no way constrained by the existing housing stock and consider the figures in Table 4.1 to be a worst case scenario.

Conclusion on market shares and concentration

- 4.57 The evidence presented above does not indicate that the homebuilding industry has a significant problem with high levels of market concentration on either a local or national level. Even if one assumes that the prices of new homes are not constrained by the existing housing stock (a cautious assumption that the OFT considers unlikely) there are only a few areas, approximately 10 per cent of local markets, where a single homebuilder constitutes a high proportion of the supply of new homes. Even then, typically this lasts for a limited period of time. We found no local monopolies. We accept that in areas where a homebuilder sells a very different type of home to that offered by other homebuilders, it may enjoy some market power but we consider these situations are likely to be rare. Moreover, if it is accepted that the existing housing stock does constrain new homes, the picture is of even greater competition and lower market shares.
- 4.58 At a national level, there has been increasing concentration characterised, in particular, by an increasing share of supply of new homes taken by firms producing more than 2000 units per year and, in particular, the recent emergence of three 'super-volume'

¹¹⁴ See 'Assessment of market power', OFT Guideline 415.

homebuilders.¹¹⁵ We do not consider that this amounts to a competition problem although, as with all trends for increasing concentration, it would be prudent that this trend be kept under review. The OFT is well placed to do so through the exercise of its first stage merger control powers.

Barriers to entry and expansion

- 4.59 A thorough competition assessment should include a consideration of barriers to entry and expansion. These have significance for competition because such barriers may impede the entry of new firms into an industry and prevent firms from growing. Both new firm entry and the expansion of smaller firms are important for vibrant consumer focused markets. New firm entry allows new ideas and innovative firms, entrepreneurs and technologies to enter an industry and 'shake things up'. Firm expansion allows for those firms which are best serving consumers to expand into new geographic areas or segments and reach a wider customer base. It follows that significant barriers to entry and expansion may be indicative of an industry that is not working well for consumers.
- 4.60 In this assessment of barriers to entry and expansion we have not restricted ourselves to a narrow orthodox interpretation of barriers (principally that such barriers must be linked to fixed costs). Rather, as befits a market study, we have also considered barriers as they are perceived by the industry and which may affect output or, in some cases, quality, both of which are relevant to this study.

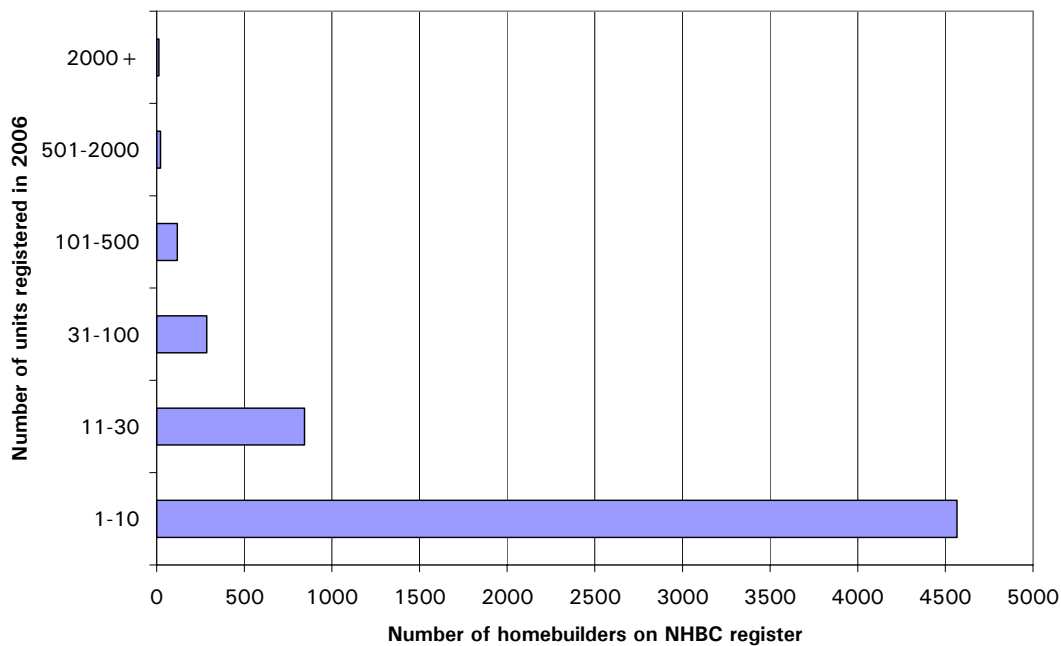
Direct evidence of entry and expansion

- 4.61 There is a high level of entry into and expansion within the homebuilding industry.

¹¹⁵ In 2006 these 'super-volume' homebuilders were Taylor Wimpey, Persimmon and Barratt. Taylor Wimpey built 21,910 units, Persimmon built 16,701 units and Barratt built 14,601 units, between them these three companies were responsible for 28 per cent of output in 2006.

4.62 In 2007 NHBC reported that 1,649 new homebuilders registered their homes for warranties. These new homebuilders registered 16,915 individual homes during the year - this is almost 10 per cent of the total number of homes built in 2007. It is possible that some of these 'new' homebuilders will have built homes previously but not in the preceding year. These figures suggest a significant level of new entry into an industry that already has a high number of smaller firms. It appears to be the case that, at the smallest end of the market, some homebuilders do not build complete homes every year but work as sub-contractors most of the time and build a home if they find some suitable land or are approached by a self builder who wants to commission their own home.¹¹⁶

Chart 4.4: Number of units registered by NHBC homebuilders, 2006



Source: NHBC, New House Building Statistics, 2007 Q3, Table 14.

¹¹⁶ In the Federation of Master Builders Q1 2008 *State of Trade Survey* respondents were asked about their attitude to homebuilding and repair, maintenance and improvement (RM&I or R&M). The report is available at www.fmb.org.uk/pdf/pub/sotsurvey/fmb108.pdf

4.63 It appears that it is not only relatively easy for firms to enter the homebuilding industry but also comparatively easy to break into the top tier of firms. Figure 4.1 illustrates the change in the top 10 homebuilders, by volume, over time. Starting at the right-hand column and working left, back through time, we can see the ranking of the 2006 top 10 firms over the previous 25 years. Of the top homebuilders in 2006, only four were in the top 10 in 1995 and only two were in the top 10 in 1980. To some extent, these results reflect mergers in the industry over that period which have led to significant consolidation between firms within the top 10.¹¹⁷ Even so, the presence of Bellway, Persimmon, Berkeley and Gladedale (which was only founded in 1996) in the top 10 homebuilders in 2006 represents strong growth on behalf of these firms, none of which was in the top 10 fifteen years previously.

¹¹⁷ It appears that most firms who leave the top 10 do so because they are taken over so they become part of a new larger homebuilder, many of whom remain in the top 10.

Figure 4.1: Top 10 homebuilder rankings, by turnover, in selected years since 1980

Barratt	McLean	Wimpey	Wimpey	Barratt	1
Wimpey	Wimpey	Beazer	Barratt	Persimmon	2
McLean	Barratt	Barratt	Beazer	Wimpey	3
Broseley	Beazer	McLean	Persimmon	Taylor Woodrow	4
Bovis	Ideal	Wilcon	Bellway	Bellway	5
Leech	Laing	Bellway	Westbury	David Wilson	6
Bryant	Lovell	Bryant	Wilcon	Redrow	7
Comben	Bovis	Persimmon	McAlpine	Miller	8
Ideal	Westbury	Raine	Bryant	Berkeley	9
MRCE/Whelmar	Wilcon	Lovell	David Wilson	Gladedale	10
1980	1987-89	1995	2000	2006	

Source: Fred Wellings, *British Housebuilders – History & Analysis*¹¹⁸, updated by OFT.

4.64 There is also significant expansion amongst firms outside the top 10. For example, Weston Homes, Higgins Homes and Telford Homes are all relatively recently established and have grown rapidly. Consistent with this evidence of entry and expansion, barriers to entry in the homebuilding industry are generally regarded as low.¹¹⁹

¹¹⁸ 1980, table 5.2 p86, 1987-89, table 5.3 p90, 1995, table 6.4 p99, 2000, table 6.5 p100.

¹¹⁹ See for example, Ball, M, 2006, *Markets & institutions in real estate & construction*, Oxford: Blackwell Publishing Ltd.

Types of barriers to entry and expansion

- 4.65 Broadly speaking there are three main types of barriers to entry and expansion. Intrinsic barriers are those that all firms face as a consequence of doing business in the industry, these relate to key inputs such as land or finance or essential skills and knowledge.
- 4.66 Regulatory barriers are those barriers that are created by Government interventions in the market. These can take many forms: permits, standards, taxes, health and safety regulations and so forth. We discuss a number of Government interventions in the supply of new homes at Annexe I.
- 4.67 Strategic barriers are those barriers that are created by incumbent firms either intentionally or otherwise. We consider each of these types of barriers below.

Land as an intrinsic barrier

- 4.68 Professor Michael Ball identified 'the institutional framework of land assembly' as a potential barrier to new entry to the industry.¹²⁰ The Barker review identified the following potential barriers to entry in respect of access to land:¹²¹
- the need for homebuilders to understand the development and planning control framework within an area
 - the need for the homebuilder to have a good relationship and reputation with LPAs, suppliers of land and suppliers of labour (contractors) in the locality
 - the need to have particular technical expertise and knowledge of development approaches tailored to particular areas, and
 - the existence of homebuilder landbanks and options.

¹²⁰ Michael Ball, *Markets and Institutions in Real Estate and Construction*, p 189.

¹²¹ Barker review Interim Report, para 5.43, p 90.

4.69 The Callcutt review also emphasised the importance of local market knowledge, finding that:

'one of the major assets of house building companies is their knowledge of local markets, which enables them to assess how to obtain the best value from the development of a particular site... this ability gives existing companies a significant edge in the highly competitive market for land, and creates a de facto barrier for new entrants who lack the local knowledge required'.¹²²

4.70 All of the homebuilders we spoke to, both public and private, during the course of this study cited access to land suitable for development as a significant obstacle to expansion into new regions. In answer to our questions to the top 10 homebuilders¹²³ all nine of those which responded said that the availability of developable land was one of the three most important factors determining the number of units they built each year.¹²⁴ Furthermore, eight said that the availability of developable land was one of the three most influential factors when they were considering expansion into a new area.¹²⁵ See Chapter 5 for a further discussion of land supply.

4.71 In our view the evidence suggests that small homebuilders are adept at finding and exploiting small scale land opportunities that are too small for

¹²² Callcutt review, ch 2, p 16.

¹²³ Questionnaire was sent to Taylor Wimpey plc, Persimmon plc, Barratt Homes, Bellway plc, The Berkeley Group Holdings plc, Redrow plc, Miller Homes, Crest Nicholson plc, Gladedale Homes and Bovis Homes Group plc.

¹²⁴ Q4, Top 10 homebuilder survey. Q4 reads, 'Please rank from the list below, in order of importance, the top three factors which are most important in determining the total number of units that you will build in a year: availability of developable land, provision of infrastructure, access to finance, availability of construction labour, general economic conditions, management capacity to manage the sites, other.'

¹²⁵ Q5, Top 10 homebuilders survey. Q5 reads, 'Please rank from the list below the top three factors which are the most influential when considering expansion into a new area: rising demand in local area, knowledge of local economic conditions, contacts in the local planning authority, availability of developable land, availability of local construction labour, other.'

larger homebuilders to handle profitably (see in particular the case studies of Danny Ward and Fairgrove Homes at Annexe F). We observe from our case studies that success does depend on local knowledge, expertise and contacts but this has not prevented significant new entry not least because these skills can be transferred from existing firms by individuals leaving and setting up new ventures (for example, see the St. James Parade case study at Annexe F).

- 4.72 It appears to us that the land barriers to expansion may be more significant than the land barriers to entry. Expansion takes smaller homebuilders away from projects too small to be of interest to larger homebuilders and brings them into competition with larger homebuilders for land. As firms grow to become very large players, land acquisition becomes a significant barrier to further growth. Many of the mergers that have created the larger firms have been in part motivated by a desire to obtain land.
- 4.73 On balance, however, we do not consider that the land barriers to expansion are themselves a significant competition problem. We have seen little evidence to suggest that the UK homebuilding industry would benefit from a greater number of larger firms.

Finance as an intrinsic barrier

- 4.74 In addition to our programme of interviews with homebuilders and our case studies, we commissioned KPMG to consider the corporate financing of homebuilders in the UK. KPMG's report is at Annexe E.
- 4.75 Both the KPMG report and the interview programme with homebuilders point to access to finance as a significant barrier at certain points in a homebuilder's lifecycle. In particular, as homebuilders expand from a small company into a mid-sized one it can be difficult for them to ensure the quality of management and managerial systems and controls to satisfy lenders.
- 4.76 Furthermore, as the KPMG report at Annexe E makes clear, many homebuilders are relatively highly geared making them vulnerable in a downturn to a breach of their banking covenants. Indeed, in recent months a number of larger more highly geared homebuilders have

announced the need to raise additional equity finance or restructure their banking arrangements to deal with this problem.¹²⁶

- 4.77 It is our view that access to finance is a limiting factor to entry but it is a more significant limiting factor to expansion. Finance for growth is only likely to be available to the best entrepreneurs and managerial teams. It is our view, however, especially in the light of the volatility of the homebuilding market that this is not necessarily a problem and almost certainly helps to create some stability in the industry by avoiding even greater levels of insolvency during downturns.

Knowledge as an intrinsic barrier

- 4.78 Although land and finance barriers to entry are low and for expansion more serious but still unproblematic, there may also be knowledge barriers facing certain entrants. In particular, entrants without prior knowledge of the UK homebuilding market are likely to face significant knowledge barriers compared to those firms and entrepreneurs that have such experience. Below, we discuss the following potential entrants: overseas firms; commercial developers and self builders.

Overseas firms

- 4.79 Foreign firms seeking to enter the UK have two methods that they can exploit - acquisition of a UK firm or to fund a start-up and pursue organic growth. Acquisition of UK firms has been the dominant strategy amongst the limited amount of foreign entry into the UK.
- 4.80 The main overseas firms that have entered the UK market by acquisition in recent years have been Centex, which acquired Fairclough Homes in 1998 (though it sold Fairclough, thus exiting the UK market in 2005)¹²⁷ and Dutch construction firm Heijmans, which bought Leadbitter in 2003.

¹²⁶ See for example the actions of Barratt Developments plc:

http://miranda.hemscott.com/servlet/HsPublic?context=ir.access&ir_option=RNS_NEWS&item=66082366817149&ir_client_id=95

¹²⁷ Wellings, op. cit. p.187.

Irish firm McInerney, which failed in 1991,¹²⁸ re-entered the UK market in 2000 and, partly through acquisition, grew to build 985 homes in 2006. Australian firm Lend Lease bought Crosby Homes in 2005.¹²⁹ There has been comparatively little entry at start-up level by foreign firms. Ballymore, an Irish company, has grown its UK homebuilding operations by developing schemes such as Pan Peninsula in London's Docklands.

- 4.81 The foreign companies that we spoke to explained that entering the UK homebuilding market was difficult. As noted in the Barker review, vertical integration is common in the UK with homebuilders typically undertaking both land assembly and homebuilding (in contrast to other countries such as the USA where these activities are more often undertaken by different firms).¹³⁰ The combined role of homebuilder and land developer taken on by most UK homebuilders is not a model adopted overseas. This means that overseas firms typically lack the skills necessary to operate in the UK market as a speculative developer. One large foreign company explained it thus, 'Candy & Candy have just spent £1 billion on a single site. We just don't understand a market like that, so our Board won't let us take the risks.'
- 4.82 Second, the use of offsite manufacturing and industrialised construction techniques (see Glossary) is much more prevalent overseas so many foreign firms are keen to use similar techniques in their UK businesses. Firms seeking to use these techniques in the UK have encountered difficulties. Skanska, for example, found that the planning systems in the UK made it difficult to achieve a final design for a building (sometimes called design freeze) at an early stage which is important to achieve the efficiencies of industrialised construction.
- 4.83 Skanska had also found many of the UK regulations more onerous than those in Sweden, for example with respect to progressive collapse,

¹²⁸ Ibid, p.268.

¹²⁹ Ibid., p.152.

¹³⁰ Barker review Interim report, Box 4.1, p 74.

disabled access, fire regulation and health and safety. Skanska also reported increased construction times in the UK compared to Sweden because of UK health and safety regulations that require crash decks and other safety measures for construction personnel working at height to be built in to the construction process for a system that does not require scaffolding but only cranes to lift pre-cast concrete into position.

- 4.84 The UK planning system is considered to be more complicated than the planning regimes in other countries. The SmartLIFE project¹³¹ found, for example, that in Cambridgeshire, 'there is a four-tier planning system where the overarching strategic decisions are taken at national level'. This compares to the much looser Swedish model, where 'the sustainable management of natural resources is pinpointed at the highest national level and the government defines very broad guidelines that are left to the municipalities to apply'. In Germany the Federal Government has authority on the planning framework, meaning it decides on principles, concepts and guidelines and 'local authorities have extensive autonomy concerning planning.'¹³²
- 4.85 The UK's planning regime might also be a specific barrier to entry for foreign companies that specialise in the use of offsite manufacturing (see Glossary). The same building methods cannot always be employed in the UK as elsewhere and making the necessary changes to the construction process can entail significant costs. Making design changes specifically for the UK may not be profitable. Contractors have told us that they find it far more expensive to comply with UK planning restrictions than in other countries.
- 4.86 It is worth observing that there are plenty of examples of Scottish homebuilders operating in England and Wales, of Welsh homebuilders operating in England and Scotland, and of English homebuilders

¹³¹ SmartLIFE is an on-going project that compares modern methods of construction (MMC, see glossary) in the UK, Sweden and Germany www.smartlife-project.net

¹³² Smartlife, Planning policies and practices in the SmartLIFE partnership, Cambridge, Hamburg, Malmö. Available at: www.smartlife-project.net/smartlife/documents/SL_WP3_D.pdf

operating in Scotland and Wales. There are not, however, many examples of these firms operating in Northern Ireland or of Northern Ireland based homebuilders operating in the UK. This largely reflects the fundamentally different nature of the housing market in Northern Ireland, which, up until relatively recently, was characterised by lower levels of demand.

- 4.87 We conclude that while – as discussed earlier - barriers to entry for small scale UK start up firms, using UK acquired knowledge and understanding, are low, entry barriers for larger foreign firms attempting to enter on a larger scale appear to be significant.

Commercial developers

- 4.88 Current planning policy puts significant weight on the need to build mixed use developments. Sometimes this is achieved through mixing the uses within a single building. Sometimes it is achieved by having a mix of dedicated buildings within a development. In either case, it is likely that alongside the building of new homes a homebuilder will now be required to make provision for office, retail or leisure space by the relevant LPA.
- 4.89 Building a mix of commercial and residential buildings requires a different set of skills to those required to build only homes. Several commentators have suggested that increasing involvement by commercial developers in provision of housing may be a consequence.¹³³ Similarly, the Barker review noted that major urban regeneration requires skills more commonly found among commercial developers than traditional homebuilders.
- 4.90 In certain geographic areas, the process of land assembly may be particularly difficult or complex, and the associated risks greater. For example, the Greater London Authority's response to the Barker review said that 'residential development in London is to a large extent limited to a small number of specialist firms who are familiar with the

¹³³ See for example, p.25 Housing Market Intelligence Report 2007, Housebuilder Media.

constraints'.¹³⁴ It was suggested to us that there are no dedicated UK homebuilders that possess the skills needed to successfully undertake large regeneration projects and that there are perhaps only three homebuilders that have the scale to undertake mid-sized regeneration schemes. Commercial developers indicated during the Barker review that they would play a greater role in housing development if the land assembly process was facilitated in urban areas.¹³⁵

- 4.91 Given their apparent competitive edge, it may then seem curious that commercial developers have not entered residential development on a larger scale. The Barker review noted that the limited role played by commercial developers in provision of housing to date is partly explained by fundamental differences in the business model. Commercial developers are primarily interested in income-generating property. Ideally, they pre-let the property, which provides a secure income stream which can be securitised to finance the development. By comparison, homebuilders traditionally have mostly adopted the 'current trader' model (see Glossary) whereby they build homes speculatively and sell them on rather than retain an interest in them for income.
- 4.92 Nonetheless, there may be some scope for convergence between the traditional homebuilding model and the typical commercial development model (for example, Land Securities' significant development at Ebbsfleet). Some private homebuilders have started to retain a long-term interest in the properties they build, through retaining units to rent, shared equity schemes or retention of the freehold. This model is particularly attractive to companies involved in urban regeneration as a long-term interest allows the company to benefit from any growth in property values consequent from their regeneration investments, even if those returns take some time to realise.
- 4.93 Of course, not all mixed-use developments have to be taken forward by a single developer skilled in both commercial and residential development. Many developments are currently being brought forward

¹³⁴ Barker review Interim report, para 4.20, p 68 and para 5.42, p 92.

¹³⁵ Barker review Interim report, para 4.39, p 74.

by consortia of specialist commercial developers and specialist homebuilders. For example, a consortium of Lend Lease, First Base, and Oakmayne is currently engaged in redeveloping the Elephant and Castle housing estate and shopping centre in London.

- 4.94 However, it has been suggested to us that commercial developers can face difficulties managing finance for mixed-use developments since commercial finance and homebuilding finance have traditionally come from different sources (reflecting in part the difference in business models referred to above). If the housing and commercial parts of the development have been separately financed, there may be difficulties over allocation of costs, risks and liabilities, especially for mixed-use buildings.
- 4.95 Overall, there has not been a widespread movement by commercial developers into homebuilding. It seems likely that the large differences between the commercial and residential development business models create a knowledge barrier that, for the most part, discourages entry by the majority of commercial developers into the area. Nevertheless, some pioneering commercial developers are experimenting with some residential development and, if successful, may start a trend for increased activity in residential developments by commercial developers.

Self builders

- 4.96 A category of development that may face particular barriers to entry is self build.¹³⁶ The Callcutt review highlighted the significance of the self build sub-sector, it is estimated to account for up to 10 per cent of new production,¹³⁷ but found that housing policies tended to neglect this category of development. In particular, the Callcutt review raised the issue of access to land. The Callcutt review recommended that LPAs and

¹³⁶ Self build is where the homebuyer is involved in the production of the home.

¹³⁷ The most prominent report on the self build market is Barlow, J, Jackson, R and Meikle, J, 2001, *Homes to DIY for the UK's self build housing market in the twenty-first century*, Report commissioned by Joseph Rowntree Foundation.

government agencies disposing of land do more to ensure that small plots are made available to self builders.

- 4.97 Self building is, rightly or wrongly, often seen as a radical option fraught with potential pitfalls. Stories of failed self build projects are not hard to come by.¹³⁸ Nevertheless, according to a survey by the Norwich and Peterborough Building Society up to 70 per cent of the public at some point consider building their own home¹³⁹ compared with only 10 per cent of new homes (less than one per cent of the housing stock over the last decade) being delivered this way. The discrepancy, suggests that there are significant barriers to self building. Anecdotal evidence¹⁴⁰ from those working in the self build industry suggests that the most acute barriers are likely to be knowledge and cultural barriers and access to upfront, pre-mortgage capital.
- 4.98 UK levels of self building are far below the levels seen in Japan, Germany and France. Self builders typically report much greater levels of satisfaction with their home than homebuyers of speculatively built homes. Given that the only credible alternative to speculatively built homes for a homebuyer who wants a brand new home is a self built one, it seems clear that an invigorated self build sector to the homebuilding market could deliver improved satisfaction and also greater output, by making new build homes more affordable and potentially accessing development sites overlooked by other homebuilders. We discuss self building in more depth in Annexe R.

Regulatory barriers

- 4.99 Annexe I sets out a list of some of the key regulatory requirements in the homebuilding industry for England, Wales, Scotland and Northern Ireland. These interventions to a greater or lesser extent determine, how

¹³⁸ OFT interviews with self build architects.

¹³⁹ Figures taken from '*DIY Urbanism: Self build in cities*' <http://esp-sim.org/?p=41>

¹⁴⁰ There is very little numerical data available for the self build industry.

many new homes can be built, where they can be built, how they can be built, and the type of home that can be built. Moreover, the regulations¹⁴¹ can be complex to understand and difficult to implement.

4.100 There are a number of regulations that may present significant barriers to entry into the homebuilding industry. In particular, the Code for Sustainable Homes¹⁴² has been repeatedly brought to our attention by homebuilders as a serious barrier.

4.101 The Code for Sustainable Homes¹⁴³ was launched in December 2006 and it became mandatory in England for all homes to have a code rating on 1 May 2008. Technically, the Code for Sustainable Homes is a standard. However, we cite it in this section as a form of public intervention which impacts on homebuilders. The Welsh Assembly Government is currently consulting on proposals to require all residential developments of more than 10 homes to be built to Code Level 3 from 1 April 2009.¹⁴⁴ It is an aspiration of the Welsh Assembly Government for all homes built in Wales from 2011 to be 'carbon neutral'.¹⁴⁵ Further details on the application of the Code for Sustainable Homes can be found in Annexe I.

4.102 The Code for Sustainable Homes sets out a series of levels of construction performance that new homes must achieve: In England, Code Level 4 applies from 2010, Code Level 5 from 2013 and Code Level 6 from 2016. Each level of the Code requires a higher level of

¹⁴¹ We are not using the word 'regulation' in the strictest sense. Here we take it to mean any governmental, administrative or public formal or informal intervention which affects the homebuilding industry.

¹⁴² OFT interview programme with homebuilders. The Code for Sustainable Homes is a standard.

¹⁴³ www.communities.gov.uk/thecode

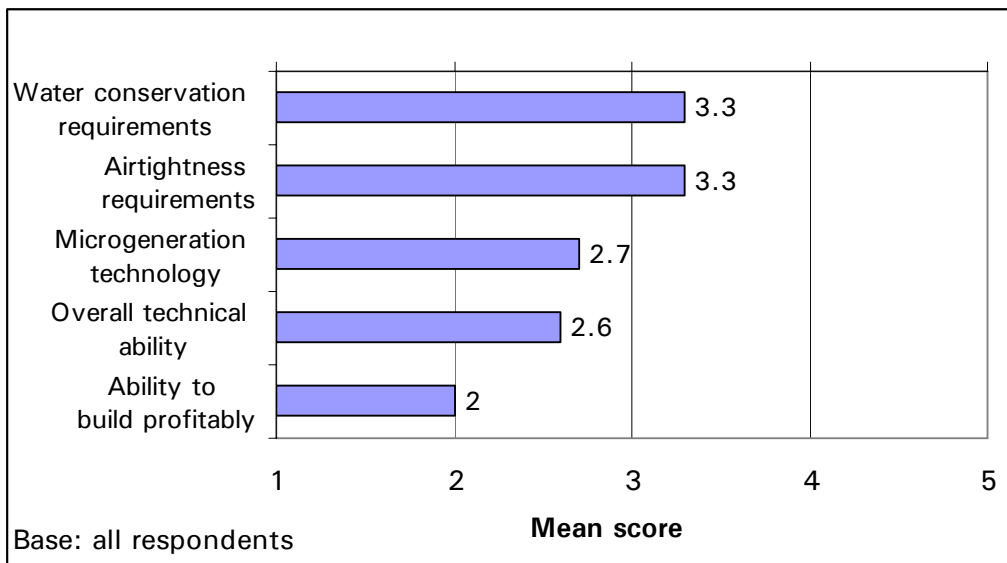
¹⁴⁴ Box 2, Welsh Assembly Government, 2008, *Consultation paper: Further consultation on planning for climate change*.

¹⁴⁵ www.walesonline.co.uk/news/politics-news/2008/04/17/wales-eco-targets-impact-on-affordable-homes-91466-20776051/

performance from new homes with Code Level 6 defined as a zero carbon standard.

4.103 Many homebuilders currently consider that it is currently technically impossible to achieve Code Level 5 or 6. See for example the survey results reported in Chart 4.5.

Chart 4.5: Homebuilder confidence in meeting Code Level 6 by 2016



1 = not at all confident, 5 = very confident

Source: Fig. 25, p69, *Zero carbon: what does it mean to homeowners and housebuilders*, HNBC Foundation, April 2008.

4.104 Other homebuilders take the view that while Code Levels 5 and 6 may be technically feasible they cannot be made commercially viable. It is clear that the view of homebuilders is that the Code for Sustainable Homes, uniquely amongst all the regulations faced by homebuilders, imposes a very significant technical challenge.

4.105 Many of the smaller homebuilders we spoke to voiced the concern that, without the resources to carry out extensive research and development,

the higher Code Levels are likely to present significant difficulties to continued participation in the industry in the future.¹⁴⁶

- 4.106 It is our view that, without significant additional support provided in a coordinated manner, many smaller homebuilders are unlikely to be able to meet the standards required by the higher levels of the Code for Sustainable Homes. If this is the case, it seems essential that the benefits of any support are made available in particular to smaller firms and new entrants in order to prevent the Code for Sustainable Homes from becoming an insurmountable barrier to entry. Also in this connection, the same concerns apply with regard to individuals involved in self build.
- 4.107 We are aware of certain central Government initiatives to address these concerns. In Scotland, the Scottish Government has chosen a lower level of performance as its target. In England the Zero Carbon delivery hub is envisaged to co-ordinate industry research efforts¹⁴⁷ and across the UK the Technology Strategy Board will invest £30million in funding the development of low carbon building products and services.
- 4.108 While these initiatives are encouraging, we still emphasise the importance - for the benefit of both competition and customer satisfaction - that the development of new technologies is properly co-ordinated, well funded and that the technologies are well tested for reliability before their wide-spread introduction.
- 4.109 To this extent we recommend that Government and the Welsh Assembly Government should consider the need to actively assist small

¹⁴⁶ Some smaller homebuilders are speaking out in the strongest terms about the general burden of regulation and the Code for Sustainable Homes is part of that burden. For instance see Professor Benfield's comments at www.benfieldatt.co.uk/media_centre/press_releases/regulate_finance_not_house_builders_02_03_07.

¹⁴⁷ There is no analogue body to the Zero Carbon Delivery hub in Wales as the Welsh Assembly Government is still consulting on the introduction of the Code for Sustainable Homes.

homebuilders and individuals building their own homes to overcome the zero carbon challenge.

Strategic barriers

- 4.110 Many of the practices which can lead to strategic barriers are absent from the homebuilding industry - the industry has a relatively low level of advertising and company brand plays only minor importance in the sale of most homes, although we recognise there are some exceptions to this general rule. Since entry to the industry is typically on a small scale it is not surprising that we heard of no reports of homebuilders aggressively targeting new entrants to the industry with either price or non price competition measures.
- 4.111 We considered whether the holding of landbanks might act as a strategic barrier to entry and expansion by preventing new firms from acquiring a key input in an incumbent homebuilder's area of operation. Our analysis of this is set out in Chapter 5 where we conclude that homebuilders have sound commercial reasons for acquiring and managing land as they do. We believe that landbanks are unlikely to present an insurmountable barrier to firms looking to enter or expand into a specific area.
- 4.112 Overall, we conclude that there are no significant strategic barriers within the homebuilding industry.

Conclusion on barriers to entry and expansion

- 4.113 There are two main intrinsic barriers to entry and expansion that affect all homebuilders. These are acquiring suitable permissioned land and finance. For small new entrants both can be a challenge but the level of new entry suggests that neither is undermining the vibrancy of entry to the industry in a significant way. That said, the current liquidity crisis is likely to present very high barriers to the acquisition of finance for entry or expansion (see for example the comments made regarding access to finance by St. James Parade at Annexe E).
- 4.114 As firms grow and expand, finance becomes more difficult to obtain as lenders increasingly look for more sophisticated management and better management controls and processes before lending. These barriers are

most significant for firms looking to grow into the mid-tier of homebuilders.

- 4.115 As homebuilders grow larger, after having established more sophisticated management, increasingly it is land rather than finance that becomes the most significant barrier to further expansion. Many of the very largest firms have had to acquire land through purchasing other homebuilders and their land holdings.
- 4.116 Nevertheless, the combined barriers to small scale entry seem low - in principle anyone with the skills to build a home could buy a small plot of land, build a home on it and then sell it. Expansion, which brings increased challenges in terms of financing, land acquisition and management (especially as the geographic spread of the company grows), appears to be much more difficult. We believe this is reflected by the market structure of a few large firms with a large competitive fringe made up of lots of small firms.¹⁴⁸ Entry is observed and although concentration has increased within the market the dynamic competitive fringe made up of smaller firms remains.
- 4.117 Looking forward, and assuming the current liquidity crisis is resolved relatively soon, it is regulatory barriers that are likely to present the highest barriers to new entrants and incumbent homebuilders looking to expand. In particular, the Code for Sustainable Homes is currently cited by many homebuilders as a barrier that they will not be able to clear unless significant additional help is provided.
- 4.118 After considering the matter, we do not consider that landbanking presents a significant strategic barrier to entry, we set out our findings and analysis in Chapter 5.
- 4.119 Overseas firms, without experience of the UK industry and in particular the UK land market, often face high knowledge barriers to entry that has manifested itself in limited entry by foreign firms and then only usually by acquisition of UK businesses. On this basis, we think it unrealistic to

¹⁴⁸ See Chart 3.3 for details of the number of small firms.

expect entry by overseas firms to deliver much in the way of innovation, output or customer satisfaction improvements in the speculative homebuilding industry in the coming years.

- 4.120 In our view, Government should take steps to ensure that regulatory intervention in the homebuilding industry does not increase the regulatory barriers to entry and expansion. We have set out our recommendations accordingly - principally Government and the Welsh Assembly Government must take steps to ensure that the homebuilding industry and its supply chain is supported in developing, accessing, using and implementing the technologies necessary to deliver the Code for Sustainable Homes.
- 4.121 Also reflected in our recommendations is that we think there is more scope for Government to support and promote self building initiatives. At present, self building is largely limited by the significant knowledge barriers faced by many of those who would aspire to build their own home.

Vertical integration

- 4.122 A firm is said to be vertically integrated when it simultaneously operates at different levels in the supply chain for a given product or service. As noted in the Barker review Interim Report, most UK homebuilders carry out every step in the homebuilding process, starting with land acquisition and finishing with sales and marketing of the completed home¹⁴⁹, that is, vertical integration is a characteristic of the UK homebuilding industry.
- 4.123 In other countries, for example, Australia and the US, it is common to have separate firms which specialise in land development and construction.¹⁵⁰ Land development firms (sometimes called land assembly firms) specialise in buying land, acquiring the necessary

¹⁴⁹ Box 4.1, p74 Barker Review Interim Report, 2003.

¹⁵⁰ Ball, M, 2003, Markets and the Structure of the Housebuilding Industry, an International Comparison, *Urban Studies*, Vol 40, No. 5-6, p897 – 916.

planning consent and installing any necessary infrastructure before selling the land to a construction company. A construction company will build homes on the site, typically making decisions about what type of homes to build and then market and sell them to consumers.

- 4.124 In the UK these roles tend to be combined into a single homebuilding business. This reflects two features of the UK homebuilding market, first there is a relative scarcity of residential development land compared to other countries and second, the detailed nature of planning permission required before development can commence.
- 4.125 Any UK homebuilder that sought to acquire development land only once it had planning permission and infrastructure would be dependent on land development firms bringing forward enough land to meet its needs. Of course, because land is relatively scarce, there is no guarantee that a land developer would have any suitable prepared land in the location the homebuilder wanted to build in. One way for the homebuilder to manage this risk is to bring some land through the development process itself, building up a portfolio of land that can be brought through the planning system as a pipeline of development opportunities.
- 4.126 The second factor militating against separating land development from home construction is the nature of planning permission. Planning permission which can be implemented is typically very detailed and will include information about the style and design of each dwelling as well as any additional requirements in relation to social housing requirements, highway upgrades and so forth. These are all key financial risks that a homebuilder would want to control. A land developer must carefully manage these risks in order to ensure that it can make a profit on the onward sale of the land – a homebuilder will not want to buy a plot with, for example, a financially unviable section 106 development (see Glossary at Annexe X and the discussion of regulation more generally at Annexe I). So, in order to understand the financial viability of land deals and planning consents the land developer must know something about the final market for homes, what they will sell for; what they will cost to construct, and how quickly they might be sold. Clearly, there is a powerful synergy between the land development function and the construction function.

- 4.127 This land-centric view of vertical integration is borne out by the practical structuring of most large homebuilders. Typically, large homebuilding businesses are driven by their land acquisition units with key corporate decisions on expansion, mergers and financial structuring most heavily influenced by the need to acquire land (see also Chapter 4 of KPMG report at Annexe E). Indeed, rather than thinking of homebuilders as construction firms that have integrated upwards into land development it may be more realistic to think of land developers who have integrated downwards into home construction. This is reinforced by the use of sub-contracting; many homebuilders outsource a large proportion of their construction work but retain their land acquisition functions in-house.
- 4.128 In theory, vertical integration could lead to individual homebuilders attempting to acquire local monopoly status through the planning system. Our analysis of local market concentration, however, suggests that there is no evidence that this happens in practice. Given the complexities of the UK's planning systems it seems likely that vertical integration allows more land to be brought through the planning process than otherwise.
- 4.129 It is our view that vertical integration in the UK homebuilding industry has not led to significant competition problems. Indeed, if anything, vertical integration appears to be an efficient market response to the challenges of dealing with the complexities of the UK's planning regimes.

Switching costs

- 4.130 In some markets customers may face obstacles to switching between different suppliers. These can come in a variety of forms, for example: inconvenience, monetary costs, time costs or a lack of information regarding alternative products. The greater switching costs, the more captive the customer and the less incentive there is on the incumbent suppliers to offer low prices and good products and service.
- 4.131 In the homebuilding market, the degree of switching costs varies depending on the stage of purchase. Before a homebuyer has put down a deposit switching costs are quite low. Once a homebuyer has committed to purchase a home the nature of the transaction – a large

infrequent purchase – means that homebuyers do not, of course, switch readily between suppliers.

- 4.132 We recognise that the observation that switching costs rise the further through the homebuying process a homebuyer goes is not unique to the homebuilding industry. We cover the issue here because it is directly relevant to our discussion of consumer satisfaction later.
- 4.133 In order for a homebuyer to switch homebuilder post purchase, in effect, the homebuyer would have to get the homebuilder to take back possession of the home and refund the purchase price. Even then incidental costs associated with the purchase may 'lock-in' homebuyers to their homebuilder. It is unsurprising that switching behaviour after the homebuyer has taken possession of the home is rare or non-existent.

Information asymmetries

- 4.134 In a competitive market, all other things being equal, a product that delivers a higher level of customer satisfaction will be expected to outsell a product with lower customer satisfaction. This outcome can only be expected if the consumer is readily able to discern how good the product is before they purchase it. In some markets consumers do not have sufficient information in order to make a fully informed choice between competing products and services. When this arises, it can have the effect of dampening the competitive pressure for those aspects of the product or service that the consumer cannot readily observe or understand.
- 4.135 In markets where the quality of the products can only be judged after purchase, then in order to decide which product to choose a consumer will depend on one or more of: repeat purchasing; branding and reputation; and guarantees or warranties.

Repeat purchasing

4.136 On average, a homebuyer will move home once every ten years.¹⁵¹ Moreover, because - within a given budget - location is the most important factor considered by homebuyers (see Chart 4.1), it follows that homebuyers will have a choice only between those homebuilders active within their favoured location. This significantly restricts the opportunity for repeat purchase from a particular homebuilder to a much lower level than for other durable consumer goods such as electrical goods or cars.

Branding and reputation

4.137 In the absence of strong brands, or comparative independent information, the level of customer service offered by a company after a product has been purchased is almost impossible to observe prior to purchase.

4.138 A brand is a way of signalling the quality of a product where quality cannot be observed by the consumer before they make their purchase. For example, very few consumers can observe all the features relevant to the quality of a car in advance but they tend to know which brands have a reputation for reliability and good customer service. In product markets with strong brands companies will spend a lot of money advertising their particular brand and trying to establish a good reputation with consumers.

4.139 The market for new homes has some unusual features. Clearly, it is difficult for a homebuyer to readily observe all of the features that will determine their satisfaction with the home once they have purchased it. Furthermore, the frequency of repeat purchase is low; on average a home is sold once every 10 years. Normally, it would be expected that an industry with such features would be characterised by a high level of branding.

¹⁵¹ Page 17, Housing, Economic Development and Productivity: Literature Review. DTZ Consulting and Research, January 2006.

4.140 Homebuilders, however, typically have low levels of brand power. The Callcutt review noted that:

'with one or two possible exceptions, the larger housebuilders have not been successful in using 'brand building' as a way of achieving higher sales through customer loyalty or a cost effective price premium through a reputation for quality. On the other hand, those developers with a poor reputation for quality do not appear to have suffered appreciable financial damage.'¹⁵²

4.141 Nevertheless, branding can be significant, Charles Church and Berkeley homes are sometimes resold by homeowners under the original homebuilder's brand. In particular, some smaller and medium-sized homebuilders have built strong brands and reputations. During this study we spoke to a number of smaller and mid-tier homebuilders who wanted to establish a strong reputation (see, for example, the case studies of Danny Ward and the Carvill Group at Annexe E). These findings echo those in the Callcutt review:

'It is interesting to note that a few smaller companies, such as Octagon and Urban Splash, have managed also to create niche reputations for themselves, based overwhelmingly on their reputation for innovation and quality.'¹⁵³

4.142 It is possible for a brand to be built up around an individual development or area. Indeed, this type of branding is typically stronger than the brand of the homebuilder. An example of this is the First Base development at Adelaide Wharf in Shoreditch, London. This development has become a reference point on the 'knowledge', the exam taken by London taxi drivers. The high visibility and public awareness of a brand such as Adelaide Wharf can have a positive effect on sales prices and sales rates if the area becomes known, through the brand, as a desirable place to live.

¹⁵² p188, Callcutt review.

¹⁵³ p188 Callcutt review.

4.143 Despite these exceptions, the general picture is of an industry with low levels of branding and weak reputations which together provide little information to the prospective homebuyer about the respective customer service and the quality of the homes of the various homebuilders they choose between.

Guarantees

4.144 Guarantees, like warranties or certificates of regulatory compliance, can be used to give homebuyers confidence in a product. Most new homes are sold with a warranty and we discuss warranties in more depth in Chapter 6. The key observation at this stage is that warranties do not cover all aspects of the build quality of a new home and none of the aspects of customer service. The OFT has not conducted a detailed review of competition in the supply of warranties. However, we have observed that homebuilders purchase warranties and homebuyers are not involved in their purchase. As a consequence the type of warranty cover associated with a new home is not part of homebuyers' consideration of whether to buy a particular new home. As such, it has little direct effect on homebuyers' choices.

4.145 New homes must comply with extensive building regulations. The building regulations are primarily concerned with protecting the health and safety of people and also address issues relating to energy efficiency and accessibility. They set out a number of functional requirements in terms of what is reasonable, adequate or appropriate, which are supported by detailed technical guidance in a series of Approved Documents, such as Approved Document K (see Annexe I for a more detailed discussion of building regulations). In theory, this means homebuyers have some knowledge about the quality of their new home. In practice, it is not the case that homebuyers necessarily understand the standards.¹⁵⁴ In any event building regulations only guarantee a

¹⁵⁴ Interview with large homebuilder.

minimum standard and homebuyers are unable to discern whether a home is built to a higher standard.¹⁵⁵

4.146 In our view there are significant information asymmetries which will have a bearing on the way competition is played out in the homebuilding industry and which could lead to lower customer satisfaction than would otherwise be the case.

Does the market deliver a good outcome for homebuyers?

4.147 Since a well functioning competitive market should deliver a good outcome for consumers, this section discusses the evidence which may directly inform us whether or not this is the case. In our assessment we consider our observations of whether the market delivers homes which are free from defects, assess measures of consumer satisfaction, estimate consumer detriment from faults and delays in moving in, and consider whether the market meets reasonable standards in terms of infrastructure and environmental issues and architectural design.

Snags and faults

4.148 When we talk about finishing defects we mean aesthetic issues such as scratched paintwork, mortar smeared onto brickwork or poorly finished plastering. By functional defects we mean issues such as leaking plumbing or the heating not working. Our consumer survey and data from snagging companies found that the majority of quality problems reported were either finishing or functional ones as opposed to structural or related to infrastructure or the environment around the home.

4.149 In our consumer survey, 30 per cent of respondents (base 1,052) said they did not experience any faults or problems. Forty-four per cent said they experienced between one and 10 faults and 26 per cent said they had experienced more than 10 faults. Estimates from two snagging

¹⁵⁵ One medium sized homebuilder explained that its standards were set by building regulations alone. While it was apparent from our interview programme that this was not necessarily the case for all homebuilders it was clearly the case for many.

companies¹⁵⁶ indicate that they would expect to find around 40 snags¹⁵⁷ for one bedroom houses and flats and around 70-75 snags for an average three bedroom family home.¹⁵⁸

4.150 Our consumer survey showed that the most common problems, experienced by 20 per cent of homebuyers who had problems, were those associated with central heating and water supply, and that 18 per cent of homebuyers with problems said they were to do with their windows/glazing. When added together plumbing defects produce an even higher frequency (39 per cent¹⁵⁹).

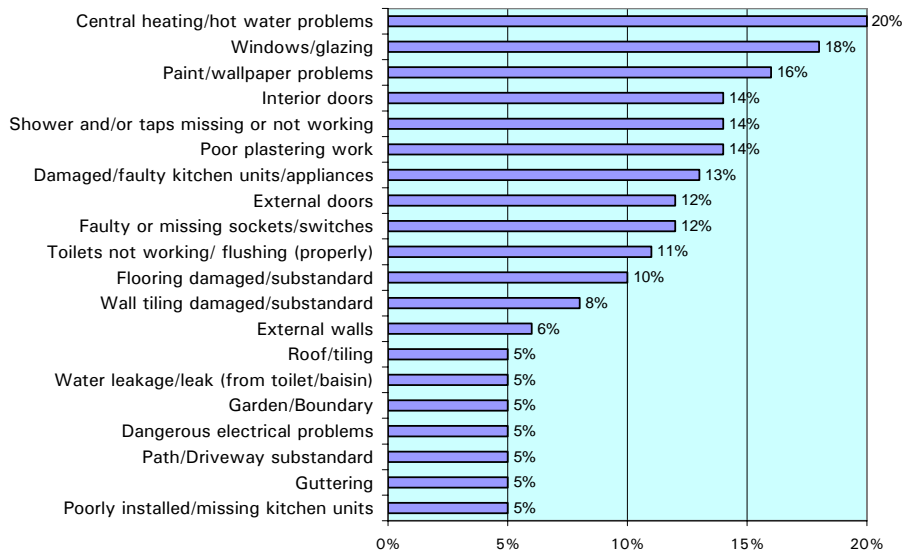
¹⁵⁶ Inspector Home Ltd and New Build Inspections Ltd.

¹⁵⁷ See Annexe X: Glossary for definition of 'snags'.

¹⁵⁸ We understand that the counting of snags depends on categorisation. For example, a door which sticks but also has scratched paintwork may count as one or two snags.

¹⁵⁹ This includes shower/taps not working, toilets not working/flushing properly, water leaks, damaged sanitary ware, poor water pressure, poor drainage and 'internal plumbing'.

Chart 4.6: The most common serious faults or problems experienced by new homebuyers



Source: consumer survey.

Base: New homebuyers who found at least one fault with their home (771), excludes answers with less than five per cent response. Respondents could give up to three answers.

4.151 If a homebuyer has a problem after they have moved into their new home their most common recourse is to their homebuilder (93 per cent¹⁶⁰ of homebuyers we surveyed who had faults or problems contacted their homebuilder). Most of these (83 per cent), did not attempt to sort the problem/s out any other way. In the event that the defects were not all sorted out to the homebuyer's satisfaction, 14 homebuyers explained that they did not do anything else because it was 'not worth the hassle', seven decided to live with the problems, four intended to do something else but had not got around to it and four said they had been given the impression that there was nothing else they could do.

4.152 There was a range of experience in terms of how quickly faults were resolved. Within the two year period after moving in which the survey

¹⁶⁰ Annexe B.

covered, of the 719 respondents who had experienced faults or problems:

- 22 per cent of respondents said the faults were resolved within two weeks
- 10 per cent of respondents said the faults were resolved within two weeks to a month
- Nine per cent of respondents said the faults were resolved between one and six months
- Two per cent of respondents said the faults were resolved between six months and one year
- One per cent of respondents said the faults were not resolved for over a year
- 48 per cent had at least one ongoing problem, and
- Seven per cent had given up trying to get all of the faults sorted out.

4.153 It should be noted that the 48 per cent who had at least one ongoing problem includes respondents who had lived in the home for as little as one month and a day through to those who had been living in their new home for up to two years at the time of the interview. Therefore, it is perhaps more valid to consider the fact that 40 per cent of those who had a problem and were living in their homes for one to two years, had at least one ongoing problem (base = 320).¹⁶¹ Even allowing for the possibility of some unsubstantiated claims (for example, where the damage was not caused by substandard work by the homebuilder), this

¹⁶¹ We do not know when respondents notified their homebuilder of any faults or problems, they may have only been reported shortly prior to interview.

indicates that for many homebuyers it takes a significant amount of time to have all defects fixed.¹⁶²

4.154 The majority (83 per cent) of respondents who only contacted their homebuilder about faults and had them all resolved, said that they were all resolved to their satisfaction. Thirteen per cent said that some were resolved to their satisfaction and three per cent (eight respondents) said that none of the faults were resolved to their satisfaction.

Measuring consumer satisfaction and consumer detriment

4.155 Our consumer survey and the HBF and NHBC industry surveys all show improvements on the overall customer satisfaction level of 56 per cent from the 2003 Housing Forum Survey quoted in the Barker review in 2004. The biggest gap between our survey's results and the Barker review's targets for customer satisfaction are in after sales service. Here our survey found 75 per cent of people were satisfied compared with the Barker review's target of at least 85 per cent for overall satisfaction. Our survey's results for satisfaction with the home itself compare favourably with the Barker review's target (81 per cent satisfied with the finishing work and 90 per cent with the construction work).¹⁶³

4.156 On the measure of whether homebuyers would recommend their homebuilder, this has also increased from 46 per cent in 2003 to 60 per cent in our consumer survey.¹⁶⁴

4.157 While trends in consumer satisfaction are informative, there are limitations to relying on customer satisfaction as a measure of how well a market or sector is working for consumers. It is very difficult to

¹⁶² Based on the assumption that we think it likely that most homebuyers report faults to the homebuilder promptly.

¹⁶³ Annexe B: Consumer survey. Excludes 'Don't know' and 'can't say' responses.

¹⁶⁴ Excluding the neutral responses from our study the figure is 76 per cent. (The 76 per cent represents those who gave a positive response out of the total who gave an opinion whether positive or negative).

determine how high a measure of satisfaction 'should be' for any particular market or industry. For this reason, while trend data on consumer satisfaction is very useful, we do not consider that targets for customer satisfaction levels are particularly meaningful when considered in isolation.

4.158 Below we consider both the available customer satisfaction data in more detail and also estimate, from the results of our consumer survey, the level of consumer detriment in the industry. Considering the information from two approaches provides a more robust picture of the level of performance in terms of the outcome for consumers.

Consumer satisfaction

4.159 According to our consumer survey, homebuyer satisfaction with the quality of service before moving in to a new home appears relatively high with 89 per cent saying they were satisfied.¹⁶⁵ Although not directly comparable, due to differences in methodology,¹⁶⁶ industry surveys typically show lower levels of satisfaction on this point at 77 per cent (HBF¹⁶⁷) and 75 per cent (NHBC¹⁶⁸).

4.160 From our consumer survey, satisfaction with the quality of both finishing work and of construction work appeared relatively high at 81 per cent and 90 per cent respectively¹⁶⁹. Finishing work was more often described as 'good' (50 per cent) as opposed to 'very good' (31 per cent). Construction work was also more often rated as 'good' (55 per cent) as opposed to 'very good' (35 per cent).

¹⁶⁵ Annexe B: Consumer survey. Excludes 'Don't know' and 'can't say' responses.

¹⁶⁶ These include differences in the type of survey used, sampling frames, coverage, response bias and reference periods. See Annexe L.

¹⁶⁷ New Home Customer Satisfaction April 2008.
www.hbf.co.uk/fileadmin/documents/barker/Cust_Satisfaction_2008.pdf

¹⁶⁸ NHBC 2007, Quarter 2.

¹⁶⁹ Where homebuyers rated the work as 'very good' or 'good' and excludes 'Don't know's.'

- 4.161 While ratings above 80% appear high in the context of the scale of the industry in 2007 the flip side of the result is that about 36,000 homebuyers were not satisfied¹⁷⁰ with the quality of finishing and about 19,000 homebuyers were not satisfied with the quality of construction.
- 4.162 The satisfaction ratings from our survey are generally higher than homebuilding industry surveys but again it should be noted that there are some differences in the methodologies used. The HBF 2008 survey found that 69 per cent of respondents said that the finish was good. The 2003 Housing Forum survey found that 73 per cent were 'satisfied with finish and construction of their new home'. The NHBC 2007 quarter two survey found 66 per cent of respondents were satisfied with the overall quality of their new home.
- 4.163 The level of homebuyer satisfaction with the quality of service after moving in to their homes was at 75 per cent¹⁷¹ according to our consumer survey. Again, this is higher than in other homebuilding industry surveys. The HBF 2008 survey found a 64 per cent satisfaction rating, the NHBC 2007 quarter two survey found 55 per cent and in the Housing Forum 2003 survey overall satisfaction with service after moving in was 56 per cent.
- 4.164 It is difficult to find other products where consumer satisfaction figures can be meaningfully compared to those for new homebuilding although Annexe L presents a few comparisons which provide some context. Satisfaction levels with the quality of new homes appear to be about the same or slightly higher than for some other products but satisfaction levels with the quality of the service provided by homebuilders are lower.

¹⁷⁰ Those who answered 'poor' or 'very poor', scaled up by number of new homes built by private enterprise in 2006/07.

¹⁷¹ Excludes Don't know/Can't say responses.

Consumer detriment

- 4.165 In order to estimate a financial figure for consumer detriment due to faults we first used data from our consumer survey about how many faults homebuyers had experienced and how long it took to rectify the defects to calculate a figure which reflects, for example, the detriment of a homebuyer not having a working shower for six weeks.¹⁷²
- 4.166 Then we summed the figures reported in the survey where homebuyers had spent additional money to rectify faults (for example, by paying another contractor to fix the problem or by engaging legal professionals to pursue a claim). In terms of the number of homebuyers in the consumer survey who spent more than £5,000 to put their defects right, there were just two such experiences which, scaled up to the UK population (for 2007 private output), equates to 369 people. Fourteen respondents had spent between £1,000 and £5,000. Again scaling up to the UK population this equates to around 2,600 people spending in this bracket. Forty-two per cent of respondents who had incurred costs had spent less than £100 trying to sort out the faults or problems.
- 4.167 To calculate the consumer detriment from delays in warranty providers fixing faults we obtained data on the incidence of warranty resolutions and warranty claims and the average time to deal with these from a leading warranty provider.¹⁷³

¹⁷² Using '*Sarah Beeny's price the job*', Beeny, S, London: Collins & Brown, 2008, we calculated the cost of installing a new shower then divided that by the expected life of the shower to calculate a price per unit of time, we then multiplied this by the length of time it took for something to be fixed. For example if a shower cost £1000 to replace and it lasts 10 years then it will be worth £100 a year, if a homebuyer does not have a shower for six months then the detriment would be £50.

¹⁷³ We scaled up these figures to the whole homebuying population and, in doing so, applied a range to take account of possible variations between different warranty providers in relation to the speed with which resolutions and claims are dealt with and also any differences in relation to the proportion of warranty claims that relate to faults in the first two years. The extremes of the range were not so far apart as to have any significant effect on the overall calculation of consumer detriment.

- 4.168 After scaling up our figures by the number of UK new homebuyers,¹⁷⁴ the total detriment for faults came to £174 million. This figure includes detriment from: faults not fixed by homebuilders, delays in fixing faults by homebuilders, delays in fixing faults by warranty provider and costs paid by homebuyers to fix faults.
- 4.169 Our estimate for consumer detriment makes no accurate estimate of the costs to homebuyers in terms of distress or inconvenience caused. It simply is not possible to estimate, in financial terms, such subjective and individual experiences. For example, the inconvenience of ill-fitting windows or faulty heating for an older person or young family in winter may be very different from the experience of a young couple in summer. Given that some homebuyers suffer relatively high levels of financial detriment it is highly likely that the same homebuyers also suffer a high level of distress and inconvenience.
- 4.170 Although some homebuyers will experience a disproportionately large amount of detriment, the overall figure, when compared with the number of new homes built and the turnover¹⁷⁵ of the homebuilding sector is relatively small. It remains, however, not insignificant in absolute terms.

Moving in delays

- 4.171 A source of homebuyer dissatisfaction can be delays in being able to move into the new home at the time expected. Where delays occur homebuyers may experience additional expense and inconvenience. For example, if they have moved out of their existing home, they may incur storage costs, rental accommodation costs and, if the delay is severe, costs associated with withdrawing from the contract and finding a new home.

¹⁷⁴ CLG table 211, we used the figure 194,000 which is the number of private dwellings which started construction in 2007.

¹⁷⁵ See Chapter 3, 'Size and structure of the industry' section.

- 4.172 Although delays may also occur when moving into an existing home, the contractual arrangements with the homebuilder cause additional difficulties for homebuyers of new homes. When a homebuyer and seller of an existing home exchange contracts they agree a moving in date which is legally binding. This is not the case for new homes (see Annex K for further details on the homebuying process).
- 4.173 Our consumer survey found that 32 per cent of respondents who were given a moving in date said that their home was not ready for them to move in by that date.¹⁷⁶ Just less than half of those who experienced a delay were able to move in within two months of the original date (47 per cent). A further 28 per cent had a wait of three to four months and three per cent were delayed by over a year.

¹⁷⁶ A total of 81 per cent of respondents were given a moving in date whether as a month or a season. 66 per cent of these were warned that it was an estimate.

Table 4.3: Length of delays from moving in date given to actual moving in date

	<i>Count</i>	<i>Per cent</i>
Up to 2 months	128	47
More than 2 months, but not more than 4 months	76	28
More than 4 months, but not more than 6 months	33	12
More than 6 months, but not more than 8 months	15	5
More than 8 months, but not more than 10 months	9	3
More than 10 months, but not more than 12 months	2	1
Over a year	8	3
Can't remember	3	1
TOTAL	273	100

Base: Those whose home was not ready to move into by the date they were told when they agreed to buy it. Source: consumer survey.

4.174 In our consumer survey eight homebuyers (3 per cent) were delayed in moving into a new home by more than a year. Scaled up by the number of new homes built in the UK in 2006/07 this would mean that between 1,000 and 2,000 homebuyers are delayed by over a year.

4.175 Based on the results of our consumer survey we were able to estimate the proportion of new homebuyers who suffered a delay in moving in and **who also** incurred a financial cost as a result. By applying this proportion to the total UK population of new homebuyers we were able to estimate a figure for the total number of new homebuyers who had incurred a financial cost as a result of a delay to their moving in date. Our consumer survey also provided us with information about the average cost incurred as a result of delay. By applying this average figure to our estimate of the total number of new homebuyers experiencing financial costs as a result of delays in moving in, we were able to calculate an estimate of the total consumer detriment arising from delays on moving in. We estimate that delays in moving in cost UK homebuyers in total around £33 million per annum.

4.176 We recognise that, if a homebuyer has sold their previous home and is having to live in rented accommodation, the cost of their rent is partly offset by not making mortgage payments. However, short term lets

tend to be expensive and there may be other costs such as furniture storage and a second set of removal charges.

Infrastructure and environmental issues and architectural design

- 4.177 Some stakeholders alerted us to the possibility of problems with infrastructure/environmental issues such as car parking, communal play areas, and site services. The Commission for Architecture and the Built Environment (CABE) has done research¹⁷⁷ in this area and found that functional quality of the development (does it work as a place) and 'delight' quality (does it lift the spirits) are major issues. They also say that homebuyers are unlikely to appreciate the importance of these types of qualities until they have lived in the new home for some time. For example, developments dominated by roads with poor pedestrian access, lack of bus stops, poorly designed and/or maintained public spaces and poorly integrated car parking may not be obvious until homebuyers start using those particular facilities.
- 4.178 Our consumer survey did not find frequent reporting of these types of issues (though it should be remembered that the survey covered homebuyers who had moved in during the last two years and therefore will include a proportion who had not lived in the new home for very long) - 12 per cent of homebuyers had lived in the house for less than three months¹⁷⁸. Only three per cent of new homebuyers said they had faults or problems with poor or missing parking facilities.
- 4.179 Unlike build quality or customer service, architectural design is something that a homebuyer can observe (at least from brochures or other media) before they make their purchase. This might be expected to give the homebuilder an incentive to invest in higher standards of architectural design that will generate higher levels of customer satisfaction.

¹⁷⁷ *'Housing audit: assessing the design quality of new housing in the East Midlands, West Midlands and the South West'*, CABE, 2007

¹⁷⁸ All respondents had lived in their new home for at least one month.

- 4.180 However, architectural design, which covers both the aesthetic appeal of the home as well as its practicality, is a particularly personal thing. As the vast majority of new homes in the UK are built on a speculative basis a homebuilder looking to ensure sales is driven to build a product with wide appeal. A homebuying population with varied and changing tastes cannot be easily accommodated on an individual basis by a speculative homebuilder. This results in a standard product that is acceptable to many rather than bespoke to the individual. This is not to say that some homebuilders do not try to find out what potential homebuyers would like in a new home. For example, some hold focus groups.¹⁷⁹
- 4.181 The important point here is that although 'good' design may not necessarily cost¹⁸⁰ more than 'bad' design¹⁸¹ it is nevertheless the case that, beyond a certain level of common interest and appeal, what makes a home attractive or practical to a homebuyer will vary significantly from person to person. This is not to deny that there are basic elements of design that, if achieved, will appeal to many but the conclusion to be drawn is that it is very difficult, if not impossible, for a homebuilder to design a home that is perfect in terms of practicality and aesthetics for each homebuyer.
- 4.182 The difficulty of tailoring homes to individual preferences stems in large part not from technical constraints on doing so, but from the business model of speculative homebuilders. Annexe R discusses some of the alternatives in more detail but, to summarise, there are essentially three main alternative development approaches that could be used to provide homebuyers with greater choice over the design of their new home.

¹⁷⁹ See Annexe F Case Studies, Fairgrove Homes.

¹⁸⁰ See the report of the debate at the RICS Wales event: *Grand designs: In for a penny, in for a Poundbury - What price higher design standards in Wales?* at www.rics.org/Networks/Regions/UK/Wales/wales_pr_643.html

¹⁸¹ CABE spokesman Matt Bell *'Good design doesn't cost more money, it's not about using the finest Italian marble instead of tarmac, it's about common sense and attention to detail.'* Winterman, D, 2007, Broken Homes, *BBC Online* [internet] 8 February 2007. available at: <http://news.bbc.co.uk/1/hi/magazine/6339469.stm> [accessed 10 July 2008]

Mass customisation, a model common in Japan, envisages homebuilders building homes to order from a standard list of design plans that it offers to homebuyers.

- 4.183 A second model is the long-term investor model. While this offers little in the way of additional choice and flexibility for the homebuyer it incentivises the homebuilder to design and maintain an attractive and functional urban environment that maximises the value of the properties they build over time.
- 4.184 The third approach is self building enabled by the use of skilled trades and project managers (rather than DIY). Suitably supported, this could yield a much higher level of supply in the UK where self build levels are substantially below those in Germany and France. Self built homes offer the ultimate in flexibility. They are bespoke and are often associated with high levels of customer satisfaction and can offer budgetary savings in return for homebuyers accepting certain risks and costs in time and effort.

Conclusion on competition in the homebuilding industry

- 4.185 Overall barriers to entry appear low, especially for small scale entrants. Barriers to expansion may be more significant, in particular expanding a homebuilding firm to a size that requires it to have more than one operating unit and to operate over a wide area. There appear to be some knowledge barriers to large scale entry from foreign homebuilders. Despite the presence of some barriers, however, entry into the industry by smaller homebuilders remains high and there is evidence that some small homebuilders have recently successfully grown into larger homebuilders.
- 4.186 Although, in theory, the extent of vertical integration in the industry could lead to individual homebuilders attempting to acquire local monopoly status through the planning system our analysis suggests there is no evidence that this happens in practice.
- 4.187 While it may be possible, in theory, that from time to time, an individual homebuilder may find itself with a measure of market power from being the sole provider of a particularly distinct type of home in a particular

location the evidence we have seen suggests these instances are rare and account for a small fraction of the total supply of new homes.

4.188 Our analysis leads us to believe that the supply of new homes is characterised by aggressive competition for land and the best locations and that existing homes act as a constraint on the price of new homes.

4.189 We believe the general picture is of an industry which despite being characterised by strong competition on some dimensions nevertheless has relatively weak brands, low levels of repeat purchasing and, by implication, poorly informed homebuyers who do not have the necessary information to empower them to choose between homebuilders on the basis of customer service and the finishing quality and functional performance of the home.

4.190 This general picture of the nature of competition in the homebuilding industry is supported by the direct evidence of market outcomes for new homebuyers.

- Overall, since the Barker review, our measures of consumer satisfaction with the quality of the product appear high at 81 per cent for finishing work and 90 per cent for construction work. Given the scale of the industry however, 19 per cent and 10 per cent dissatisfaction implies that each year approximately 36,000 and 19,000 homebuyers are not satisfied with the finishing and construction of their new home (respectively) – the biggest investment they are ever likely to make.
- Delays in moving in are a significant contribution to consumer detriment in the industry. Between 1,000 and 2,000 homebuyers are delayed by more than a year across the UK or 6,000 by more than six months (based on 2006/07 volumes).
- Relative to the size of the industry, our estimate of consumer detriment is low at £206 million¹⁸² per annum – but not insignificant

¹⁸² The detriment figures of £33m (delays on moving in) plus £174m (defects) are rounded up figures.

in absolute terms. It is not possible to put a financial figure on distress and inconvenience which, for some consumers at least, will be significant, and

- Most new homes will have some faults and many of these faults will be fixed quite quickly. Nevertheless, 70 per cent had a problem. This is equivalent to approximately 134,000 homebuyers when scaled up by the number of new homes built by private enterprise in 2006/07.

4.191 In the light of these problems, in Chapter 6 we consider in detail the homebuyer's experience of the homebuying process and the arrangements in place for consumer protection in the homebuilding industry.

4.192 However, before we look at that in Chapter 5 we now deal with issues around the supply of land and landbanking.

5 LAND SUPPLY AND LANDBANKING

- 5.1 This study does not directly address the issue of how the finite amount of land in the UK should be allocated by the planning system between the competing uses to which it might be put. This is a question, concerning sustainability, environmental protection, economic growth, urban sprawl and access to green space, that extends beyond the OFT's remit in this review of competition and consumer satisfaction in the homebuilding industry.
- 5.2 This section of the study addresses whether, as some contend, there appear to be competition problems in the supply of land. Annexe S provides an example of the sort of behaviour in the land market that has prompted some planning professionals to question whether there are substantial competition problems at the core of the land market. Two separate but related allegations have been put to us:
- insufficient amounts of residential land are released by landowners even when land values are high, and
 - homebuilders do not build on permissioned land but instead hoard it in landbanks and so restrict output.
- 5.3 Before addressing these two points it is first necessary to examine the availability, ownership and pricing of land in the UK.

An introduction to land supply for use in the homebuilding industry

- 5.4 Homebuilding is a cyclical industry. Output of new homes rises and falls significantly over time. Homebuilding output in England had increased year since 2001/02 until mid 2007.¹⁸³
- 5.5 In Scotland and Wales the number of new homes built has remained fairly stable. In Northern Ireland the number of homes built each year has doubled since 1998/99 (see Figure 2, Annexe T).

¹⁸³ A presentation of the statistical data discussed in the 'Introduction to land supply for use in the homebuilding industry' section is at Annexe T.

- 5.6 In recent years, the focus of planning policy has moved away from new development on greenfield sites towards the redevelopment of brownfield sites, (see Glossary for an explanation of terms) typically, but not exclusively, in urban areas. In 1996, 57 per cent of new homes in England were built on brownfield land, in 2006, the number was 75 per cent, representing a 40 per cent increase in the number of homes being built on brownfield land.¹⁸⁴
- 5.7 These developments have often supported higher development densities (see Figure 4, Annexe T). The consequence of this has been that not only has the amount of greenfield land changing to residential use plummeted but the total amount of land changing to residential use has also fallen despite the fact that the number of dwellings built has risen (see Figure 5, Annexe T).
- 5.8 The target density planning requirements which underlie much of this trend have also driven the much higher level of supply of flats both in absolute terms but also relative to houses.

Land ownership

- 5.9 The greatest problem facing a researcher seeking to examine land supply in any detail is the absence of any aggregate source of database regarding land ownership. The UK's land databases present only a part of the overall picture of land ownership. Nevertheless by combining a variety of sources, held both publicly and privately, it is possible to assemble a picture of who owns the land most suitable for residential development within the UK.¹⁸⁵
- 5.10 We have compiled our data from a number of sources: data collected by a leading property services firm, Savills, the National Land Use Database (NLUD), the Scottish Vacant and Derelict Land Survey 2007 (SVDLS)

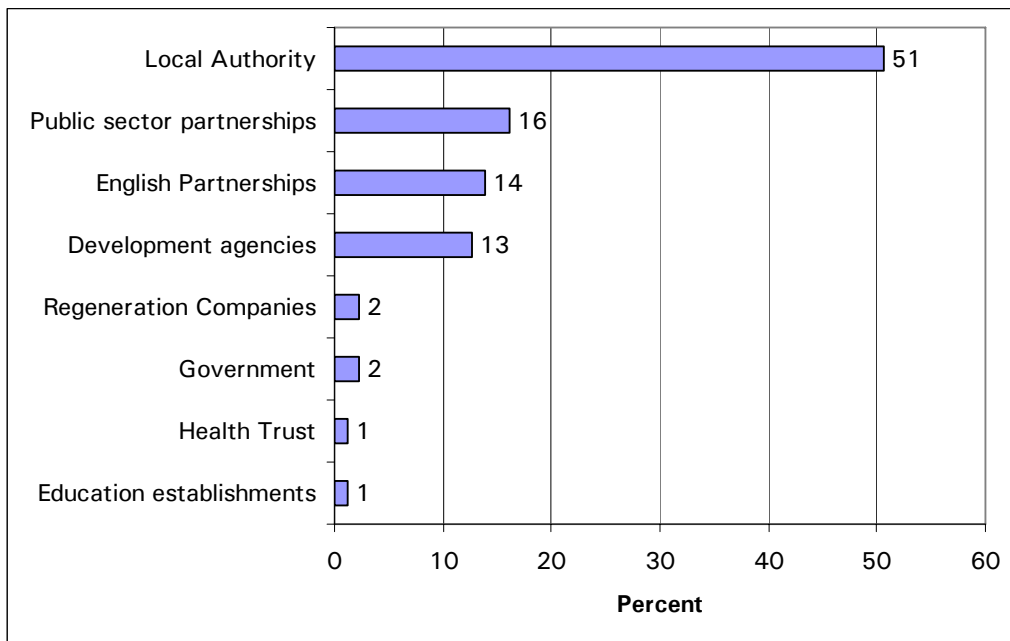
¹⁸⁴ CLG www.communities.gov.uk/documents/planningandbuilding/xls/679241.xls

¹⁸⁵ Note that although it is possible to use the databases together they overlap to a certain extent and so it is not meaningful simply to add them together.

and the Northern Ireland Housing Executive (NIHE). Between them it is possible to build up an outline picture of residential land supply in the UK. See Annexe U for the details of these databases. Annexe x also discusses some of the data difficulties inherent in analysing land supply and its conclusions should be borne in mind when reading our analysis.

5.11 The most striking feature of the details of the three main databases is the amount of public sector held land as a proportion of the total. Nearly two fifths of land on the Savills database and nearly a quarter of land suitable for residential development on the NLUD database is owned by public sector bodies. In the SVDLS 29 per cent of all sites suitable for residential development, where the owner was known, were in public ownership and a further five per cent in mixed public and private ownership. Of the public sector owned sites on the Savills database, nearly one half were accounted for by local authorities. Chart 5.1 contains the detailed breakdown of public sector ownership of land suitable for residential development.

Chart 5.1: Owners of public sector land suitable for residential development, UK



Source: Savills Research.

5.12 There are few centralised reliable data sources that can be used to address the question of how much public sector land is suitable for residential development. Although, the three databases we have used suggest that the public sector accounts for between a quarter and a third of all land currently deemed suitable for residential development.

The supply of land

5.13 The supply of development land is influenced by the price at which it can be sold (Annexe O contains a summary of how land prices are calculated). At its simplest level, as the value of residential land increases, more land can be profitably converted from its current use to residential use. As residential land values increase, even profitable other uses (such as, say, retail use) may become less profitable than residential use. Of course, the relationship between land prices (or land values as they are referred to within the homebuilding industry) and the volume of development land sold is heavily influenced by the planning regime. The planning system is complex and needs to be negotiated with skill, it is not uncommon for experts from as many as a dozen different disciplines to be required to complete the various expert analyses that must be submitted in support of a planning application.¹⁸⁶ It follows that, in acquiring planning permission for a development, a homebuilder can incur significant costs.

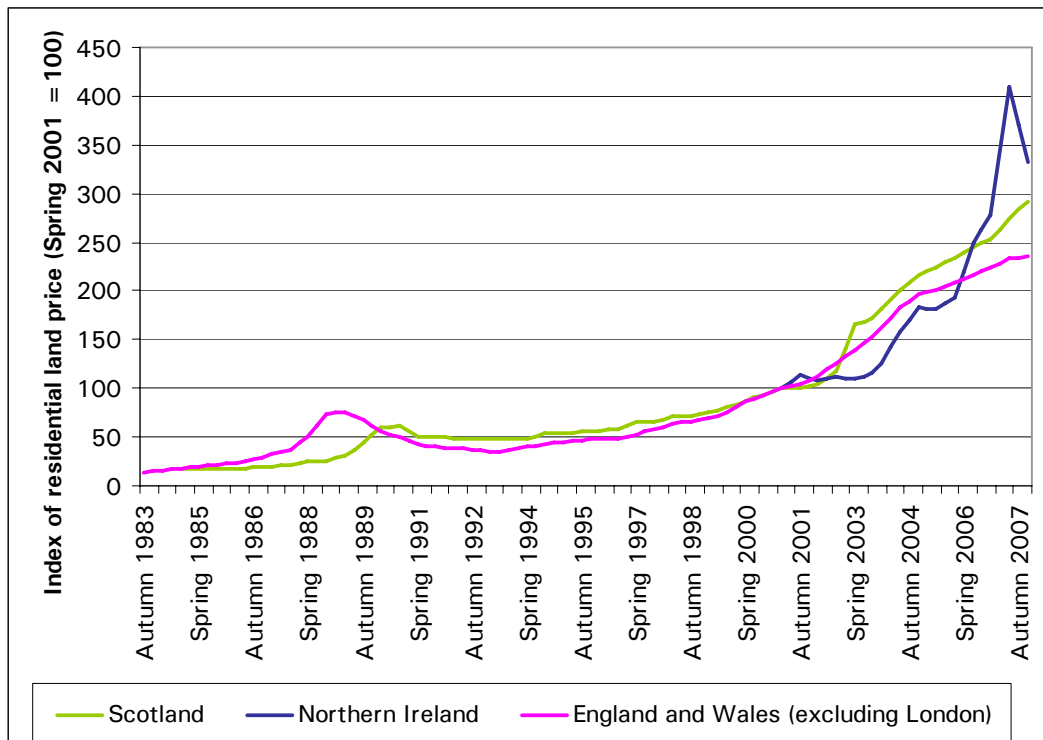
5.14 This has two important and related implications. First, it means that the 'production' of residential development land by bringing land through the planning system is as much a commercial process as the production of new homes. Second, this process is subject to the same risk-reward appraisal as any other commercial venture. Consequently, in order to understand the mechanics of land supply it is necessary to understand the commercial risk and reward trade-off in bringing land through the planning system.

5.15 A landowner or a homebuilder with land under conditional contract or under option (see Glossary for an explanation of terms) has two main

¹⁸⁶ Interview with large homebuilder.

risks that they must address when obtaining residential planning permission. The first is whether the value of the land in residential use will be greater than the existing use value. While for many greenfield sites this may be relatively easy to predict, for more marginal sites with high existing use values it may be more difficult to estimate, particularly during a period of housing market volatility. Land prices will tend to rise more rapidly than house prices when house prices are rising and fall more rapidly when house prices are falling. Over the last 20 years land values have tended to be characterised by long periods of increasing values, followed by relatively sharp declines and then a return to increasing values (see Chart 5.2).

Chart 5.2: Land price index in the UK, Autumn 1983 to early 2008, quarterly



Source: VOA property market report January 2008. Available at:
www.voa.gov.uk/publications/property_market_report/pmr_jan_08/residential.htm

- 5.16 Not all planning applications are successful, (approximately one-third of English planning applications are rejected¹⁸⁷) and for those that are successful the time for obtaining permission can be lengthy, the average time taken is 22 months.¹⁸⁸ There are some extreme cases where planning permission has taken up to a decade to acquire on sites that were already zoned for development.¹⁸⁹ This means that acquiring planning permission is a risky venture. Application costs are not refundable and can routinely run to hundreds of thousands of pounds for a development of, for example, 50 homes. In one example given to the study the homebuilder incurred costs of £220, 000 -£230,000 during the five years it took from the site being identified to construction beginning.¹⁹⁰
- 5.17 In theory, any level of risk can be offset by an adequate potential financial reward. An analysis of land supply is, in reality, an analysis of the balance between financial risk and financial reward in its supply. The more generous this balance, the more residential land we might expect to see offered for supply. Risk is largely determined by the planning system and macro-economic conditions. Financial reward depends on whether the planning applicant is a landowner or has the land under option in anticipation of a development return. In the former case, the reward takes the form of an increase in land values. In the latter case, it takes the form of a share of the increase in land values (some option agreements allow for the option holder to pay the landowner only a proportion of the true market land value). Put differently, all other things being equal, land values will be lower if risk is higher. Similarly, for any given level of risk, the higher land values are the more residential land we would expect to see supplied.

¹⁸⁷ CLG, Development Control Statistics, 1999/00 to 2007/08.

¹⁸⁸ Source: HBF. See Figure 5.1.

¹⁸⁹ OFT interview programme with homebuilders.

¹⁹⁰ We present these figures only to demonstrate the significant investment required to obtain some planning permissions. The National Audit Office is conducting a separate study into the efficacy of the planning system.

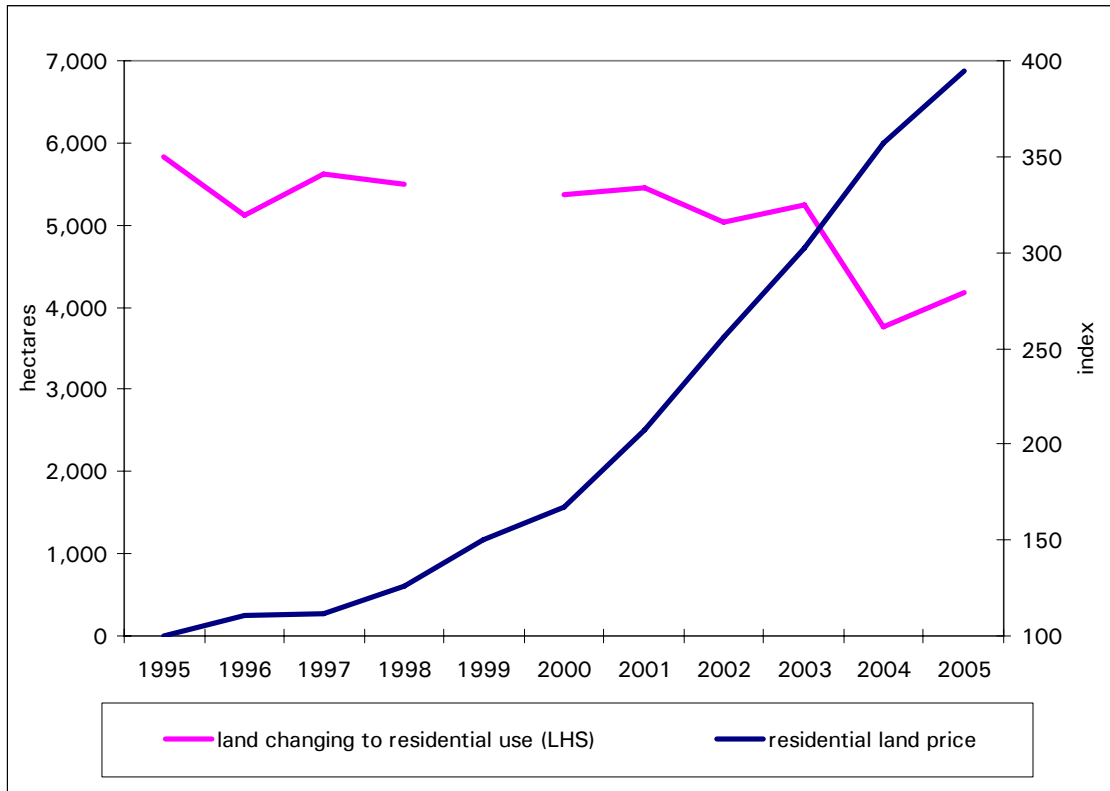
5.18 It follows that in order to understand land supply it is necessary to understand the factors that influence land values.

Risk, reward and land supply

5.19 The reward for accepting the risks of the planning regime – residential land values - are not only highly variable but are affected by a wide range of factors (see Annexe O). The actions of homebuilders and LPAs, the nature of the site in question and the wider economy will all have a bearing on land values.

5.20 It is possible to consider the relationship between risk, reward and return over time. It is a relatively straightforward task to quantify residential land supply and residential land values and these two variables are shown in Chart 5.3.

Chart 5.3: The price of residential land and the amount of land changing to residential use, England¹⁹¹



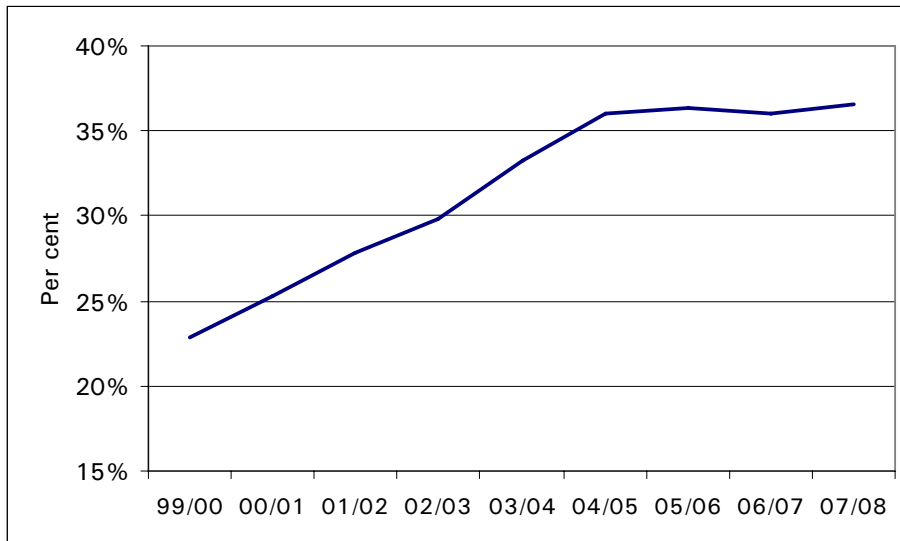
Sources: CLG live tables P222 Land Use Change: Hectares of land changing to residential use, England, 1989 to 2005 and 563 Housing market: Average valuations of residential building land with outline planning permission.

- 5.21 The most notable feature of Chart 5.3 is the fall in the supply of residential land against a rapidly increasing reward for doing so. In 10 years the value of residential land quadrupled while supply fell by a third. Chart 5.4 offers one possible explanation of this relationship.
- 5.22 Over the period in question planning risk increased significantly. In 1999/00 23 per cent of residential planning applications were rejected.

¹⁹¹ No data is available for the number of hectares changing to residential use in 1999. No data about the amount of land changing to residential use could be found for Wales, Scotland or Northern Ireland.

In 2007/08 that figure had risen to 37 per cent. It is possible that the increased level of risk was not being adequately compensated by the increase in residential land values.¹⁹²

Chart 5.4: Percentage of residential planning applications rejected, England



Source: CLG, Development Control Statistics, 1999/00 to 2007/08, Table 1.4.

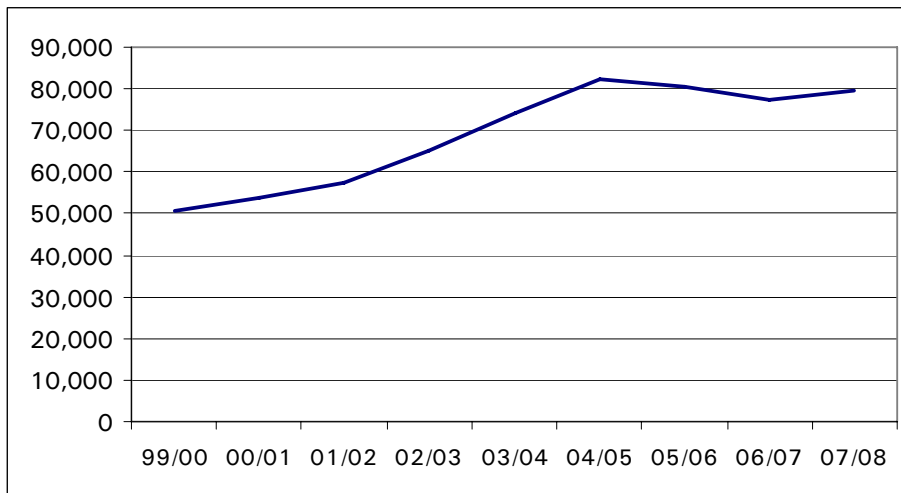
5.23 Nevertheless, a quadrupling of land values might have been expected to offset the increased risk of the planning system. One alternative explanation is that the fall in residential land supplied reflects the restrictions of the planning system, not the balance of risk and reward. This effectively imposes an overall cap on development irrespective of the number of planning applications made.

5.24 One way to consider this hypothesis is to examine whether there are a greater or fewer number of planning applications being submitted into the planning system. If risk really is amply rewarded by residential land values then the number of applications for planning permission would

¹⁹² Equally, it may be that pre-planning permission land values had not fallen adequately. The degree to which such pre-planning land values can fall is, of course, constrained by existing use values.

not fall and may even rise as land values rise. As Chart 5.5 shows, the number of applications submitted in each year between 1999/00 and 2004/05 increased steadily, fell in 2005/06 and 2006/07 and rose again in 2007/08. Far from being deterred from submitting planning applications landowners and option holders have done so with an increased vigour as residential land values have risen. This suggests that increased land values have offset any increase in the risk associated with applying for planning permission.

Chart 5.5: Planning decisions made, 1999/00 – 2006/07, England



Source: CLG, Development Control Statistics, 1999/00 to 2007/08.

5.25 It is not possible to say for certain that there is, in effect, an absolute cap on land supply imposed by the planning regime. Nevertheless, it is our view that, on balance, the evidence suggests that the planning regime has acted as a constraint on land supply especially during an upturn in the housing market. We note, however, that not all commentators on this topic would necessarily agree with this finding.¹⁹³

5.26 Recent reform by CLG of PPS 3 explicitly forbids LPAs from refusing applications for residential planning permission on the grounds that a

¹⁹³ See for example, Meen, G, 2005, On the economics of the Barker review of housing supply, *Housing Studies*, Vol. 20, No. 6, p949 – 971.

target level of housing supply has been met.¹⁹⁴ This may be effective in ensuring that the relationship between land values, planning regime risk and land supply is restored.

- 5.27 The Welsh Assembly Government requires that each LPA has a five year supply of land for housing available at all times.¹⁹⁵ The Welsh Assembly Government has also announced that where an LPA does not have a five year plan housing developments should be awarded planning permission where all other considerations are met. In Scotland there are no reforms similar to those put in place by either the Welsh Assembly Government or CLG reforms.
- 5.28 As well as considering planning restrictions on land supply, we have also considered the evidential support for one of the points frequently made to us by homebuilders: that increased regulatory costs¹⁹⁶ will depress land values to a level where landowners decide not to sell.

Regulatory compliance and land supply

- 5.29 In research carried out by the NHBC Foundation homebuilders gave their opinion about how the cost of the new Code for Sustainable Homes would be met, Table 5.1 shows their responses (respondents were allowed to give more than one answer).

¹⁹⁴ Paragraph 72, CLG, 2006, *Planning Policy Statement 3 (PPS3): housing*.

¹⁹⁵ See paragraph 9.2.3 of the Housing Ministerial Interim Planning Policy Statement, available at: http://new.wales.gov.uk/docrepos/40382/epc/planning/403821/4038212/39237_ACs_English_LoRes.pdf?lang=en

¹⁹⁶ Throughout references to regulatory costs should be read as monetary regulatory costs. This would include the costs of meeting s.106 requirements, the costs of making planning applications and the cost of complying with other regulations and standards such as the Code for Sustainable Homes.

Table 5.1: Meeting the cost of the Code for Sustainable Homes

How will the cost be met?	Percent
Decreasing land values	60
Homebuyers	42
Builders	29
Don't know	2

Source: p82, Zero carbon: what does it mean to homeowners and housebuilders? NHBC Foundation, April 2008.

5.30 It is difficult to estimate what level of additional regulatory costs will lead to a decrease in land supply.¹⁹⁷ In part this is because regulation is only one of the many factors affecting land values. Moreover, those factors are subject to many potential variations; property values can rise and fall, LPAs have discretion to vary the level and type of social housing they ask for, construction costs can increase dramatically on brownfield sites and so forth. Furthermore, it is not clear that all of the costs will be passed through to land values. As Table 5.1 identifies some 42 per cent of homebuilders think homebuyers will also make a contribution, by having to pay a higher price, and 29 per cent of homebuilders believe that they will have to make some contribution.

5.31 Nevertheless, it is clear that land values are sufficiently sensitive to the costs of regulation that it is entirely conceivable that, if not managed carefully, the regulatory burden on the homebuilding industry could depress land values to a level where landowners will not sell land for residential development.¹⁹⁸

¹⁹⁷ We note that not all commentators consider that these specific regulations will create significant costs but the general proposition holds true. See for example Bell, Malcolm and Lowe, Robert. 'Building regulation and sustainable housing'. Structural Survey, 2001, Vol.19, Issue No.1

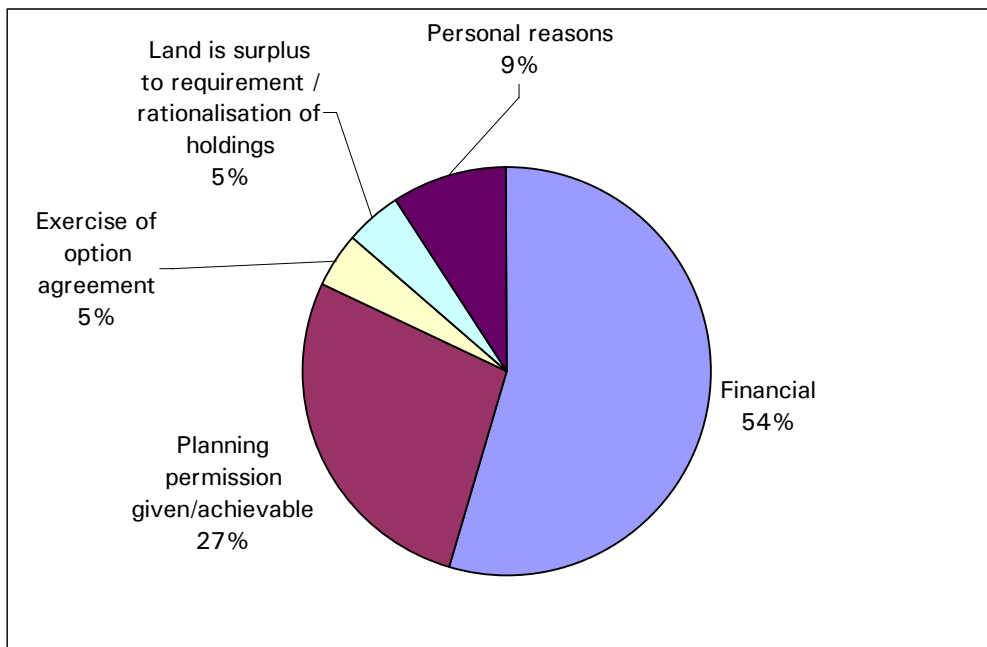
¹⁹⁸ If the regulatory burden applies just to homebuilders then land will not be used for residential development because it will not be profitable. The land may be used instead for a different purpose, for example to build shops on. If regulation applies to all construction, residential and commercial, then land owners will not sell their land at all.

5.32 It is also clear that the magnitude of the effect will vary significantly across the country. For example, one homebuilder explained to us that because of the costs of brownfield remediation, the extra regulatory burden meant that even sites in growth areas like Swindon were becoming commercially unviable. More than one homebuilder asserted to us that under a high cost regulation scenario it would not be long before all development north of Cambridge would be unviable, including greenfield sites.

When to sell

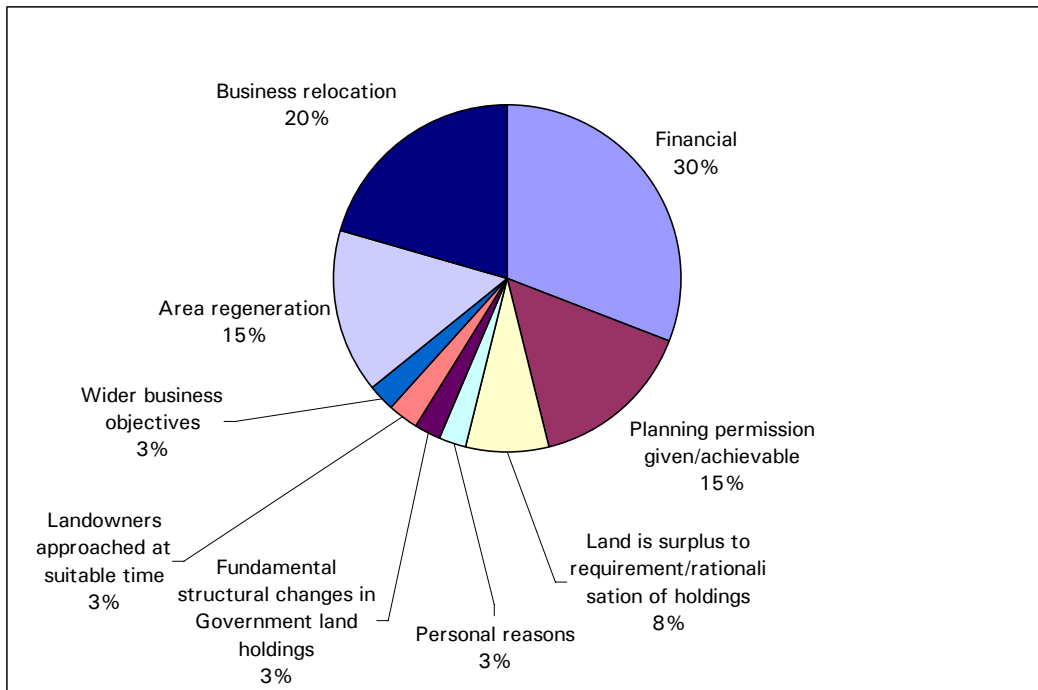
5.33 Land values rise and fall over time and the exact trajectory is difficult to predict. Well advised landowners will understand this and will take it into account when deciding when to sell any land that they own. Charts 5.6 and 5.7 show that the most common cause of both greenfield and brownfield land sales is financial reasons.

Chart 5.6: Reasons for selling greenfield land



Source: Savills Research 2004.

Chart 5.7: Reasons for selling brownfield land



Source: Savills Research 2004.

5.34 If landowners anticipate that land values will be higher at some point in the future, they may delay selling land they own. One of the key features of the planning system is that it grants planning permissions rather than obligations.

5.35 The effect of these two features is that, in practice, a landowner may not be inclined to sell land as soon as it achieves planning permission.¹⁹⁹ Understanding land supply requires an understanding of the timing of land sales as well as the motives for land sales. In particular, some land owners may decide that some of the regulations and standards affecting land values, such as the Code for Sustainable Homes, will be revised at a future date and hold their land off the market in anticipation of a better land value in the future generated through lower construction costs.

¹⁹⁹ Note that planning permission is time limited if it is not exercised. This may encourage land owners to sell land with planning permission before planning permission expires but this still leaves a time period over which sale can be delayed.

Whether landowners currently think this is unclear but some homebuilders clearly fear this scenario.

Conclusion on the land supply market

- 5.36 On the evidence that is available, it appears that the land supply market is working how we would expect and there are no obvious competition problems - landowners and option holders attempt to supply more residential land when residential land values are high. The planning regime, however, may have acted as a constraint on that market, preventing it from delivering an increased amount of land to homebuilders. This is a constraint that CLG and the Welsh Assembly Government have recognised and have addressed through planning regime reform.
- 5.37 The health of land supply in the future will depend not only on the success of these initiatives but also upon land values and landowners' attitudes to future land values. The inherent variability of land values means that there is always the possibility that future land values may be higher. While GDVs are generally pro-cyclical, rising and falling with the economic cycle, regulatory compliance costs are affected by political decisions rather than the economic climate. What effect regulations have on land supply depends not just on the new land value but to a large extent on the attitude of landowners. If landowners think the regulations will only be in place temporarily, they may be tempted to hold their land off the market until the regulation is removed and land prices rise. This exacerbates any reduction in land supply because of the lower price as a result of the new regulation. The current slow down in the housing market and its consequent affect on land prices, if prolonged, will worsen matters further.

Landbanks

- 5.38 The homebuilding industry has been criticised repeatedly over the practice of landbanking that is, hoarding stocks of permissioned land without developing them. Various related allegations have been put to us, for example:

- homebuilders are sitting on significant stocks of land – if these were released, new homes could be developed at a faster rate
- homebuilders corner the market in land locally in order to push up house prices, and
- the major homebuilders buy up or option much of the available land at an early stage in the planning process, which makes it difficult for smaller homebuilders or self builders to obtain land for development.

5.39 The homebuilding industry, however, claims that scarcity of land for development, combined with delays and uncertainty in the planning process, mean that it is not possible to adopt a 'just in time' approach to managing stocks of land. It argues homebuilders must hold a pipeline of land at various stages in the planning process to be sure of having sufficient land that is ready for development at any one time.

5.40 The issue of landbanking has been addressed by previous reviews which, broadly speaking, recommended against any intervention to restrict landbanking. Yet the practice remains a concern for a range of stakeholders.²⁰⁰

5.41 In this section we attempt to draw together the arguments around landbanks and the available evidence in order to come to a view on whether the practice could have a negative impact on the quantity of new homes being delivered or an impact on competition.

²⁰⁰ For example, CLG has announced a consultation on whether homebuilders should be required to build out planning consents more quickly. See page 7 of the Housing Green Paper, available at:

www.communities.gov.uk/documents/housing/doc/Homesforthefuture.doc?bcsi_scan_A2018E0826464712=0&bcsi_scan_filename=Homesforthefuture.doc

Barker and Callcutt Findings

- 5.42 Both the Barker and Callcutt reviews examined landbanking. The Barker review considered whether the practice of landbanking indicated that homebuilders were failing to bring forward land for development quickly enough. The review looked first at strategic land, that is land without planning permission which homebuilders control, typically through options (see Glossary). The review found that options serve a number of functions that should facilitate the bringing forward of land for development, for example allowing homebuilders to bring their financial resources and expertise to the promotion of land through the planning system, while leaving certain risks (for example, unexpected section 106 costs (see Glossary)) with the landowner.
- 5.43 The Barker review then considered whether the use of options could be a barrier to entry if homebuilders tied up large areas of land under option which they were not actively promoting, thus preventing other homebuilders from acquiring the land and developing it. However, the Barker review noted that various features of typical option agreements, notably the requirement that the homebuilder not option any other land in the area, made this unlikely. Overall the review concluded that,
- 'optioning does not prevent land from being promoted through the planning system and may even encourage it.'²⁰¹
- 5.44 The Barker review then looked at core landbanks, that is land that homebuilders own, which has at least outline planning consent. The review noted that major UK homebuilders typically have core landbanks equivalent to three to seven years' production but that only a portion of this land has implementable permission and is ready to be built on. The review noted that homebuilders in the US, where land is more freely available, typically have shorter landbanks, at two to three years, while homebuilders in Hong Kong, where land is particularly scarce, are reported to have landbanks several times as long as those of UK homebuilders.

²⁰¹ Barker review, para 5.13, p 82.

5.45 Overall, the Barker review did not advocate taking action to ensure that landbanks were built on as quickly as possible. The review concluded that any such measures would risk deterring investment and thus further depress housing supply, particularly on the more difficult to develop brownfield sites.

5.46 The Callcutt review also addressed landbanking. By and large, the review found little cause for concern about the practice. The review concluded that:

'There are no doubt some individual cases where house builders hold land for longer than they need. But, in our view, the current evidence does not support the suggestion that this practice is at all widespread.'

5.47 While the Callcutt review also recommended against general measures to force more rapid build-out of landbanks, it did recommend a change to the planning regime to prevent a particular kind of behaviour, whereby a homebuilder undertakes minor work at a site solely to prevent the planning permission from lapsing.

5.48 Despite the conclusions of the Barker and Callcutt reviews, submissions received by the OFT continued to express concerns about homebuilders' landbanks. For example, CAGE submitted that:

'several of the majors appear to own or have options on significant landbanks, with significant areas where planning permission has already been granted. An open book verification of the claim that there is a shortage of developable land would be welcome to move the debate beyond this single sticking point.'²⁰²

5.49 This section considers all the available data on landbanks and, in the light of the findings from previous sections, considers whether

²⁰² See also the report, 'Opening up the debate: Exploring housing land supply myths', published by the RTPI and available at: www.rtpi.org.uk/download/1708/Opening-up-the-debate-June-2007.pdf

homebuilders are able to hoard land to the detriment of competition or build out rates.

Stocks of land and flows of homes

- 5.50 Landbanks are **stocks** of land held by companies, while the amount of land being developed for homes each year is a **flow**. In a steady state (that is, when the landbank is constant in size), the stock of land in the landbank does not affect the flow of housing. In other words, it does not matter whether landbanks are equivalent to two years of future production or 12 years – the rate of flow of land out of a landbank is determined by the rate of flow into it, not by the size of the landbank.
- 5.51 Changes in the stock of land held will temporarily affect the flow of homes. If homebuilders were to reduce their land holdings, the impact would be a temporary increase in the rate of flow of land for development. Other things being equal, the flow would in due course return to the previous level.
- 5.52 When a landbank is in a steady state, the rate of flow of land for homes depends on:
- how much land is available for purchase, and
 - the proportion of that land that obtains planning approval.
- 5.53 The size of the landbank held by homebuilders does not of itself affect the rate at which new homes can be built.

The debate over land shortages

- 5.54 It has been suggested that there is a common misperception about the relationship between the availability of land for homes and the price of land.²⁰³ Professor Alan Evans of Reading University has noted that, during the 1970s and 1980s, the policy response to homebuilders' complaints about a shortage of land was to set up joint committees to

²⁰³ Alan W. Evans, *Economics, Real Estate and the Supply of Land*, chapter 13.

try to reconcile homebuilders' and planners' views about the availability of land. The assumption implicit in this effort was that if the amount of land available was equal to or exceeded the amount of land needed, then planning policy was non-restrictive. Of course, this assumption was not borne out by the facts – rising prices were observed even where there appeared to be available land.

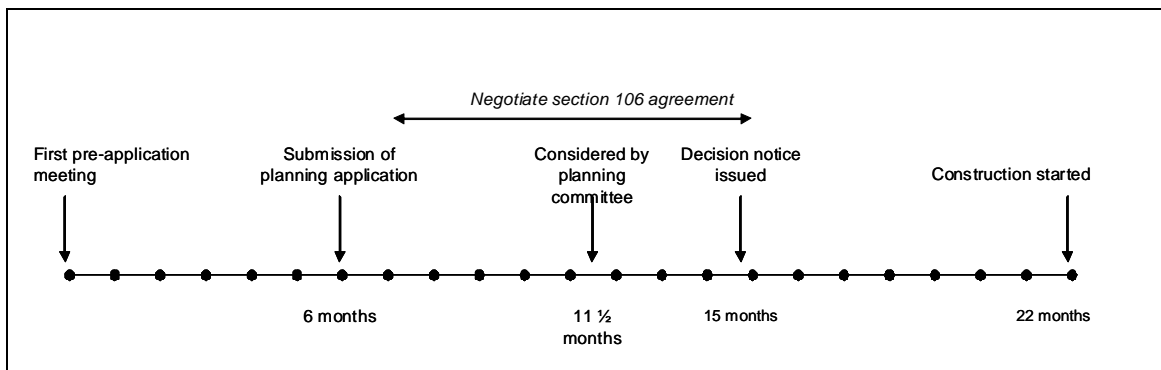
- 5.55 Evans argued that a more accurate model of the land market would recognise the fact that the market is imperfect (in an economic sense, being characterised by uncertainty and information asymmetries) and that a margin of available land is therefore needed to avoid price inflation. He draws an analogy with the labour market: it is widely accepted that vacant jobs can coexist with unemployment and that any attempt to run an economy with an excessively low rate of unemployment will result in wages being bid up.
- 5.56 The charge that homebuilders should not complain about a shortage of developable land while they have several years' worth of land in their landbanks may be grounded in a common view of the land market: that provided there is some land available, there is no shortage. However, it may be more realistic to recognise that the market needs a margin of available land at any one time, and therefore that there may be no inconsistency between homebuilders' holding significant landbanks and a claim that there is a general shortage of land.
- 5.57 In addition, many of the large homebuilders are public limited companies and their shareholders expect them to have a certain stock of land to ensure they will be able to reach their sales targets (based on the number of units sold) over the next few years.²⁰⁴ It is also worth noting that a homebuilder's landbank will consist of land at different stages of the planning process. There are many stages land has to progress through before homes are built on it.

²⁰⁴ The weight attached to this in corporate valuations varies from analyst to analyst. Equally, as we show at Annexe W, the need to hold landbanks is not necessarily stronger for quoted companies than it is for private ones.

Planning timelines

- 5.58 Homebuilders maintain that they need to build up stocks of developable land at various stages in the planning process. It takes time to promote land through the planning system, so a homebuilder will necessarily hold some land in the pipeline.
- 5.59 The HBF undertook some research about planning timelines in November 2006.²⁰⁵ Data was gathered for 581 sites, from 72 regional or head offices of 13 homebuilders and the figures averaged. The results are summarised below.

Figure 5.1 Results of HBF Planning Timeline Survey



- 5.60 These results are broadly consistent with those of the London Development Research (LDR) presented in the Callcut review.²⁰⁶ The LDR research, however, suggested that the pre-application process took significantly longer – 15.4 months on average for the schemes surveyed, and 25.1 months for schemes of 150 units or more. This may reflect particular difficulties associated with developing sites in Inner London.
- 5.61 It is also worth noting that planning permission is usually granted subject to certain conditions being agreed. These are called 'reserved matters' and usually include section 106 agreements (see Glossary) but can also

²⁰⁵ Home Builders Federation, Planning Process Timeline Analysis of Survey, November 2006.

²⁰⁶ Callcut review, p 35.

include section 278 agreements (see Annexe I) and the time taken to finalise the details of these agreements can be considerable. One homebuilder gave details about the typical time taken to achieve planning permission for a variety of stages:

- time taken for a detailed application = eight months
- reserved matters (section 106 agreements etc.) = six months, and
- outline planning application = nine months.

5.62 In the HBF's submission to the study the time for the section 106 agreement to be drafted and signed was estimated at 120 days (17 weeks).

5.63 Homebuilders we spoke to during the study offered support for the HBF and LDR findings. Berkeley told us that of the sites containing the 30,126 plots in its landbank at the 30 April 2007, it took over 2 years for it to secure a planning consent on 13,948 plots, equivalent to 46 per cent of the plots in the landbank. Berkeley's data allocates only 2 months for pre-application negotiations with the planners, even though in many cases the negotiations took considerably longer than this, often in excess of six months. The HBF submission to us said,

'A housebuilder promoting a strategic site for allocation in a development plan through both the RSS [regional spatial strategy] process and then an LDD [local development documents] can be faced with a six year lead time merely to have the site allocated and identified in an adopted development plan.'

5.64 Although most sources quote the same average time to obtain planning consent, there was significant variability in relation to some schemes. One firm said the actual time to achieve planning permission on a site varied from 4 - 20 months. In data from the top 10 homebuilders, six of the nine respondents said they could predict the length of time to achieve planning permission on a site to within six months. For more complex sites three firms said they could predict the time to within a year.

- 5.65 Furthermore, a significant proportion of residential planning applications are unsuccessful – at present 37 per cent of English applications are refused.²⁰⁷ The time taken to process residential planning applications varies between local planning authorities across the UK. This uncertainty over planning outcomes might lead homebuilders to hold more land in the pipeline than they expect to gain permission to use.
- 5.66 A planning timeline of almost two years, and a refusal rate of about one in three, would correspond to the need for a pipeline of land equivalent to three years worth of production going through the planning system at any one time.

Size and composition of landbanks

- 5.67 One of the difficulties in the debate around landbanking is obtaining comprehensive and comparable data on companies' landbanks. Indeed, one recommendation of the Callcutt review is that a common definition of landbanks be established and implemented. A panel of academics submitted to the OFT that:

'Published data on landbanks tends not to be particularly accurate. There can be wide variation in size between the landbanks of different companies since no consistent method exists for the definition or measurement of landbanks within company reports. Also, to identify solely land with planning permission is to underestimate significantly the amount of other land holdings recorded in company accounts.'²⁰⁸

- 5.68 We have attempted to gather and compare information on landbanks from the following sources:

- published information on company landbanks
- information submitted by homebuilders to the Barker review

²⁰⁷ CLG, Development Control Statistics, 2007/08.

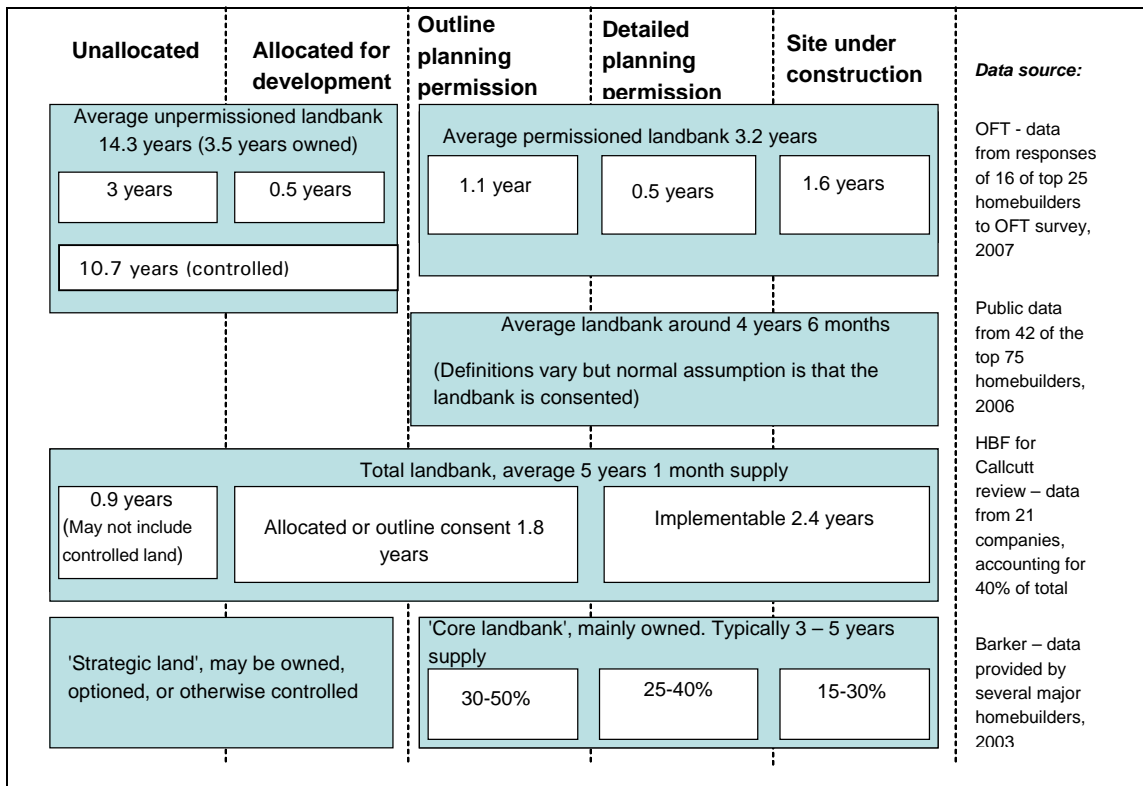
²⁰⁸ Michael Ball *et al* submission to OFT.

- information compiled by the HBF for the Callcutt review, and
- information submitted in response to the our homebuilders' survey.

5.69 The most common way of expressing the size of a landbank is in number of years of production at current rates, that is the number of plots in the landbank divided by the number of plots completed in the most recent financial year. Figure 17 of the KPMG Financing Study at Annexe E sets out a selection of homebuilders' published data on their landbanks.

5.70 Figure 5.2 presents a summary comparison of the available data on landbanks. Fuller descriptions of the data sources are given in Annexe V. All the sources, including the OFT's own survey data, draw disproportionately on the information available from large firms. Furthermore, the data sets were gathered at different times and are therefore not directly comparable. Nonetheless, the information drawn together in this way presents a broad brush picture of landbanking behaviour generally and a detailed examination of the landbanks of the larger homebuilders.

Figure 5.2 A Comparison of Available Landbank Information



5.71 The OFT data above shows that the vast majority (82 per cent) of the land in homebuilders' landbank is strategic land which may be some years away from gaining planning permission. Estimates produced using data submitted to the OFT as part of this study shows the average landbank for land directly under a homebuilder's control is a little over three years, which is broadly in line with the findings in other reports. The size of landbanks therefore appears to be consistent with the time taken to achieve detailed planning consent and agree reserved matters.

5.72 16 of the top 25 homebuilders provided information about their landbanks to the OFT.²⁰⁹ An average of 18 per cent of the land in the landbank was made up of sites which either had outline or detailed planning permission, or where construction was taking place. Sixty-one

²⁰⁹ Only 14 of the 16 responses contained data on unallocated land or land allocated for development. Figures for these categories of land are based on data from 14 homebuilders.

per cent of the total landbank was held under option agreements or conditional contract. This is land which the homebuilder is generally obliged to promote through the planning system. In order to reduce risk, normally the homebuilder does not want to buy the land at a pre-planning stage in case it is not granted planning permission.

- 5.73 Although the homebuilder does not own the land it does incur significant costs while it is taking the land through the planning system. In one example given to the study, it was a year after the site was identified before the conditional contract was exchanged with the landowner (see Glossary for details of conditional contracts). It was another four years until construction began and the homebuilder incurred costs of £220,000 - £230,000 in fees during this five year period in addition to the management time required.
- 5.74 It is impossible to come up with an average figure for the cost to a homebuilder of taking a site from identification to starting construction, but having option agreements is one way to reduce the risk the homebuilder faces during this process.
- 5.75 One area of controversy surrounding landbanks has been the suggestion that homebuilders are sitting on significant stocks of land that, if released, could be used to develop new houses at a faster rate. The available data on the size of landbanks does not appear to support this suggestion. Homebuilders' landbanks appear to be largely explicable in terms of the amount of time it takes to promote land through the planning system, and the risks involved in doing so.
- 5.76 One point of debate has been the amount of land that firms hold that has planning permission and that could be built on but where construction has not yet started. The Barker review suggested that that 25-40 per cent of a firm's landbank might have detailed planning permission yet not be under construction. However, the HBF claimed in its submission to the Callcutt review (with reference to the data they had collected) that:

'of the implementable land bank, only 2.6% of plots were on sites where work had not started three months after permission was granted.'

- 5.77 The figures collected by the OFT show that only three per cent of units have detailed planning permission but are not under construction. A further six per cent of units have outline planning permission and 82 per cent do not have any kind of planning permission, the remaining nine per cent was land where construction was taking place. A large proportion (75 per cent) of the sites without planning permission is not owned by the homebuilder but is subject to option agreements or conditional contracts. Typically this means that the homebuilder will be obliged to promote the site through the planning process. If only sites with detailed planning permission are considered, the proportion of land not under construction is approximately 22 per cent, almost in line with the figure estimated by the Barker review. As we show above, this is in fact a small proportion of the overall landbank and equivalent to only a few months of new housing supply.
- 5.78 Part of the reason for the discrepancy between the different sets of figures is that there may be a gap between obtaining detailed planning consent and arriving at the point where that consent is implementable. For example, the parties might need to finalise a section 106 or section 278 agreement, or there may be conditions attached to the consent which need to be discharged before construction can begin. The Barker review noted that in some cases around 10 per cent of the land with detailed planning permission was awaiting completion of external infrastructure or was subject to other delay, for example due to environmental or archaeological issues.
- 5.79 The OFT has also received evidence that it is not uncommon for homebuilders to have obtained planning permission but for other factors to delay the start of construction. In our homebuilders' survey only around a quarter of small homebuilders (27 per cent, base 64) said they had housing developments held up by delays in obtaining infrastructure compared to 63-64 per cent of medium and large homebuilders (base 30 and 22 respectively) and the majority of Top 25 homebuilders (88 per cent, base 17). Around half (49 per cent) of all respondents had experienced delays in their development due to delays in infrastructure

(base 133).^{210 211} Anecdotally, concerns were raised about delays due to factors outside the planning system such as section 278 agreements, DEFRA licences, and restrictions imposed by English Nature.

- 5.80 CLG launched a study 'Planning Applications: a faster and more responsive system' in March 2008 which aims to reduce the bureaucratic delays in the planning system.²¹² Similarly, the Scottish Government has commissioned research, 'Processing Planning Applications for National and Major Developments', which is to look at best practice in the handling of national and major developments including effective engagement of consultees and around the use of processing agreements.²¹³ The Welsh Assembly Government plans to take forward any recommendation from the CLG review that is appropriate for Wales. The Northern Ireland Executive is undertaking a wide ranging review of all aspects of its planning policy, with reforms not requiring legislative change to be introduced on an on-going basis and legislative reforms to be introduced in 2011.
- 5.81 Overall, the evidence presented to the OFT suggests that homebuilders are not delaying building on permissioned land to an extent that would appreciably affect the rate of delivery of new homes. The OFT acknowledges that there are some sites which have planning permission and which are not under construction but it appears that, in the majority of cases, there are other, external factors delaying the start of construction. In particular, the current sudden downturn in the housing market which dramatically affects the rate of sale of new homes will of course lead to some homebuilders changing their plans to build out certain sites.

²¹⁰ The response rate for the survey of homebuilders was exceptionally low: just three per cent of businesses contacted. It is likely that the opinions and experiences of those who chose to respond are not the same or representative of those who did not respond.

²¹¹ Whole section – Homebuilders' survey Q6.13

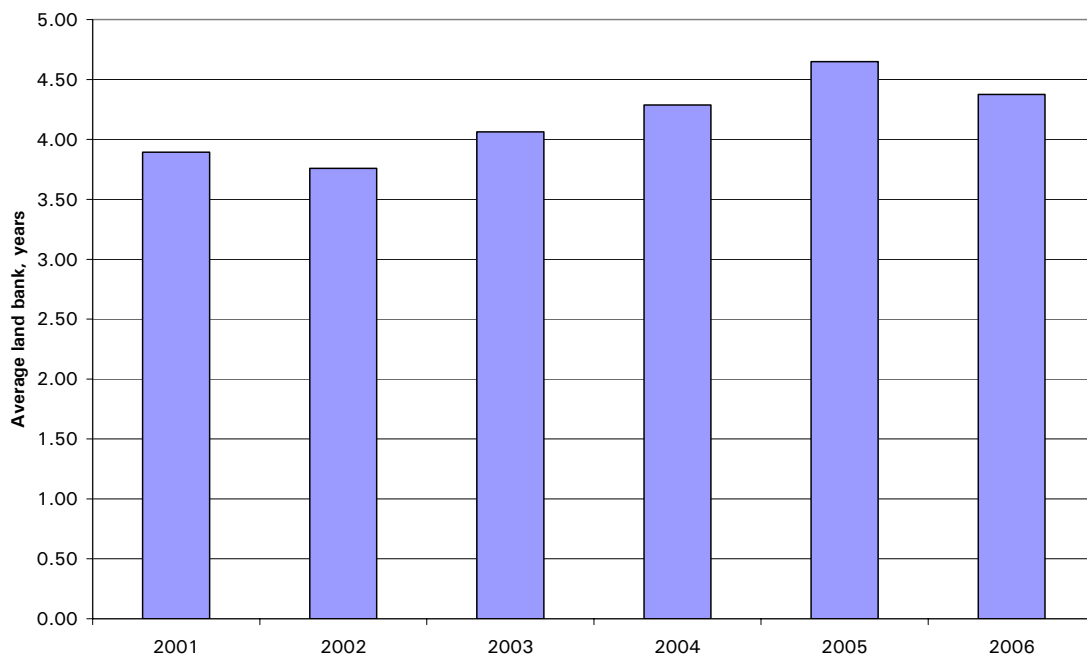
²¹² www.planningportal.gov.uk/england/professionals/en/1115315772911.html

²¹³ See: www.scotland.gov.uk/Publications/2007/12/11104120/0

Movement in landbanks over time

5.82 There is some evidence that landbanks have been increasing in recent years. Chart 5.8 shows how the average landbank has changed since 2001 for a subset (all those for whom the data was available) of the top 100 homebuilders based on publicly available data. Over the period 2001 to 2006 average landbanks showed variability from a low of 3 years nine months years in 2002 to a high of 4 years seven months in 2005, an increase of approximately a quarter.

Chart 5.8: Average Landbanks for Large Homebuilders



Source: Housing Market Intelligence Report 2007 and Private Housebuilding Annuals 2003-6.

5.83 The increase in landbanks might reflect a number of factors. There is some evidence of an increase in the average length of time taken to obtain planning permission; the average length of time taken for a home to gain consent from the final application has risen from approximately 20 weeks in 2000 to approximately 30 weeks in 2006, a fall from the

2005 figure which fits with the situation shown in Chart 5.8.²¹⁴ The HBF told us,

'There is no doubt that, ten years ago, gaining an implementable planning permission took weeks rather than months.'²¹⁵

- 5.84 In addition, the rate of planning approvals has declined over the period. CLG figures for planning decisions for new dwellings in England indicate that the approvals rate fell from 75 per cent in 2000/01 to 63 per cent in 2007/08.²¹⁶ This rise might be because of the target for planning decisions to be taken within 13 weeks or submission. Anecdotally we were told this target has led to planning applications being rejected and then re-submitted whereas before the target was introduced the application would have been granted permission after a negotiation period.
- 5.85 Landbanks and the time taken for planning approval to be granted have risen at a similar rate. This does not necessarily mean that homebuilders have increased their landbanks as a result of the longer planning process but this does remain a possible explanation.

Landbanks and type of firm

- 5.86 We considered whether landbanking behaviour was correlated with particular types of homebuilder. Annexe W sets out the data we considered. In summary, we found that landbanking behaviour was not closely correlated with firm size or type of ownership (that is, whether the firm was listed or private) but those homebuilders with a high proportion of their developments on brownfield sites did tend to landbank more than firms with a lower proportion of their developments on brownfield sites.

²¹⁴ Graph 6, p53, *Housing Market Intelligence Report 2007*.

²¹⁵ HBF submission to OFT study.

²¹⁶ CLG Planning Control Statistics, Table 1.4.

5.87 As brownfield sites are more complex, more risky and take longer to develop than greenfield sites, this, in our view, reinforces the finding that homebuilders use landbanks primarily as a risk management strategy.

Conclusions on landbanking

5.88 Having a stock of land helps a homebuilder cope with fluctuations in the housing market and also helps to reduce risk. Shareholders in those homebuilders that are quoted companies consider having an adequate landbank as an important asset.

5.89 We have not found any evidence to support the view that, at the national level, homebuilders are hoarding a large amount of land with implementable planning permission on which they have not started construction. This suggests competition has not been impaired by homebuilders mothballing permissioned land to create a barrier to entry and artificially raise prices even during the long upturn in the market until 2007. Equally, there is little evidence to suggest that homebuilders have been able to systematically obtain market power at a local level by acquiring planning permissions.

Conclusion

5.90 When looked at as a whole the private market for the supply of land with residential planning permission appears to work as expected. The level of planning activity increases as land values increase. While activity may have been suppressed by the planning regime, measures are already being put in place which may make the planning regime less restrictive on overall land supply.²¹⁷

²¹⁷ CLG have reformed PPS 3 so that LPAs will not be able to cite having met their residential housing targets as a reason for refusing planning permission. The Welsh Assembly Government has also announced that where an LPA does not have a five year plan housing developments should be awarded planning permission where all other considerations are met.

- 5.91 The homebuilding industry, which owns a significant landbank, does not appear to systematically hoard land with implementable planning permission; most land of this type is under construction. This finding is supported by the analysis of KPMG (see Chapter 4 of the Finance study at Annexe E).
- 5.92 It is possible that other industries, land traders or strategic land funds for example, may landbank permissioned land more extensively than homebuilders. The fragmented nature of land records has made it impossible for this study to consider these industries' practices within the scope of the current study. Notwithstanding this, the evidence suggests that, whatever the practices of non-homebuilder private landowners with their landbanks the landbank owned by the public sector is at least as large if not larger.

6 CONSUMER PROTECTION

- 6.1 In Chapter 4 we concluded that while, generally, the homebuilding industry is free from competition concerns, the characteristics of the product, the inability of homebuyers to accurately assess the quality of the product in advance of purchase and the - perhaps overwhelming importance of price and location - mean that homebuilders may not compete as fiercely as they might on some aspects of quality and customer service.
- 6.2 While overall financial consumer detriment from faults and delays may be low compared to the size of the industry, it is not insignificant in absolute terms. Our consumer detriment figure did not attempt to put a value on distress and inconvenience nor did it capture any detriment which may arise from failings in the sales process rather than failings in the new home or delivery of the new home.
- 6.3 While many homebuyers experience faults with a new home, many of which are quickly fixed, some homebuyers experience significant detriment, distress and inconvenience which come with major, or many, faults in a new home. During this study we have heard from many individual homebuyers who had unfortunate experiences buying a new home and – to make sure we understood the experiences of these individuals – sent some who experienced serious problems short questionnaires. There is no doubt that when homebuyers experience significant or persistent problems the distress and inconvenience caused can be substantial.
- 6.4 Against this background, this Chapter of the report details the results of our mystery shopping exercise and consumer survey which we used to examine the homebuyer's experience of the sales process for a new home, our analysis of the methods of redress open to homebuyers when things do go wrong and an analysis of the general level of consumer protection which currently exists for homebuyers purchasing new homes.

Selling the home – adverts, marketing material and show homes

- 6.5 We looked at a number of press advertisements for new homes which did not generally raise any significant issues of concern.²¹⁸
- 6.6 Our mystery shop found that mystery shoppers broadly agreed that show homes matched advertised descriptions. For example, advertising for 25 per cent of the properties assessed contained the word 'luxurious'.²¹⁹ The majority (73 per cent) of these properties were also identified by mystery shoppers as 'luxury' and the remainder were considered to be 'standard'.
- 6.7 Our mystery shoppers agreed that the home they viewed lived up to the description provided by the salesperson in 89 per cent of assessments. They judged that sometimes standard homes were over-sold, while budget and luxury homes were generally pitched at the correct level. Nine per cent of sales people described homes judged as standard by mystery shoppers as 'extremely high quality' or 'luxury'.
- 6.8 Four of the six buy-to-let investors we interviewed however, who have the benefit of seeing the final product and of significant repeat purchases, thought that marketing literature was inaccurate and the other two thought that although it was not inaccurate, claims in the literature were exaggerated.
- 6.9 Our mystery shoppers reported that show homes were sometimes made to look as spacious as possible by a generous use of mirrors and unusually small furniture. Forty two per cent of mystery shoppers felt that there was an excessive use of mirrors or transparent surfaces, 36 per cent thought that there appeared to be a limited amount of standard

²¹⁸ Although it should be noted that we observed on several occasions a feature of some advertisements which stated: '*5 per cent deposit paid*' or '*deposit paid*'. It was not clear to us from the advertisements what exactly was on offer and whether the price of the deposit had to be repaid at any stage and on what terms.

²¹⁹ Annexe C: mystery shop.

furniture and 22 per cent thought that the furniture was unusually small.²²⁰

- 6.10 Our consumer survey revealed a more positive picture - but not necessarily an inconsistent one, since homebuyers may easily be able to identify the impact of mirrors and small furniture - in relation to the general presentation of show homes. Three quarters of homebuyers who had viewed a show home said that their expectations had been met. One quarter of respondents who had viewed a show home said that their home was either more like (nine per cent) or less like (16 per cent) the show home than they had expected.²²¹ There were very few cases where the new home differed greatly from the respondents' expectations. For example only eight per cent of those who expected their home to be a 'five' or 'six'²²² in terms of comparability to the show home (that is, midway between 'completely different' and 'identical') found that their new home was in fact 'completely different'.
- 6.11 Evidence from both our consumer survey and our mystery shop found that generally homebuyers and mystery shoppers said that they did not experience a 'hard sell'. In the consumer survey only nine per cent²²³ felt that they had experienced a 'hard sell'. In the mystery shop only seven

²²⁰ Annexe C: Mystery shop.

²²¹ Respondents who had viewed a show home rated how similar they expected their new home to be using a scale of 1-10, with 1 representing 'completely different' and 10 representing 'identical'. They then rated how similar their new home actually was compared to the show home. This result categorises the cross-tabulation of these results into three groups. Those whose score for how similar they expected their home to be was greater than it actually was (less like show home than expected), those whose scores were the same and those who scores for how similar they expected their home to be was lower than the actual comparison rating (more like show home than expected).

²²² Where 1 = 'expected new home to be completely different to show home and 10 = 'expected new home to be identical to show home.

²²³ Annexe B: Consumer survey.

per cent²²⁴ stated that they felt hurried or under pressure to commit to a purchase.

- 6.12 The role of marketing literature, advertisements, show homes and sales people is to sell homes and it is inevitable, and many homebuyers will expect, that new homes will be presented to prospective homebuyers in a very positive light. We did not find any evidence which prompts concerns about widespread misrepresentation in marketing material or widespread pressure selling - although the extent to which homebuyers feel pressured may well vary depending on the state of the housing market.

What about snags and faults?

- 6.13 The mystery shop showed that 22 per cent²²⁵ of our mystery shoppers were told that there are normally some teething problems with a new home and it would need 'running in'. For example:

'I was told that the house took time to "settle" and I could expect jamming doors and handles, "give" in the walls and other minor problems.'

- 6.14 One sales person made it clear that the homebuilder would only fix certain types of problem:

'Settling in cracks were mentioned and that only those above the size of a £1 coin would be their responsibility.'

- 6.15 The mystery shop also found that benefits of purchasing a new home over an existing home were mentioned (unprompted) by 31 per cent²²⁶ of sales people. For example:

²²⁴ Annexe C: Mystery shop.

²²⁵ Ibid.

²²⁶ Ibid.

'There would be no maintenance problems for a number of years. It would be better insulated.....'

- 6.16 The mystery shop found that most shoppers were given information on quality assurance (90 per cent)²²⁷ but only after prompting in around two-thirds (70 per cent) of these cases. For those not given information on quality assurance, the main comments were that the sales person did not seem to have much knowledge or assured them there would be no problems with the home:

'I was told it would be unlikely there would be any problems with a new home.'

- 6.17 When mystery shoppers enquired about quality assurance, sales people most frequently referred to snagging²²⁸ processes or warranty providers²²⁹, in particular NHBC.

'I was told that there is a 10 year NHBC warranty on the property. I was assured that nothing would be wrong with the property.'

- 6.18 Mystery shoppers were given oral guarantees concerning snagging issues in 38 per cent²³⁰ of mystery shops, sometimes referring to warranty cover, sometimes referring to the homebuilder's own snagging procedures and sometimes both:

'The sales agent said that the NHBC would make sure that the house was perfect when I move in but there would be 24 hour cover in the unlikely event that anything should go wrong.'

- 6.19 Overall, we believe the picture to be that some homebuilders and their sales people are managing homebuyers' expectations well but some may

²²⁷ Annexe C.

²²⁸ See glossary.

²²⁹ Warranties are discussed in more detail later in this Chapter.

²³⁰ Annexe C.

be too dismissive about the possibility of any imperfections in a new home.

Availability of contractual information

6.20 The mystery shop revealed that information about contracts, warranties and after sales service was often not complete, sometimes inaccurate, sometimes not clear, not often volunteered, and not provided in a timely manner.

6.21 Purchasing agreements and/or contracts or missives were only given freely to three per cent²³¹ of mystery shoppers and a further three per cent were given or sent these documents after pushing for them. However when this documentation was forwarded to the research agency it was apparent that all but one mystery shopper had been sent or given documents that were not the purchase agreement.²³² Some of our mystery shoppers were told:

'The sales adviser suggested that this request was never honoured by the company as the information as offered was "too complex" for the average purchaser.'

'I was told that missives²³³ would only be provided to those who had reserved a property.'

'The representative said she would have to phone and ask, which she did. She said she had spoken to one of the directors, and they had said that it was not possible, although they did say that if we made an offer which was accepted, and started the process of buying, that they would then consider letting us see it.'

²³¹ Annexe C.

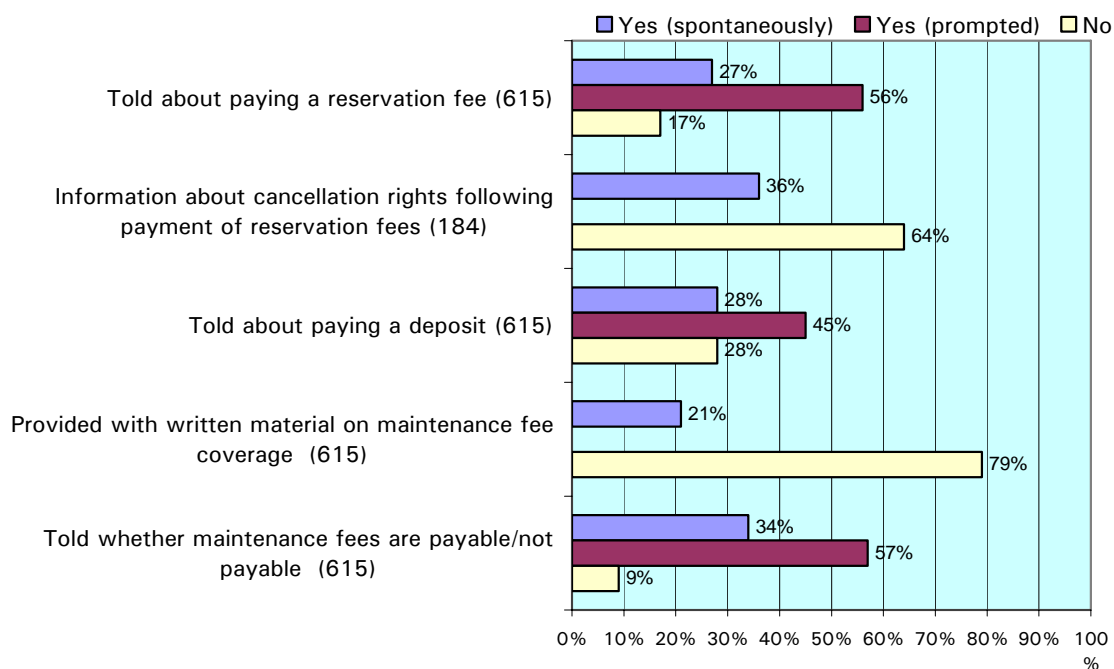
²³² Ibid.

²³³ Refer to Annexe G or Glossary.

- 6.22 From our interviews with homebuilders and the Council for Licensed Conveyancers we understand that contracts are provided after reservation documents have been signed and, where applicable, reservation fees paid (where applicable). This means that homebuyers will already have paid a reservation fee without sight of the exact terms and conditions of the contract. Even when the homebuyer or their legal representatives receives the contract, they may not be given very much time in which to consider it and undertake appropriate searches before the homebuilder requires contracts to be signed and exchanged. In Scotland, it is usual for the reservation fee to have been paid by the homebuyer before the formal offer to sell setting out the proposed terms and conditions of the contract is sent to the homebuyer's solicitor.²³⁴
- 6.23 In our mystery shop, much of the information about reservation fees, deposits, cancellation rights, warranties and maintenance fees was not volunteered by sales people without prompting from the mystery shopper.

²³⁴ Source: Law Society of Scotland, email dated 8 September 2008.

Chart 6.1: Information provided during mystery shop



Source: mystery shop, base indicated in brackets.

Reservation fees and deposits

6.24 Homebuilders' policies on reservation fees and deposits vary in terms of whether they are payable, the amount and whether or not they are refundable. Our mystery shoppers found that the information on reservations fees was often unclear:

'I asked about a reservation fee and was told that this was not applicable as the house was complete already. However, in the email I later received, in response to unanswered questions during the site visit, I was told that there was a non-refundable fee of £1,000.'

'I was told about reservation fees after prompting. The first adviser who showed me the property said it was £200 and was non-refundable. However, when I spoke to the Sales Executive I was told it was £500 and was non-refundable.'

'I was told that the reservation fee was £500. However, on browsing through the literature at home later, I noticed that on the current Price List of available property, it reads 'Only £99 Reservation Fee and move in!'

'The reservation fee was £5K. The estate agent was not sure if this was the deposit also.'

Maintenance fees

- 6.25 We have received some direct representations from homebuyers about maintenance fees payable by residents of new homes (such as in flats or on estates for upkeep of communal areas). One of the problems appears to be that, at the time of purchase, homebuyers had been unaware of the level of fees to be paid, what mechanism was used to review these levels and how maintenance contracts could be sold on. Homebuyers told us about examples where maintenance fees had suddenly increased by a large amount.
- 6.26 In the mystery shop a few sales people (nine per cent) did not know whether maintenance fees were payable. Where they were payable, the majority of shoppers (90 per cent) were provided with cost details although in 63 per cent of these cases, shoppers had to prompt for this. Fees ranged from a few hundred pounds to £2-3,000 per annum with an average of £940 a year.
- 6.27 Only 26 per cent of shoppers were told the fees were subject to review and 12 per cent of sales people said that the homebuilder could sell on the maintenance contract to a maintenance company or managing agent.
- 6.28 We do not expect sales people to give legal advice but consider that they should be able to provide information about the homebuilder's policy on reservation fees, deposits, cancellation rights and so forth and provide copies of key contractual documentation. This would allow homebuyers to have the opportunity to consider them before parting with any money and enable comparisons to be made between different homebuilders and with the cost of buying an existing home.

Moving in delays

- 6.29 The construction of new homes is a complex process. As building work takes place outdoors homebuilders are vulnerable to delays owing to, for example, bad weather or unusual problems with the site. Third parties, such as providers of utilities, may not complete their work when needed. However, these are known risks for the homebuilder while the homebuyer will be much less aware of these issues and the likelihood of them occurring.
- 6.30 In the reservation documents and contracts of sale we have examined,²³⁵ we have found that homebuyers' do not have unlimited rights to reclaim their reservation fees, their deposits or other monies they may have paid out, by reason of delay, even where the delay has been unreasonable. In all the contracts we reviewed there is a term which excludes or limits liability for late completion in a very wide range of circumstances.
- 6.31 Even where delays are unreasonably long, homebuyers are usually unable to withdraw from the contracts with the homebuilders without penalty or loss of money. It appears to us that this signifies an imbalance between the degree of risk carried by the homebuyer and the homebuilder.
- 6.32 In our consumer survey most homebuyers who had incurred costs as the result of delays said that they did not receive any kind of compensation (85 per cent²³⁶). When we asked homebuilders about what they would typically do for a new homebuyer if the construction of their property was not completed within six weeks of the moving-in date, nine of the 16 Top 25 homebuilders who responded to our homebuilders' survey said 'nothing' (53 per cent).²³⁷

²³⁵ Received nine out of the top ten builders by volume.

²³⁷ Annexe D: Homebuilders' survey. Base = 17 Top 25 homebuilders.

- 6.33 If the delay was of three months or more in duration, six of the 16 Top 25 homebuilders who responded (38 per cent) still said that they would do 'nothing'. Of those which would do something, six stated that they would pay for storage fees and seven said they would pay for temporary accommodation. Three said that they would allow the contract to be cancelled without penalty, three said they would provide free upgrades on fixtures and fittings, one said they would refund the deposit, one said they would refund the reservation fee and one said they would reimburse some of the money paid.
- 6.34 Respondents who were in the Top 25 homebuilders in our homebuilders' survey said that delays of three months and more were unlikely or very rare. Our consumer survey, however, found that 17 per cent²³⁸ of all homebuyers who were given a moving in date experienced a delay of more than two months.
- 6.35 The extent to which homebuilders are able to control delays or provide homebuyers with more accurate moving in dates is uncertain. Nevertheless, it does not seem equitable that homebuyers have difficulty in withdrawing from contracts, or obtaining compensation, if the homebuilder fails to deliver the product within a reasonable period of time. It seems to us that a minimum requirement should be that contracts allow the homebuyers to withdraw from the contract and have their deposits and reservation fees refunded, where significant delays have occurred.

Warranties

- 6.36 The vast majority of new homes sold in the UK come with a warranty provided from one of the main warranty providers (see two paragraphs below).²³⁹ This is because most mortgage lenders insist on some form of warranty which covers the home for a specified period of time,

²³⁹ Some homebuilders have their own two-year guarantee or warranty in addition to these.

usually 10 years.²⁴⁰ Professor Sommerville's research commissioned by the OFT for this study, see Annexe J, describes his view of the UK's system of warranty provision, and compares it to systems operating in other countries. Notwithstanding this background research, our observations of the warranty market in this report have been tempered by the fact that warranties are, for a large part, insurance products and, therefore, fall into the realms of financial services. Accordingly, our analysis of warranties has been necessarily limited in a report principally focussed on the delivery of new homes.

- 6.37 A new home warranty is an insurance policy which is purchased by the homebuilder and which typically provides cover against latent defects (that is those which are not immediately apparent) which may occur in new homes for certain periods of time. Warranty provision also includes inspection against construction standards (either the warranty provider's standards, published regulations or a combination of both).²⁴¹ The warranty fee, which is paid by the homebuilder to the warranty provider, therefore covers both the long term insurance of the building against structural defects which may develop and the provision of inspections made by the warranty provider during specific stages of the construction of the new home.
- 6.38 About 80 per cent²⁴² of new home warranties in the UK are provided by the NHBC. Other providers are Zurich Building Guarantee, Premier Guarantee, and two relatively new entrants, Building Life Plans Ltd (BLP) and LABC New Home Warranty. BLP's model is different from the other warranty providers in that its warranty provides insurance for latent

²⁴⁰ Any mortgage lender that is a member of the Council of Mortgage Lenders (CML) generally requires new homes to have a warranty before they will provide a mortgage. Ninety eight per cent of UK mortgage lenders belong to the CML.

²⁴¹ It should be noted that a new home warranty is not evidence of compliance with building regulations.

²⁴² NHBC Annual Review 2007, P2.

defects throughout the period of insurance, that is, for 10 years from completion.²⁴³

6.39 Apart from BLP, other providers have generally similar models to the NHBC. The NHBC warranty provides the following for homebuyers:

- Some protection against homebuilder insolvency - for example, subject to certain limits it will pay for the house to be completed, or for a lost deposit to be refunded, if the homebuilder goes out of business
- In the first two years of the warranty period – NHBC may make available a resolution service for addressing certain defects where rectification by the homebuilder has not occurred. Defects are defined as a breach of any mandatory NHBC Requirements by the homebuilder (or anyone acting for them)²⁴⁴ , and
- In years three to 10 the full cost of repair, if it is more than £1000, for a list of defects contained in the policy mainly relating to any actual damage resulting from a defect relating to structural issues.²⁴⁵ If the warranty provider does not accept the claim the homebuyer can appeal the case to the Financial Ombudsman Service (financial ombudsman).

6.40 Only five per cent²⁴⁶ of homebuyers in our consumer survey contacted the warranty provider for their home to try and get their faults fixed. This is not surprising given that, in the first two years of most warranties, it is the homebuilder who is supposed to rectify defects. Three per cent did not use the warranty provider's resolution or claims

²⁴³ The BLP warranty does not cover the pre-completion phase.

²⁴⁴ The definition does not include mere breaches of NHBC guidance.

²⁴⁵ A full list is provided by the warranty provider but these are primarily defects which carry implied risks relating to future building integrity and occupier health and safety.

²⁴⁶ Annexe B.

process and two per cent did so. The two per cent constitutes 17 people. For nine of them²⁴⁷, the process was still ongoing at the time of interview. The rest said it had taken the following periods of time to rectify the faults²⁴⁸:

- two weeks or less (five people)
- over four months and up to six months (one person), and
- over six months and up to one year (one person).

6.41 As noted earlier, the NHBC is by far the most frequently used warranty provider. In 2006-07 it registered 181,000 new homes for warranties (a total of 1.7 million homes were covered by NHBC warranties in 2007).²⁴⁹

6.42 NHBC provided us with the following data. Of the 17,311 insurance claims to NHBC active in 2006/07, there were 7,313 (42 per cent) in which all items reported were found to require work; 1,583 (nine per cent) where some of the items reported were found to require work and 8,075 (47 per cent) where no items reported required work. Some 340 (two per cent) claims were not yet decided.

6.43 Of the few cases submitted to the financial ombudsman,²⁵⁰ the majority are settled in the NHBC's favour. For example, of the 41 (out of 17,311) cases submitted to the ombudsman in 2006/07, 34 were settled wholly in favour of the NHBC.

²⁴⁷ Annexe B, para 2.30 and 9.45.

²⁴⁸ Excepting one respondent who did not answer the question.

²⁴⁹ Letter from NHBC dated 11 January 2008.

²⁵⁰ Insofar as warranties are insurance products, where homebuyers disagree with the NHBC's findings in relation to their claim, they may appeal to the financial ombudsman.

- 6.44 Although the average number of claims to the NHBC rose from 14,190 in 2005/06 to 17,311 in 2006/07, the average mean payout per claim fell slightly from £5,333 in 2005/06 to £4,970 in 2006/07.²⁵¹
- 6.45 As described earlier, the NHBC may offer its resolution service in the first two years of the warranty period. In 2006/07 the NHBC received a total of 65,665 contacts²⁵² relating to warranty concerns. Of these the number of active resolution cases was 7, 012 and the number of active insurance claims was 17, 311 (that is, relating to homebuilder's insolvency or failure to complete the home to NHBC standards).
- 6.46 The NHBC receives a large number of contacts from homebuyers which do not progress to become active resolution cases or active insurance claims. There were 41,342 of these contacts received in 2006/07. Since June 2007 the NHBC has also coded the contacts in order to identify the reasons for such contacts. It has broken down these reasons as follows:
- years three to 10, items not covered by the warranty 36 per cent
 - general advice on the warranty 31 per cent
 - further information requested from claimant 16 per cent
 - years three to ten, cost does not exceed minimum claims value 8 per cent
 - general NHBC advice (not claims related) 6 per cent
 - policy expired 2 per cent, and
 - years zero to two, items not covered by warranty 1 per cent.
- 6.47 We generally concur with Professor Sommerville's conclusion that, while not perfect, warranty provision in the UK is relatively robust. However, it

²⁵¹ Letter from NHBC dated 11 January 2008.

²⁵² Letter from NHBC dated 19 March 2008.

should be noted that warranties are certainly not complete guarantees for homebuyers. They do not cover every possible eventuality which could arise under the contract of sale. In this regard, in particular, warranties provide no cover for failings in the sales process, delays in moving in, deficiencies in contracts and exclude many items included in the purchase price.

- 6.48 Instead, warranties provide homebuyers with a very specific type of insurance cover in particular circumstances. It is inevitable that there will be limitations in any insurance policy, although data from our consumer survey indicates that homebuyers appear to think that warranties cover much more than they do. The sale of insurance products, of course, falls within the remit of the FSA (Financial Services Authority).
- 6.49 In the first two years of the warranty, it is the homebuilder's responsibility to rectify items which do not meet the warranty provider's standards. If the homebuilder does not do this or there is a dispute, then the warranty provider may offer its resolution service. If, in the warranty provider's view, the item is not suitable for resolution or the homebuyer disputes the resolution findings, then the homebuyer may attempt to take their dispute to another form of dispute resolution. However, in such cases, there is no recourse to the financial ombudsman since the matter does not fall within the insurance cover provided. However, if the homebuilder fails to carry out work highlighted in a resolution report the NHBC in its 'Buildmark: Your Warranty and Insurance Cover'²⁵³, states that it will: 'at our option, pay the cost of the work...'.²⁵⁴

²⁵³ www.nhbc.co.uk/NHBCpublications/LiteratureLibrary/Homewarranties/Buildmark/BuildmarkPolicyDocuments/filedownload,24117,en.pdf Section 2: The first 2 years after completion: The Resolution Service.

²⁵⁴ The NHBC, in an email of 5 September 2008, say: 'Where NHBC finds in the homeowner's favour, NHBC ensures the work is done, either by the builder or if necessary by NHBC stepping in and taking over the repairs as a claim.'

6.50 Notwithstanding whether a problem is covered by a warranty, a new homebuyer may always turn to the law for redress.

The legal framework

6.51 We have reviewed the legal framework relevant to the homebuying process, both before and after legal completion of the purchase of a new home. Full details of our review are set out in Annexe G.

6.52 In summary, this is a particularly complex area of the law which is likely to be difficult to understand for the average homebuyer. The legal framework is comprised of various statutes, regulations and the common law, all of which have to be analysed to understand the full extent of the framework and the limits of protection afforded to homebuyers.

6.53 In our view, this analysis is not a task that the average homebuyer could accomplish without recourse to professional advice. It follows, therefore, that it would be extremely difficult for the average homebuyer to draft their claim and argue their case against an infringing homebuilder, relying on the existing legal framework. In addition, we note that access to justice through the court system is still an expensive and time consuming undertaking. We have also looked at the various ADR schemes open to homebuyers and our findings can be found at Annexe H.

6.54 For these reasons and because of the financial and psychological importance of the home to the homebuyer, we consider that the homebuyer's current access to redress via the court system is unlikely to provide many homebuyers with effective protection.

Homebuilder's contractual documentation

Reservation agreements

6.55 A reservation agreement is usually the first formal document received by homebuyers. It is often presented as a necessary step towards the purchase of a new home. The reservation agreements we have looked at usually state that:

- the homebuilder will not sell to or negotiate the sale of the new home with a third party for a specified period²⁵⁵
- the homebuyer must pay a reservation fee which is either totally or partially non-refundable
- if the homebuilder and homebuyer do not exchange contracts for the sale of the new home within a specified period the homebuilder can sell to another homebuyer, and
- the agreement is 'subject to contract' or does not commit either party to enter into a legally binding contract for the sale and purchase of a new home.

6.56 Our central concern here is whether or not the prospective homebuyer clearly understands the nature of the bargain. A homebuyer would be mistaken if they believed that a reservation agreement:

- compelled the homebuilder to negotiate with the homebuyer alone
- amounted to a promise that the homebuilder will negotiate in good faith, and
- amounted to a promise to sell to the homebuyer if they are ready within the specified period to exchange contracts (which would amount to an option).²⁵⁶

6.57 In our view, agreements to that effect, especially those which seek to impose a duty to negotiate, may be in law unworkable, uncertain and unenforceable. This is because while the parties are in negotiation, either

²⁵⁵ It is a lock out agreement-we will not negotiate with third parties as opposed to a lock in agreement we will negotiate with you and you only.

²⁵⁶ An option to purchase land is usually a contractual arrangement by which a seller gives a prospective buyer a right to buy land within a particular time frame. See Millichamp Jones [1983] 1 ALLER 267. This contract may amount to a proprietary interest in the land which can be registered under section 2 of the Land Charges Act 1972. Section 2 lists the type of proprietary interests which can be registered as land charges.

of them would be entitled to break off negotiations at any time and for any reason.

6.58 It does not seem clear what the homebuyer receives in return for the reservation fee. Given this, and the circumstances in which the agreement is presented, reservation agreements may potentially be problematic under the Consumer Protection from Unfair Trading Regulations 2008.²⁵⁷ In these Regulations, it is an offence to engage in a commercial practice which deceives a consumer in the:

- presentation of a product, and
- leads to the provision of material information in a way that is unclear, ambiguous and fails to identify the supplier's true commercial intent, causing the consumer to take a 'transactional decision' he would not have taken otherwise.²⁵⁸

Excluding or restricting liability for oral statements

6.59 In most of the contracts of sale we have reviewed, a term is included which excludes or limits a homebuilder's liability for any oral statements made by the homebuilder's staff or their agents which may have caused a homebuyer to buy a new home. This excludes or limits the homebuilder's liability for oral misrepresentations (fraudulent or negligent). This too could be problematic under the Unfair Terms in Consumer Contract Regulations 1999 (UTCCRs). It may also be problematic under the Misrepresentation Act 1967²⁵⁹ (applying the requirement for reasonableness set out in the Unfair Contract Terms Act 1977).²⁶⁰ The reasons why this may be the case are:

²⁵⁷ S.I.2008/1277.

²⁵⁸ This amounts to a commercial practice which is a misleading action as defined in regulations 3 and 5 of the 2008 Regulations.

²⁵⁹ Section 3 of the Misrepresentation Act 1967.

²⁶⁰ Section 11(1) of the Unfair Contract Terms Act 1977.

- homebuilders may be substantial commercial enterprises with more knowledge of property law and business than homebuyers
- statements made by the homebuilder's sales people and agents are influential, and
- solicitors acting for homebuyers may limit their work on new home sales to undertaking basic title searches - they are unlikely to engage in an extensive review and negotiation of terms for their clients and this may increase a homebuyer's reliance on statements made by or on behalf of a homebuilder.

Homebuilder's right to vary design and construction

6.60 In the contracts of sale we examined there is usually a term which requires the homebuilder to complete the building works in words such as a 'good and workmanlike manner'. The homebuilder may also be required to carry out the works in accordance with, specifications, planning permissions, building regulations or warranty providers' standards.

6.61 In some contracts the homebuilder has the right to make such unilateral variations to design and construction as are 'reasonable'. This too may be problematic. The reasons for this are:

- the determination of what is reasonable in some of the contracts is solely within the discretion of the homebuilder, and
- because of the unilateral right to vary design, construction and so forth, a homebuilder can decide that something is reasonable because it satisfies its financial interests rather than those of the homebuyer.

Delays

6.62 In all the contracts for sale we have reviewed there is a term which requires a homebuilder to complete the building works within a reasonable time. The term lists events that can delay the building works

and states that a homebuilder's liability for delay is excluded or limited if any occur. Typical examples include:

- labour disputes or shortage
- late delivery of materials
- default of contractors, sub-contractors or suppliers
- weather conditions (for example fire, storm, tempest), and
- events 'beyond the (homebuilder's) reasonable control.'

6.63 Subject to the points made in the next paragraph the term may be problematic for the following reasons:

- there may be instances where the homebuilder is not able to prevent delay - however, it usually has some control in that it chooses contractors and suppliers on site, enters into contracts with them and as a result has access to remedies against them for breach of contract (for example, rescission, damages)
- there could be circumstances in which labour disputes or shortages are within a homebuilder's control
- the effect of the term is that the risk of delay shifts to the homebuyer. The burden is on the homebuyer to establish there has been unreasonable delay, even though they are unlikely to know the circumstances and risks at the outset
- the term provides for completion in a reasonable period of time, but does not give the homebuyer the means to bring the issue of delay to a head.

6.64 The OFT Guidance on unfair terms covers the points above.²⁶¹ It should be noted that it is not unfair to exclude or limit liability for: 'any cause beyond the reasonable control' of the homebuilder as long as that is really the case. This is reinforced by paragraph 2.6.5 of the OFT Guidance which states that clauses: 'excluding liability for delay may be acceptable where they are restricted in scope to delays unavoidably caused by factors beyond the supplier's control.'

State of the home on the completion date

6.65 Some contracts contain terms which compel the homebuyer to pay the full purchase price when there are substantial works (albeit sometimes external) outstanding. Examples include, erection of fences, surfacing of drives, turfing the front garden and roads, footpaths, drains and sewers.

6.66 There are also terms which state that the homebuilder is only obliged to carry out outstanding infrastructure or remedial works within a reasonable time (if at all). These terms may be problematic under the UTCCRs in that:

- a homebuilder's right to obtain full payment provides no incentive for it to complete outstanding work
- a homebuyer has the burden of proving there are outstanding works and there has been delay in completing them, and
- although there is sometimes a right to recover costs or charges for outstanding infrastructure works, there is no right for the homebuyer to retain sums if these works are outstanding, (for example, incomplete roads).

²⁶¹ For example, paragraph 18 of 'Unfair Contract Terms Guidance' September 2008 states that a contract may be considered imbalanced if it has a term which makes a consumer carry risks that a seller is better able to bear. Paragraph 18.2.3 states that the: 'supplier should not make the consumer his insurer.' Whilst paragraph 2.6.6 states that a right of cancellation without penalty where there is substantial delay makes terms on completion unfair.

Conclusion

- 6.67 On the whole, we did not find significant problems with the marketing of new homes through advertisements and show homes. However, some sales people were not as clear as they might be about the possibility of snags and faults and what quality assurance procedures were in place. Availability of contractual information in advance of payments appears to be poor.
- 6.68 Warranties generally appear to address problems with homebuilders becoming insolvent and with many serious defects but they do not cover all faults and they do not cover all matters comprised in the contract of sale.
- 6.69 Homebuyers have limited ability to withdraw from contracts and obtain refunds of reservation fees and deposits when there are unreasonable delays.
- 6.70 The existing legal and regulatory framework is complex and not conducive to inexpensive and swift redress for homebuyers. There are some issues relating to homebuilders contracts in terms of excluding or restricting liability for oral statements; homebuilders' rights to vary design and construction; delays; and the state of the home at completion.
- 6.71 In the next Chapter we propose remedies for the issues we have identified so far in this report.

7 REMEDIES

Consumer detriment remedies

- 7.1 We published much of our evidence and background reports in advance of this final report to allow our stakeholders to comment on, and contribute to, our findings. During the course of this study, the industry acknowledged the concerns that we raised around problems with the finishing, and faults with the functionality, of some new homes and aspects of the sales process.
- 7.2 The following organisations have said that they are now committed to the introduction of a code of conduct²⁶² which meets the consumer protection concerns raised in this report:
- Construction Employers Federation (NI)
 - Council of Mortgage Lenders
 - Federation of Master Builders
 - House Builders Association
 - Home Builders Federation
 - Homes for Scotland
 - LABC New Home Warranty
 - National House Building Council
 - Premier Guarantee
 - Retirement Housing Group (of The Home Builders Federation), and
 - Zurich Building Guarantee.

²⁶² This is the industry's own proposed self-regulatory code, and not an OFT Consumer Codes Approval Scheme one.

- 7.3 We very much welcome this initiative on behalf of the homebuilding industry. We have little doubt that an industry scheme, if successful, would deliver speedy – perhaps faster than the introduction of any additional regulation – and cost effective solutions to the concerns we have identified.
- 7.4 Letters of commitment received from the steering group set up by the industry, and individual letters from each organisation, can be found in Annexe M. The industry has agreed to endeavour to put in place a self regulatory system which will address the concerns raised in this report, including a code of conduct and an independent means by which homebuyers can obtain redress for any failings in the process of buying a new home.
- 7.5 While, of course, the purpose of self regulation in an industry is to allow the industry professionals to devise solutions, we have set out below the OFT's view of what success for the scheme might look like:
- Homebuilders or their sales teams (and/or estate agents²⁶³) provide accurate and fair information about the sale of a new home (for example, the standard of the home, the time it will take to construct it, planning permissions, specifications, building and environmental regulations and warranty cover etc)
 - Homebuilders do not exclude or limit liability for any oral or written statements which may cause a homebuyer to buy a new home (for example, statements made by their sales team and/or estate agents or in brochures)
 - Homebuilders or their sales team and/or estate agents provide all relevant pre contract information (for example, the reservation agreement and the contract of sale) to the homebuyer as soon as the homebuyer demonstrates a genuine interest in purchasing the new home and before payment of a reservation fee. Alternatively, it is

²⁶³ Throughout the inclusion of estate agents only covers the situation where estate agents are acting as agents and the homebuilders as principals.

made clear that the reservation fee is refundable (less a small and justifiable administration charge if necessary) if the homebuyer (or their legal representative) is unhappy with the contract of sale

- Homebuyers are given a reasonable period to look at the pre contract information supplied and if they choose to consult a lawyer and negotiate terms (for example regarding the reservation agreement and contract of sale) they can do so before parting with any money unless the reservation fee is refundable (less a small and justifiable administration charge if necessary)
- Homebuilders and their sales teams and/or estate agent provide accurate information as to the true legal status of the reservation agreement. The homebuyer clearly understands whether or not the reservation agreement prevents the homebuilder from selling the new home to another homebuyer
- Homebuilders ensure that the reservation agreement clearly allows the homebuyer to obtain a refund of their reservation fee if the sale does not go ahead, subject to the homebuilder's right to deduct a reasonable administrative fee that reflects the true cost of providing the reservation agreement. The refund should be available on the day the reservation period expires or within say 7-14 days after that date
- Homebuilders and their sales teams and/or estate agent provide accurate information as to the contents of the contract
- Homebuilders ensure that the homebuyer is provided with accurate and full information about any maintenance fees
- There is: (a) rectification of problems notified to the homebuilder by a homebuyer within a reasonable time, but without causing significant inconvenience to the homebuyer, and (b) if those problems are not resolved the homebuyer has a right to obtain compensation for out of pocket expenses, distress, inconvenience and loss of facility
- Where there is unreasonable delay in the completion of the construction of a new home it is made clear to the homebuyer that

they can issue a 'completion' notice: (a) requiring the homebuilder to complete the works within specified time; and (b) giving the homebuyer the right to cancel and claim damages and interest if the notice is not complied with

- Homebuilders have reviewed the contents of their reservation agreements and contracts of sale to ensure compliance with all relevant consumer protection legislation, including the Unfair Terms in Consumer Contract Regulations 1999, and
- An independent, fair, effective and efficient dispute resolution system is put in place for homebuyer complaints in relation to new homes – covering the whole process of buying a new home and all items included in the price of the home.

7.6 Four years ago the Barker review called on the industry to develop a code of conduct and seek OFT approval for that code. Part of the driver for this report was the absence of any code resulting from the Barker review. So, despite welcoming and supporting the efforts of the industry, it is still appropriate for us to make a recommendation that should be activated automatically in the event that the industry fails to meet any one of four agreed milestones on the way to its proposed deadline of a fully operational code of conduct by March 2010.

7.7 These milestones are:

- **December 2008:** create the body which will administer the code of conduct
- **March 2009:** finalise and consult upon the detailed content of the code of conduct (and associated contract terms issues) and dispute resolution scheme(s)
- **September 2009:** have in place the necessary administrative arrangements to support the code of conduct and dispute resolution scheme(s), and

- **March 2010:** system test and refine the various processes and provide communication and advice to the industry and other interested parties and formally launch the code of conduct.

7.8 The industry has also committed to fully demonstrating the effectiveness of the code of conduct and dispute resolution scheme(s) by providing six monthly reports on complaint data and monitoring of the operations and annual reports which include homebuilder and homebuyer surveys and mystery shopping exercises. The OFT will, of course, stay in close contact with the industry to assist in the monitoring of the milestones and demonstration of effectiveness.

A statutory redress scheme

7.9 Annexe H describes the existing patchwork of ADR schemes associated with construction and homebuying in the UK. Schemes which cover parts of the process of buying a new home include: The Ombudsman for Estate Agents (OEA), The Surveyors Ombudsman Service (SOS), The Independent Property Codes Adjudication Scheme (IPCAS) and the Financial Ombudsman Service. SOS and IPCAS are schemes which relate to Home Information Packs (HIPs) and surveying services, and HIPs-related services and services undertaken as part of the property purchasing process respectively and therefore, at present²⁶⁴, do not address the heart of the concerns raised in this report. The OEA covers estate agents and therefore, to a limited extent may provide redress for new homebuyers where the complaint pertains to an estate agent who was a member of the OEA scheme. However, 80 per cent²⁶⁵ of new homebuyers buy directly from homebuilders and therefore many homebuyers of new homes will not fall within its jurisdiction.

7.10 The financial ombudsman is brought into the new homebuying arena due to the existing system of warranty provision – to the extent that the

²⁶⁴ CLG is considering extending the mandatory requirements for information provision in HIPs which may address some of our concerns.

²⁶⁵ Annexe B: Consumer survey.

warranty is an insurance product the resolution of complaints about the warranty provider falls within the financial ombudsman's jurisdiction.

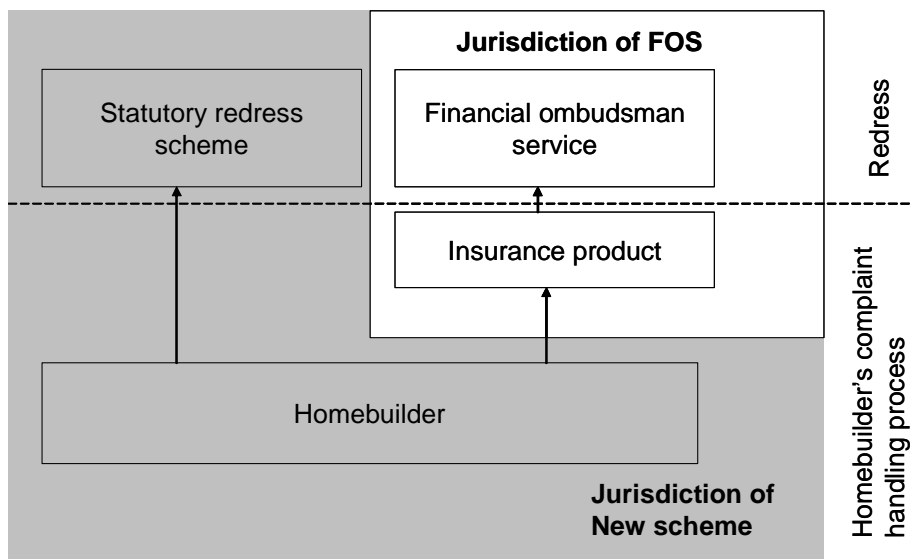
- 7.11 Some commentators²⁶⁶ have recommended or are discussing the concept of grouping all property related disputes under one redress structure. That may be difficult to do with new homes. Currently, most new homes are covered by warranties which, insofar as they are contracts for insurance, fall within the remit of the FSA and the jurisdiction of the financial ombudsman. It may not be practicable for new homes to fall within a single redress structure for all property related matters, without addressing either the role warranties play or the position of the financial ombudsman's compulsory jurisdiction.
- 7.12 Despite the partial coverage of some existing schemes and the limited access to the financial ombudsman, there is no scheme which directly and comprehensively covers failings by the homebuilder – in the event that the industry fails in its efforts to bring about change, we recommend the introduction of such a scheme.
- 7.13 If we reach the point where it is necessary to recommend that a statutory redress scheme is introduced this will, unfortunately, mean that the industry scheme has been unsuccessful. If this were to happen, we would recommend a single statutory scheme to which all homebuilders are obliged to belong, set up independently of the industry, and funded by a levy on the industry.
- 7.14 The central objective of the recommendation is that the introduction of a mechanism, via which homebuyers have a means of redress directly against the homebuilder, should be a force for change in the industry. This means that the scheme should have real weight and the ability to award redress and compensation for any failings in the sales process, shortcomings in contracts, delays or faults. To help offset the asymmetry of information between the homebuyer and the homebuilder,

²⁶⁶ For instance see recommendation 17 of The Carsberg Review of Residential Property www.rics.org/NR/rdonlyres/C65D9E57-4587-450D-8A3E99706A2B33DB/0/CarsbergReviewofResidentialProperty.pdf

which leads to the inability of the prospective homebuyer to choose the highest quality homebuilder, the results of the redress scheme - in terms of the number and outcomes of complaints made against individual homebuilders - should be made public.

7.15 As described in earlier sections, there is already a system of warranties in place in the homebuilding industry. We have concluded that, on the whole, although limited, the warranty system generally works adequately. We imagine that, if a single statutory redress scheme were in place covering the whole of the sales process for a new home, the existing system of warranties would become, effectively, part of the homebuilder's complaint resolution system. This prospect raises the potential complication of the interaction with complaints which currently progress to the financial ombudsman. This potential complication is described in the figure below.

Figure: 7.1



FOS = Financial Ombudsman Service.

7.16 We note that if the industry chooses to implement the voluntary dispute resolution scheme, covering all the aspects under the contract of sale which currently fall outside the warranty system, by a mechanism of insurance then – providing this is provided or sold to the homebuyer as an insurance product – complaints about the outcome and handling of

matters under the voluntary scheme are likely to fall within the financial ombudsman's jurisdiction. We believe this would be a good outcome for homebuyers.

- 7.17 It is not our intention, in making this recommendation, to displace the current system of warranty provision. As we explain above, we imagine that there is a role within the framework of a single statutory redress scheme which includes the existing system of warranties. How the statutory scheme achieves this would be a matter for consultation and discussion during the establishment of such a scheme. We note, however, that Figure 7.1, in addition to displaying a potential complication, suggests a potential straightforward solution which is, if it were possible, to bring the homebuilding industry within the jurisdiction of the financial ombudsman. The financial ombudsman's remit is set by the Financial Services and Markets Act 2000 and the Consumer Credit Act 2006 and an extension of its jurisdiction may not be particularly straightforward or even desirable. Nevertheless, we raise this potential solution which may avoid some complications with the existing system of warranty provision and the jurisdiction of a new comprehensive scheme.
- 7.18 If it is decided that the financial ombudsman is not the appropriate jurisdiction in which to house a statutory redress mechanism then we recommend that Government introduces new primary legislation to bring about the recommendation of a statutory redress scheme.
- 7.19 We have outlined the complexity of the law surrounding the purchase of a new home. Given this complexity, and the desirability of homebuyers being able to understand their rights and actively seek redress when things go wrong, it appears to us that it would be desirable for the scheme to operate on a less formal basis than a strict application of the law. We recommend a more straightforward application of a test, having regard to relevant statutes, regulations and the common law, of a fair outcome for the homebuyer.
- 7.20 Given the potential sums involved in purchasing a new home, we recommend the statutory redress scheme should have an appropriately high limit placed on any awards it is able to make. As with all redress

schemes, timescales, definitions of jurisdiction, governance, processes and procedures, promotion to homebuyers and ease of access should be the subject of full consultation before such a scheme is established.

Further recommendations

- 7.21 Our analysis of competition within the industry identified a number of potential difficulties for the industry which may hinder output in the future and thereby the Government's target of building 240,000 new homes a year by 2016.
- 7.22 In this regard, we have four specific recommendations to make that may alleviate some of these difficulties.

New technology and zero carbon

- 7.23 As we discussed in Chapter 4 the challenges of the zero carbon agenda in England and any instruments that may be introduced by the devolved administrations puts a significant burden on the homebuilding industry and its suppliers. That burden falls especially heavily on smaller homebuilders and self builders who have fewer resources to dedicate to the necessary research and development and less management time to devote to bodies such as the Zero Carbon Hub.
- 7.24 Smaller homebuilders and self builders are an extremely important source of supply of new homes. They account for some 32 per cent of overall homebuilding (see Chart 3.2) and typically work with smaller sites that are not efficient for larger homebuilders. Retaining smaller homebuilders and self builders in the industry is therefore likely to support the Government's overall targets.
- 7.25 To that extent, we recommend that CLG and the Welsh Assembly Government ensure that they fully consider the needs of smaller homebuilders and self builders and that appropriate measures are put in place to ensure that smaller homebuilders and self builders have access to the necessary technologies to deliver zero carbon.
- 7.26 We recognise that CLG have already taken the first steps towards this goal. The establishment of the Zero Carbon Hub and the pump priming

funding that CLG has contributed will play an important role in assisting the industry in delivering zero carbon in England.

Community Infrastructure Levy

- 7.27 To provide further support to smaller homebuilders and self builders we recommend that for small developments (perhaps between one and five homes) that the CIL only become payable once a home is completed. This will ease the up front cash requirement which is often a constraint on self builders in particular who cannot release their full mortgage until after construction is complete. Delaying CIL payments (should they apply to self build) until the end of construction will reduce the risk for the self builder and help to promote output through this much overlooked element of new homebuilding.
- 7.28 Similarly, the smallest homebuilders working with the smallest plots (and hence the ones least likely to be utilised by larger homebuilders) will be assisted by delaying the payment of CIL until construction of a home is finished.

Enabled self building

- 7.29 As we have discussed above, we estimate that self building (in all its forms) accounts for approximately 16,000 new homes every year (see Annexe R for the analysis underlying this estimate). While this accounts for approximately 10 per cent of new home output across the housing cycle in the UK, it falls well below the levels of self building seen in France, Germany or Japan.
- 7.30 Self building can also make homes more affordable. Much self building is about reducing costs rather than designing dream homes and, by removing the need for a homebuilder's margin, many self builders can save up to a third of the price of a similar home on the open market.
- 7.31 There are, however, significant knowledge barriers to self building. Even the more 'hands-off' forms of self building can be daunting. Enabled self building can make self building more accessible by providing 'oven-ready' plots with infrastructure and planning permissions to be developed under the guidance of a project/site manager.

7.32 We recommend that local authorities consider whether land within their land portfolio which is suitable for development could be used for enabled self building to deliver more affordable housing within their communities.

8 THE FUTURE OF THE HOMEBUILDING INDUSTRY

Industry concentration

- 8.1 Since the Second World War concentration in the industry has steadily increased, especially among the top homebuilders. At the beginning of the 1960s the top 10 homebuilders were producing about eight to nine per cent²⁶⁷ of total industry output; by 2006 this had risen to 44 per cent.²⁶⁸
- 8.2 The increase in industry concentration has occurred as a result of the cyclical nature of the housing market. Market conditions during both a downturn and an upturn encourage increased concentration.
- 8.3 In a downturn, some homebuilders fail which means there are fewer homebuilders left in the market. When the market starts to expand again output eventually returns to a similar level, however, concentration is higher because there are fewer homebuilders.
- 8.4 During an upturn there are a number of constraints that effect whether a homebuilder can expand output. For fast growing homebuilders, one of the most acute constraints is the rate at which they can access a sufficient number of different sites with the appropriate planning permission. As explained in Chapter 5, taking land through the planning system can take many years, so rapidly expanding homebuilders will often merge with other homebuilders to gain access to a greater range of sites.
- 8.5 Acquisition of a greater number of sites becomes a critical part of these fast growing homebuilders' expansion strategies. It is far easier to sell 100 homes a year from four different sites (because of the absorption rates on each site) than it is to sell 100 homes from a single site. Consequently, for a homebuilder looking to grow rapidly the key is to

²⁶⁷ Paragraph 1, p66, Wellings, F, 2006, *British Housebuilders, History & Analysis*.

²⁶⁸ Housing Market Intelligence Report 2007 and CLG live table 211.

acquire more sites rather than expand production on the sites that it already has. This imperative drives many of the mergers and takeovers.

- 8.6 We reviewed six OFT decisions made between 2001 and 2007²⁶⁹ regarding mergers between homebuilders, all of which were approved. In most cases access to landbanks were cited as part of the rationale for the mergers. This is consistent with Professor Ball's analysis of homebuilders' strategies.²⁷⁰
- 8.7 This increased merger activity leads to increased concentration, in particular among larger homebuilders. It appears that most firms who leave the top 10 do so because they are taken over so they become part of a new, even larger, homebuilder.
- 8.8 Anecdotally, the current downturn has caused some smaller homebuilders to leave the market, although in practice this may just be a temporary switch to renovation work.
- 8.9 Because concentration increases throughout the whole housing cycle, we think the trend for rising concentration will continue for the foreseeable future. In the immediate future, small increments to industry concentration or the share of supply accounted for by the largest firms are unlikely to give rise to serious competition concerns. Nevertheless, the overall trend should be kept under review. The OFT is well placed to do so through the exercise of its first stage merger control powers.

²⁶⁹ The mergers reviewed were: acquisition by Persimmon plc of Beazer Group plc, March 2001, acquisition by George Wimpey plc of Laing Homes plc, November 2002, acquisition by Taylor Woodrow plc of Wilson Connolly Holdings plc, October 2003, acquisition by Persimmon plc of Westbury plc, December 2005, acquisition by Barratt Developments plc of Wilson Bowden plc, April 2007 and acquisition by Taylor Woodrow plc of George Wimpey plc, May 2007.

²⁷⁰ Ball, Michael, *Firm Size and Competition: A Comparison of the Housebuilding Industries in Australia, the UK and the USA*, Reading University Business School Department of Real Estate and Planning Working Paper 02/07, April 2007. Also Ball, Michael, *Markets and Institutions in Real Estate and Construction*, Blackwell Publishing, 2006.

Regulation

- 8.10 At present only the energy efficiency targets within the Code for Sustainable Homes²⁷¹ (see Annexe I) are mandatory and they apply only to England. By 2016 all new homes built in England will be required to meet a zero carbon standard. However, both Wales and Scotland are considering policy initiatives which would significantly increase the mandatory energy efficiency standard required of all new homes.
- 8.11 The Welsh Assembly is consulting on introducing a policy which would move towards a zero carbon standard and, possibly, target an earlier introduction date than 2016.²⁷²
- 8.12 The Scottish Government is set to review its building regulations in 2010. It is widely expected that this review will be used to introduce a higher energy efficiency target although it is unlikely that this will be a zero carbon standard.
- 8.13 As discussed in Chapter 4 regulatory barriers to entry are currently reasonably low but we think the mandatory elements of the higher levels of the Code for Sustainable Homes and any similar intervention by the devolved administrations will create higher barriers to entry in the future, in particular for smaller homebuilders.
- 8.14 Evidence suggests that the technology that allows homebuilders to achieve Code Level 6 homes in 2016 will be available.²⁷³ It is not clear, however, whether these products will be well tested and understood. Homebuilders of a variety of sizes told us of their concerns about the

²⁷¹ We understand that technically this is a standard.

²⁷² See the consultation document at:
<http://new.wales.gov.uk/consultations/currentconsultation/plancurrcons/climatechangeconsult/?lang=en>

²⁷³ CLG, 2008, *Code Analysis of the Code for Sustainable Homes, final report*, report prepared by Cyril Sweett. Available at:
www.communities.gov.uk/documents/planningandbuilding/pdf/codecostanalysis.pdf

performance of this new technology. Nevertheless, the prevailing view is that the higher levels of energy efficiency can be achieved but that there may be significant initial problems.

- 8.15 New technology poses challenges for homebuilders as they use unfamiliar products and construction techniques. New technologies, however good, if installed poorly can lead to significant consumer detriment and dissatisfaction. It is not unreasonable to expect that there will be some problems in the initial stages which will lead to increased consumer detriment. There are historical examples of beneficial technologies creating significant problems when installed incorrectly.²⁷⁴
- 8.16 There is also the prospect that many of the technologies required to achieve the zero carbon standard will not be available 'off the shelf'. The new Code is of particular concern for smaller homebuilders who do not have the resources to carry out extensive research and development and so will be reliant on off the shelf solutions.²⁷⁵ Those already in the industry may be unable or unwilling to comply with the regulations and so leave the sector altogether. If these new technologies are brought forward by the larger homebuilders either individually or in clubs pooling their research and development resources there is a real risk that smaller homebuilders will be excluded from the industry by lack of access to vital technologies.
- 8.17 In our view, the Zero Carbon delivery hub²⁷⁶ is a crucial step in the right direction. There are efficiencies to be had from homebuilders and suppliers co-ordinating their research and development response to the zero carbon target. However, it is of vital importance that the Zero

²⁷⁴ For example double glazing and solar panels.

²⁷⁵ Some smaller homebuilders are speaking out in the strongest terms about the general burden of regulation and the Code for Sustainable Homes is part of that burden. For instance see Professor Benfield's comments at:
www.benfieldatt.co.uk/media_centre/press_releases/regulate_finance_not_house_builders_02_03_07

²⁷⁶ For further details of the Zero Carbon delivery hub see: zerocarbonhub.org/index.html

Carbon Delivery Hub improves access to new technologies for all homebuilders, including the smaller homebuilders.

- 8.18 Retaining smaller homebuilders in the industry is important both in terms of output and competition. A homebuilding industry that contains smaller as well as larger homebuilders can make more efficient use of land development opportunities as smaller plots can often not be efficiently developed by larger homebuilders (see paragraph 4.71). Moreover, the smallest homebuilders account for a large proportion of output, 23 per cent of total industry output (see Chart 3.2).
- 8.19 In March 2008 the Government launched 'The Future of Building Control'²⁷⁷ consultation. One of the proposals in the consultation was the introduction of a periodic review of building regulations every three years instead of the current ad-hoc manner. This should help reduce homebuilders' uncertainty about what future regulations might involve and cost and as such has been broadly welcomed by the industry.

Output and skilled labour

- 8.20 Most homebuilders use mainly sub-contracted labour to help mitigate the risks posed by the cyclical housing market. When there is a downturn, as is currently the case, this sub-contracted labour may find work on renovation projects or it may leave the industry all together. Anecdotally, we were told by homebuilders that when the market picks up again, not all the labour force will return to the market because they will have found jobs elsewhere. This was especially considered to be true of internationally mobile migrant labour on which the UK industry had become increasingly dependent.
- 8.21 There is also the possibility that the downturn in the housing market due to the liquidity crisis and the slowdown in the economy more generally will lead to a historically low level of homebuilding through the second half of 2008 and 2009. There are indicators that, once the market picks

²⁷⁷ www.communities.gov.uk/publications/planningandbuilding/future

up again, the industry will take a long time to build up the capacity it has lost.

- 8.22 The story of output since the housing market crash of the early 1990s is an instructive one. Between early 1995 and 2007 house prices rose consistently. Despite this homebuilding output stayed largely flat until 2004 before increasing quite markedly. In our interviews with homebuilders they consistently told us that the main reason for this was a series of constraints on their ability to expand output in response to an upturn in market conditions.
- 8.23 Principally, these constraints were: delays in obtaining planning permissions; a lack of suitable skilled labour and, in particular, a lack of experienced site managers. Most of the homebuilders we spoke to put the shortage of skills during the late 1990s and early 2000s down to the crash of the early 1990s. In effect, the large reduction in capacity in the industry in response to the downturn in market conditions forced a lot of skilled labour away from the industry. When market conditions improved that labour did not necessarily return even as construction wages increased significantly in real terms.
- 8.24 This raises the possibility that, when the UK homebuilding sector emerges from its current depressed state, the industry may struggle to expand capacity. In addition, it seems probable that, in the future, any skills shortages may be more severe than those seen during the last decade because even experienced members of the workforce will not have sufficient experience of the new technologies. One prominent report produced for the Federation of Master Builders has noted that:

'The skill sets of traditionally defined tradespeople (for example plasterers, electricians, etc) will need to be expanded so that they understand enough of the low carbon refurbishment agenda to play their part effectively.'²⁷⁸

²⁷⁸ P.25. Killip, Gavin. Building a Greener Britain, A report for the Federation of Master Builders, 2008.

8.25 Both the Barker review and the Callcutt review covered in extensive detail the problems associated with a weak output response to house price inflation and the readiness of the industry to deliver the Government's targets respectively. They also made extensive recommendations as to how particular problems might be addressed.

Customer satisfaction

8.26 There are two factors which may have a detrimental impact on customer satisfaction in the future: the current industry downturn and the introduction of new technology.

8.27 The current downturn in the new homebuilding industry is particularly severe. Some of the largest homebuilders have been forced to refinance in order to avoid breaching their banking covenants.²⁷⁹ Homebuilding output seems certain to fall to historically low levels.

8.28 In such difficult conditions, the pressures to cut corners on costs are more acute than ever.²⁸⁰ This could lead to build quality and customer service being compromised with a consequent reduction in customer satisfaction and increase in consumer detriment.

8.29 A lack of skills and new regulation may make it difficult to maintain quality even for those homebuilders not trying to cut corners. The difficulties with general skill shortages have been set out above but it is important to emphasise the link between skilled labour and customer satisfaction and consumer detriment.

8.30 Many of the homebuilders we spoke to told us that they were actively pursuing better customer satisfaction largely through a better skilled

²⁷⁹ See for example the recent trading statement of the UK's largest homebuilder at: www.taylorwimpey.com/main/cms/includes/asp/cmFileGetFile.asp?fi=4197

²⁸⁰ See for example the comments of John Callcutt at: www.building.co.uk/story.asp?sectioncode=555&storycode=3120411&c=2

workforce. This was typically a combination of improved building skills and improved customer service skills. The risk for the future is that a prolonged downturn in homebuilding activity and the dramatic reduction in capacity in the industry will combine to undo the good work that has been begun by forcing skilled labour out of the industry.

- 8.31 It is our view that the downturn in the homebuilding industry, skills shortages and the introduction of new technologies pose a significant risk to improving customer satisfaction standards in the industry. This further underpins our view that an industry redress scheme will be a vital element in consumer protection in this industry in the future.

Conclusion

- 8.32 As outlined above we expect the levels of concentration to increase among the larger homebuilders, although it is unclear what, if any, effect that would have on homebuyers. In theory it means they will have less choice between new homes built by different homebuilders but as outlined in Chapter 4 the existing housing stock is considered by most homebuyers (and the OFT) to be a substitute for new homes so it is unlikely homebuyer satisfaction will fall as a result of increased concentration. We will continue to keep the situation under review through exercise of our first stage merger control powers.
- 8.33 Similarly the overall effect that new regulation will have on homebuyer satisfaction could be significant. It is likely that if not trialled adequately and installed by sufficiently skilled labour new technology will create some initial problems as both homebuilders and homebuyers learn how to use it correctly.
- 8.34 Any future skills shortage is likely to have a negative effect on both homebuyer satisfaction and homebuilding output. Skills shortages could cause new homes to be of lower quality and possibly also increase the delays experienced by homebuyers.
- 8.35 The short term effects of the credit crisis and the economic slowdown in the UK economy more generally seem very likely to be translated into muted output in the homebuilding industry because of the difficulties the industry has in expanding output following a downturn. In particular, the

industry will need to achieve unusually high levels of year on year growth to meet the Government's delivery target of 240,000 new homes a year by 2016.²⁸¹

- 8.36 Customer satisfaction is likely to be affected in future by both the short term pressures of the economic slowdown but also the medium and long term pressures of the higher technical requirements for new homes. Shortages of skilled labour and potential difficulties with the introduction of new technologies will all need to be carefully managed if they are not to have a negative effect on homebuilding output, customer satisfaction and consumer detriment.

²⁸¹ The NHPAU has recently published its test ranges for housing supply towards the 2016 target. See: www.communities.gov.uk/nhpau/newsroom/housingsupplyrange/