

BRIEFING



OFT Market Study: Homebuilding in the UK

25 Sept 2008

The study, announced in June 2007, was launched to look at the state of competition and the effectiveness of consumer protection in the UK homebuilding industry. The main report of 177 pages begins with a 7 page Executive Summary [please click here to view](#). In addition there is a large number of annexes.

The study drew evidence from: written submissions; discussions with stakeholders; face-to-face interviews with 1052 new build homeowners; 615 mystery shopping visits; questionnaires to 7,000 homebuilders and more detailed questionnaires to the top 10 companies; a KPMG study of financing issues; 14 case studies; reviews of the legal framework, alternative dispute resolution, regulation and the homebuying process; an academic report on warranties; a comparison of consumer satisfaction surveys; consultation with stakeholders on the provisional findings.

The report is valuable for a number of reasons: a remarkably clear-cut clean bill of health in most areas; a source of information about homebuilding and the industry; demolition of several persistent myths about the industry; recommendations to guide the industry as it sets up a code of conduct; recommendations to government, most notably on the impact of regulation.

KEY FINDINGS

Competition: no significant problem with high levels of market concentration at national or local level; the only major barriers to entry and expansion are regulation, especially the Code for Sustainable Homes; vertical integration is not a competition issue, indeed it is an efficient response to the complexities of planning.

Government: give additional support to smaller house builders to cope with zero-carbon challenge; ensure regulatory intervention does not increase regulatory barriers to entry and expansion; should release more public land for housing development; should take account of regulatory burden on land values and supply.

Competition and Customers: buyers unable to choose between homebuilders on the basis of customer service, finishing quality and functional performance; faults are widespread (70% of buyers), but most are finishing or functional, not structural, and are fixed quickly; but a

minority result in significant consumer detriment; customer satisfaction with product quality the same or higher than some other products, but lower for quality of service; consumer detriment for faults and delays valued at £206m against an industry turnover of £45bn.

Land: public sector accounts for one quarter to one third of potential residential development land; planning is a constraint on land supply; regulatory burdens depress land values and risks landowners not selling; land supply raises no competition issues; landbanks are a response to planning times; no evidence of hoarding developable land at national or local levels or delaying building; no evidence of developers obtaining market power at local level through planning permissions.

Consumer Protection: homebuilders may not compete sufficiently on quality and customer service; lack of customer information on reservations fees, deposits, cancellations rights and contractual documents; OFT concerned about widespread contract limits on developer liability for late completion; other concerns are liability for oral statements, homebuilder's right to vary design and construction, delays, state of home at completion; OFT welcomes industry-led efforts to establish code of conduct, but will impose a statutory redress scheme paid for by an industry levy if the code is not fully operational by March 2010.

The Future: the market downturn and technology requirements of zero-carbon raise OFT concerns about the industry's ability to raise output in the recovery and about risks to customer satisfaction standards

SUMMARY AND QUOTES

Because the study coincided with the credit crunch and market downturn, the OFT "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".

- **Competition in the Homebuilding Industry**

From a competition perspective, housing markets must be analysed at the level of local markets, it is not meaningful to consider markets as subdivided by size of homes, and new homes are in the same market as existing homes so that there is a high level of price competition exerted by second-hand homes over new homes. Even where a single homebuilder supplies a significant proportion of new homes in a local market the ability to influence prices will be limited. Build-out rates are determined by local market absorption rates, not by the technical speed at which homes can be built.

Even if new homes are considered as a separate market from the market for existing homes, "there appears to be little evidence of any problems with competition in local markets".

Even if a homebuilder wishes to sell homes more quickly by reducing prices, “this is not usually a profitable strategy, in the sense that faster sales and hence lower interest costs do not offset the reduction in prices”.

Nationally, “concentration in the industry is low by comparison with that in many other consumer goods manufacturing industries”.

Even in local markets where a single homebuilder has a high market share because of ownership of a single large site, this is almost always temporary and is only “as a result of the planning system”.

So the evidence “does not indicate that the homebuilding industry has a significant problem with high levels of market concentration on either a local or national level”. “We found no local monopolies.” Although there has been increasing concentration at the national level, “we do not consider that this amounts to a competition problem”.

“There is a high level of entry into and expansion within the homebuilding industry.” It is also “comparatively easy to break into the top tier of firms”. “It appears to us that the land barriers to expansion may be more significant than the land barriers to entry.” “On balance, however, we do not consider that the land barriers to expansion are themselves a significant competition problem.”

“It is our view that access to finance is a limiting factor to entry but it is a more significant limiting factor to expansion.”

“entry barriers for larger foreign firms attempting to enter [the UK market] on a larger scale appear to be significant”. “Overall, there has not been a widespread movement by commercial developers into homebuilding”, although some experiments “may start a trend for increased activity in residential developments by commercial developers”.

“There are a number of regulations that may present significant barriers to entry into the homebuilding industry. In particular, the Code for Sustainable Homes has been repeatedly brought to our attention by homebuilders as a serious barrier.” “Many homebuilders currently consider that it is technically impossible to achieve Code Level 5 or 6...Other homebuilders take the view that while Code Levels 5 and 6 may be technically feasible they cannot be made commercially viable.”

“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.” “To this extent we recommend that Government and the Welsh Assembly Government should consider the need to actively assist small homebuilders and individuals building their own homes to overcome the zero carbon challenge”.

“After considering the matter, we do not consider that landbanking presents a significant strategic barrier to entry”. “Overall we consider that there are no significant strategic barriers within the homebuilding industry.” Looking forward, “it is regulatory barriers that are likely to present the highest barriers to new entrants and incumbent homebuilders looking to expand”.

“We think it is unrealistic to expect entry by overseas firms to deliver much in the way of innovation, output or customer improvements in the speculative homebuilding industry in the coming years.”

“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.”

“Given the complexities of the UK’s planning system it seems likely that vertical integration allows more land to be brought through the planning process than otherwise. It is our view that vertical integration...has not led to significant competition problems, 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.”

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

“warranties do not cover all aspects of the build quality of a new home and none of the aspects of customer service”.

“the majority of quality problems reported [by homebuyers] were either finishing or functional ones as opposed to structural or related to infrastructure or the environment around the home” [contrary to evidence submitted by CABE]. “Most new homes will have some faults and many of these faults will be fixed quite quickly. Nevertheless 70 per cent [of buyers] had a problem.”

“In our consumer survey, 30 per cent of respondents said they did not experience any faults or problems. Forty-four per cent said they experienced between one and ten faults and 26 per cent said they experienced more than 10 faults.”

Of homebuyers who reported faults or problems to their builder and had all their problems resolved, 83% said they were all resolved to their satisfaction. However the survey evidence “indicates that for many homebuyers it takes a significant amount of time to have all defects fixed”.

From the 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 respectively.” “The level of homebuyer satisfaction with the quality of service after moving in to their homes was at 75%”.

“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.”

The OFT estimated that the value of the detriment to UK homebuyers from faults was £174m per year. “Although some homebuyers will experience a disproportionately large amount of detriment, the overall figure, when compared with the number of new homes build and the turnover of the homebuilding industry [estimated by the OFT as £45bn] is relatively small. It remains, however, not insignificant in absolute terms.”

In addition, the OFT estimated the cost of consumer detriment from move-in delays at £33m per year.

- **Land Supply and Landbanking**

The three databases examined by the OFT “suggests that the public sector accounts for between a quarter and a third of all land currently deemed suitable for residential development.”

“it is out view that, on balance, the evidence suggest that the planning regime has acted as a constraint on land supply especially during an upturn in the housing market”.

“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.”

“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...The planning regime, however, may have acted as a constraint on that market [land], preventing it from delivering an increased amount of land to homebuilders.” On land banks: “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.” “The size of landbanks therefore appears to be consistent with the time taken to achieve detailed planning consent and agree reserved matters.”

“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.” “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.” “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...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.”

“When looked at as a whole the private market for the supply of land with residential planning permission appears to work as expected.”

- **Consumer Protection**

“homebuilders may not compete as fiercely as they might on some aspects of quality and customer service”.

“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”.

On show homes: “There were very few cases where the new home differed greatly from the respondents’ expectations.”

“Generally homebuyers and mystery shoppers said that they did not experience a ‘hard sell’”.

“We did not find any evidence which prompts concerns about widespread misrepresentation in marketing material or widespread pressure selling”.

“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.” “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 reservations fees, deposits, cancellation rights and so fourth and provide copies of key contractual documents.”

“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. Even where delays are unreasonably long, homebuyers are usually unable to withdraw from the contracts with the homebuilders without penalty or loss of money.” The report talks further about “a reasonable period” of delay, and “significant delays”.

“while not perfect, warranty provision in the UK is relatively robust”.

One key concern is “whether or not the prospective homebuyer clearly understands the nature of the bargain” when they pay a reservations fee, such that reservations agreements may be problematic under the Consumer Protection and Unfair Trading Regulations 2008”.

Other related issues of concern to the OFT were liability for oral statements, the homebuilder’s right to vary design and construction, delays and the state of the home on completion.

- **Remedies**

On the industry’s proposals to introduce a code of conduct, “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...and cost effective solutions to the concerns we have identified”. In the event that the industry fails to meet one of four milestones towards setting up a fully operational code by March 2010, the OFT “would recommend a statutory redress scheme to which all homebuilders would be obliged to belong, set up independently of the industry, and funded by a levy on the industry”.

- **The Future**

The OFT’s analysis of competition “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”. These include the zero-carbon agenda, described as “a significant burden”, especially in relation to smaller companies, and the impact on small developers of the requirement to pay the Community Infrastructure Levy (CIL) at the start of building.

Capacity lost in the downturn will act as a supply constraint when the market starts to rise again.

“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.”

John Stewart
Director of
Economic Affairs