

# putting new houses in order

**NCC's submission to the OFT market study into housebuilding in the  
UK**

August 2007

#### **About the National Consumer Council**

**The National Consumer Council (NCC) makes a practical difference to the lives of consumers around the UK.**

**With changes in provision of services by government and companies, there is apparently more choice, and more talk about meeting consumers' needs. Yet, the rhetoric does not always match people's experience: markets can operate in ways that act against consumer interests; and consumers who are disadvantaged or inarticulate can be ignored.**

**The NCC uses its insight into consumer needs to advocate change. We conduct rigorous research and policy analysis to investigate key consumer issues, and use this to influence organisations and people that make change happen. We don't just respond to policy discussions, but shape future debate through our groundbreaking thinking.**

**An open and collaborative organisation, we seek to work with public service providers, businesses and regulators. We hold regular policy forums which provide us with a unique opportunity to exchange views and test our thinking.**

**Our relationship with the Department of Trade and Industry – our main funder – gives us a strong connection within government. But we are ready to challenge any organisation, public or private, that does not give consumers a fair deal.**

**We have linked organisations in Scotland and Wales, and a close relationship with colleagues in Northern Ireland. We play a leading role within European and worldwide consumer groups, ensuring that cross-border consumer issues are tackled and the consumer voice is heard within global institutions.**

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# Summary of key messages for the OFT

Two current specific NCC objectives are to make markets work for consumers and to ensure disadvantaged and vulnerable consumers get a fair deal. This submission focuses on the approach we believe the OFT should take to make the housebuilding market work better for consumers.

- Competition amongst housebuilders is concentrated in the early stages of the process, when securing land available for development. Once the land has been secured competitive pressures are reduced and consumers are unable to exert influence on business practices.
- Where land is in relatively scarce supply, the absence of competition in terms of product quality, innovative design features or customer service puts developers in a position to “sell anything”. Constraints in terms of location and time when choosing a new home, further weakens the consumers’ bargaining position.
- The imbalance between supply and demand creates conditions in which rational behaviour by housebuilders creates consumer detriment that would not occur if the market operated efficiently. Controlling production rates is one example.
- Statutory protection should be introduced, similar in principle to the Sale of Goods Act. A fully independent redress scheme also should be introduced for buyers, enabling access to redress for a wider range of consumer detriment. It could be established through a CCAS application or legislation.
- An OFT-approved code of practice, must be adopted by all builders and developers within a realistic and challenging deadline. It must incorporate the provision of clear and helpful pre-contractual information, accurate completion dates and a user-friendly complaints procedure.
- Regulators should make effective use of reputational information to help consumers during the decision-making process and enable the market to work more efficiently.
- A fair contract should be adopted by the whole industry to address the noticeable distinctions that currently exist between new-build and second-hand properties, including definition of completion dates and a minimum snagging period. We support a co-regulatory approach, with a credible threat of statutory intervention if realistic and challenging deadlines are not met.

# Background and context

Buying a house is the largest purchase most people ever make, but levels of customer satisfaction with housebuilding firms in the UK have been low for many years. The focus often falls on ‘snagging’ faults that arise after moving in, affecting more than 9 in 10 new-build owners, but problems arise throughout the buying process.

We are concerned that the UK market does not operate in the interests of consumers. Low levels of consumer satisfaction have been underpinned in the past by a lack of adequate customer protection, creating a climate in which contracts are unclear and include wide ranging exclusions of liability, which can be detrimental to customers. Land contracts are partially exempt from the Unfair Contract Terms Act 1977 and the industry disputed whether the Unfair Terms in Consumer Contract Regulations 1999 applied to consumers buying new homes until case law was used to determine that it does indeed apply.

While the number of complaints to Trading Standards departments and Consumer Direct about house construction are not particularly high compared with the number of houses built, this is unlikely to give a true picture of the extent of the problem. Most buyers will pursue matters through solicitors, who oversee a purchase from the beginning.

In a competitive market, customer dissatisfaction should act as a driver for improved business practices amongst firms wanting to retain and increase their share of the market. But home buyers are not able to influence firms in this way when purchasing a new home.

The make-up of the new housebuilding market has changed markedly in recent years with a large reduction in the number of housebuilders due to consolidation within the sector. This trend has been prevalent amongst larger firms, with fewer firms now controlling a larger share of the market. The UK’s top 5 control an estimated 39% of the market. In 1995 the proportion was 19.9%.<sup>(i)</sup> Major construction companies have increased their focus on the housebuilding sector following the growth of mixed-use developments, but this has not mitigated against the overall reduction.

Without the arrival of new competitors, the range of options available to buyers when choosing a developer is reduced without any evidence that customer satisfaction will improve.

In March 2004, the final report of the Barker Review recognised that housebuilders do not have to deliver a good product, or high levels of customer service, to win market share. **(ii)**

Market features cited as causes of consumer detriment included:

- limited land supply means that competition tends to be focussed on land acquisition rather than on consumers;
- regulatory complacency has allowed the industry to settle into a low output equilibrium that suits many players in the market with the exception of those in need for housing; **(iii)**
- aversion to risk amongst builders manifests itself in low levels of innovation, such as a reluctance to invest in new production techniques; and
- a lack of responsiveness, often arising from industry anxiety about being caught out by a period of housing market decline. **(iv)**

The report put forward recommendations for the industry to adopt that would increase levels of customer satisfaction within three years.

The recommendations required the House Builders Federation (HBF) to:

- 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.
- develop a code of conduct by the end of 2004 for new house sales in full compliance with the framework provided by the Office of Fair Trading's Consumer Codes Approval Scheme. This code of conduct should require fair contracts complying with the Unfair Terms in Consumer Contracts Regulations 1999.

It also stated that if progress is unsatisfactory, or if consumer satisfaction levels do not rise substantially within the next three years, the Office of Fair Trading (OFT) should conduct a wide-ranging review of whether the market for new housing is working well for consumers. Since then, we have been disappointed with the response from industry, which has failed to implement an OFT-approved code of conduct measures while consumer satisfaction with the quality of new build homes has fallen.

# NCC points in detail

## **An Uncompetitive Market**

Research by the HBF has found no correlation between a company's market share and the extent to which consumers are willing to recommend their housebuilder to others in future. This suggests that the trend for consolidation within the industry will not lead to improved customer satisfaction by itself. In 2003, four of the nine worst performing companies – Persimmon, Barratt, Wilson Connolly and Westbury – were among the top ten house builders.**(v)** In the most recent survey, the situation does not appear to have changed. None of the five largest builders by market share during the period in question – Barratt, Bellway, Persimmon, Taylor Woodrow and Wimpey – perform favourably compared with other firms.**(vi)**

The Barker Review found that competition amongst housebuilders is concentrated in the early stages of the process, when securing land available for development. Once the land has been secured competitive pressures are reduced and consumers are unable to exert influence by forcing improvements in business practices when they enter the market.**(vii)** Combined with a reduction in the number of players in the market this results in two areas of consumer detriment.

Firstly, where land is in relatively scarce supply, fewer sites with permission for development means fewer builders competing in an area. This puts firms in a position to “sell anything” in the absence of competition on product quality, innovative design features or customer service. Secondly, consumers experience constraints in terms of location when choosing a new home, due to professional or personal circumstances, or often both.

The focus on competing for the acquisition of land has been to the detriment of innovation in house-building. Risk aversion, coupled with a lack of incentives, was cited as a reason for the reluctance to invest in off-site manufacture and other innovative production techniques in the Barker Review.**(viii)** The Royal Institute for British Architect's (RIBA) claims that 29% of new developments were ‘poor’ quality, compared with 18% that represented ‘good or very good’ quality.**(ix)** High quality design not only adds value to homes and their surroundings, they will last longer, be more energy efficient and benefit from greater security. All of these factors contribute to improved satisfaction levels and reduce the amount of time and money required to fix poor housing stock.

The Government has proposed a 20% increase in the UK's house-building programme, with 3 million new homes by 2020. **(x)** This is an ambitious target in

response to the clear long-term trend for increased demand in new-build housing, whilst the level of supply has lagged behind. But while structural inefficiencies remain within the industry it could prove difficult to deliver the extra 40,000 extra homes whilst maintaining high standards.

The Barker Review noted that market power enjoyed by a housebuilder during the development phase can be great enough to “trickle-out” houses, controlling production rates to protect themselves against price volatility and any adverse influence on prices in the local housing market. We have not seen the data that informed the Review, but anecdotal evidence supports this. Where houses are purchased off-plan, delays to the completion of a home and entry-date have occurred while finished properties in the same development sit empty. While it may be rational behaviour for housebuilders in a demand-led market, they would be expected to behave differently if the market was operating efficiently.

Remedies are needed that empower home buyers and increase competitiveness in the market further down the supply chain. While entry barriers and the lack of supply are important issues, they must be considered alongside the difficulties consumers face when trying to drive competition through innovative design, quality of finish and customer service.

## **Statutory Protection for Buyers**

Low levels of consumer satisfaction have been underpinned in the past by a lack of adequate customer protection. Land contracts are partially exempt from the Unfair Contract Terms Act 1977 and the industry disputed whether the Unfair Terms in Consumer Contract Regulations 1999 applied to consumers buying new homes until case law was used to determine that it does indeed apply.

In 2005, the Scottish Consumer Council, published *The Regulation of the New House Building Market in Scotland*. The paper looked at the current extent of regulation within the new-build market in Scotland, the legislation currently in place, the gaps that exist with regard to consumer protection and the implications for the consumer. **(xi)**

Evidence suggesting that new build home buyers all too often experience a wide range of problems included:

- late completion of houses;
- pressure to accept incomplete houses;

- an after-build service delivered late or in some cases, not at all; and
- inadequate means of redress.

These examples of consumer detriment are relevant throughout the UK, but consumer law that applies to housing does not provide adequate protection when things go wrong. New-build homes are exempt from the protections provided by the Sale of Goods Act 1979, leaving consumers with fewer statutory rights than when buying goods on the high street.**(xii)**

The purchase of property in the UK, whether new-build or second-hand, has traditionally been governed by the private law of property, and the common law rule of *caveat emptor* or 'let the buyer beware' has always applied. With a lack of basic consumer protection, new-build homebuyers are significantly disadvantaged from the outset.

In 2003, the Scottish Executive's Housing Improvement Task Force, stated:

*'We believe that caveat emptor may need to be qualified in respect of new build developments, where the sale is not between two private individuals and where the builder is in a similar position to other commercial providers of goods and services who are expected to comply with consumer protection legislation'***(xiii)**

We endorse this point of view and propose that statutory protection for consumers should be introduced in relation to new-build properties, similar in principle to the Sale of Goods Act. It states that goods must be of satisfactory quality, be reasonably fit for the particular purpose for which they are bought and correspond with their description**(xiv)** – characteristics that would reasonably be expected when purchasing a new home. In line with the Act, it should also include provisions that:

- Goods are of satisfactory quality if they reach the standard that a reasonable person would regard as satisfactory, taking into account the price and any description.
- Aspects of quality include fitness for purpose, freedom from minor defects, appearance and finish, durability and safety.
- Examples of inherent faults include an error in design so that a product is manufactured incorrectly or in manufacturing where a faulty component was inserted. The "fault" may not become apparent immediately but it was there at the time of sale and so the product was not of satisfactory standard.

## *Redress*

Access to arbitration is a feature of warranties and insurance policies for new-build homes, for example the National House-Building Council's 'Buildmark', which means major structural issues have been inspected before being signed off. This is an important tool, but its scope does not extend to decisions on whether it's actually satisfactory to live in a property and does not adequately insure homebuyers against poor quality housing. The lack of a fully independent redress scheme in this sector means consumers frequently find they have no option but to resort to the courts to resolve disputes – an expensive and daunting prospect. This is likely to be a contributing factor to the low number of complaints to Trading Standards departments and Consumer Direct compared with the number of houses built.

The OFT must address the absence of an independent redress scheme and its impact on consumers. The introduction of such a scheme could form part of an application for the OFT's Consumer Codes Approval Scheme (CCAS), or it could be established through legislation.

## **An OFT-approved Code of Practice**

While the introduction of statutory protection is essential, it should underpin effective self-regulation by the house-building industry. The Barker Review recommendation for a code of practice to be developed put the onus on industry, but it has failed to meet this target.

HBF produced a template Code of Conduct for its members in April 2006(xv), although to our knowledge consumer groups were not consulted on its content. In its current form there are inadequate assurances concerning the date of legal completion and the availability of pre-contractual information needs to be more explicit. It is also a voluntary scheme and at present there are no indications it will become mandatory for members.

Applying the CCAS 'core criteria' will ensure that:

- consumers are provided with clear and helpful pre-contractual information reducing the imbalance of knowledge and experience that exists between builders and consumers;
- completion dates are accurate; and
- a user-friendly complaints-handling procedure is in place with access to an independent redress scheme.

We remain both disappointed and frustrated at the lack of progress to fill a regulatory gap that needs to be addressed as a matter of urgency. Clear timescales for setting up a self-regulatory scheme in compliance with CCAS should be the first step, with proactive engagement with stakeholders, including government and the OFT, throughout its development.

Action needs to be taken for the following reasons:

- To our knowledge, CCAS approval for the Code has not been sought from the OFT.
- The development of the Code was undertaken in isolation, without input from consumer organisations.
- The HBF Code remains a voluntary condition of membership and we are unaware of any proposals to enforce compliance with the Code, for members who do adopt it.
- The ownership and governance of the Code, and any subsequent enforcement, lie solely with the industry. There are insufficient measures to ensure that the necessary degree of independence is in place to give consumers confidence that they can purchase homes that are fit for purpose and that they will receive fair treatment when things go wrong.

## **Reputations and regulation**

*Warning: Too Much Information Can Harm*, an interim report by the Better Regulation Executive and National Consumer Council on regulated information requirements, highlights the importance of effective information is crucial to help consumers make choices and ensure markets work efficiently.

The report explores the potential of reputational information. The central idea is that, by putting appropriate information about regulatory compliance in the public domain, regulators can tap into the impact of business reputation on consumer behaviour to spur firms to comply with the rules.<sup>(xvi)</sup> There are some implementation issues to ensure that these systems are well understood by consumers and do not drive the wrong type of behaviours in businesses, but they should not be insurmountable.

This could be applied in the housebuilding sector by making quality surveys publicly available, exposing the performance of firms to the competitive marketplace. Including as many housebuilders as possible, and making the results publicly available

to people when they consider purchasing a new house, would provide an incentive for firms to improve quality.

## **A standard and fair contract of sale**

There are two main differences between contracts of sale for new-build homes and those for second-hand properties. Firstly, in the cases of new-build properties, contracts usually require a deposit to be paid by the buyer at an early stage. Secondly, with the sale of a new build, there is an offer to *sell* by the builder, as opposed to an offer to *buy* from the buyer, which is the case with second-hand properties.

These differences in the relationship between the consumer and the developer mean that buyers of new-build homes are usually in a weakened bargaining position compared with those buying second-hand homes. Each developer has its own standard contract, and, unlike sales of second-hand property, the buyer usually has little room for negotiation on its terms. This can lead to the problems identified by the Scottish Consumer Council's research, particularly late completions and after-build services.

### ***Late completion of houses***

The first main issue of concern is the lack of a specific entry date. Most builders' contracts simply define the date of legal completion within a notice period. It can be distressing and cause severe difficulties for buyers to be advised that the target date of entry is not guaranteed and that actual completion of the property could be sooner or later than this.

This is particularly problematic where the buyer has their own property to sell and feels under pressure to secure a fixed date of entry to secure their new home and satisfy the purchaser of their property. Even if the target date is met, the buyer will still face weeks or months of uncertainty without any assurances from the builder. Delays of up to several months are not uncommon, which can result in families needing to find temporary accommodation at short notice and at their own expense.

A specific review of this issue is needed with the aim of agreeing how a fair definition of the completion date can be incorporated into a standard contract. A co-regulatory approach to the introduction of specific entry dates, through self-regulation, would be our favoured approach. This requires industry to confront its aversion to risk and take into account the interests of consumers, who need greater certainty. It should compel developers to adhere to specific entry dates agreed with buyers, with the risk of financial penalties for those who fail to do so.

### *After-build service*

The second issue concerns ‘snagging’ problems. The average new home will have 100(xvii) and with an absence of statutory protection in relation to the quality of new homes, many buyers experience real difficulties when trying to get them fixed. A decline in satisfaction with the service provided by housebuilders over successive stages of the purchase process was identified in the Barker Review, with dissatisfaction levels particularly high with after-sales service.(xviii) This is in line with RIBA’s findings on quality.

We understand in the past it was common practice for builders’ contracts to contain a provision to the effect that snagging items identified and intimated within the first twelve months of ownership would be put right at the builder’s expense. The Scottish Consumer Council has found that such clauses have now become the exception rather than the norm in many cases, and even if specified ‘snagging periods’ are included in the contract, these are often short. New homes take time to bed-in, with problems that aren’t apparent on the completion date taking months, or sometimes longer, to emerge. A minimum ‘snagging period’ would offer reassurance that any problems would be fixed.

Again, a co-regulatory approach to the introduction of a standard fair contract would be our favoured approach. The status quo is not an option, but we are sceptical that industry will deal with this issue adequately without a firm timetable that sets realistic and challenging deadlines. The credible threat of statutory intervention is also likely to be necessary.

In the current climate housebuilders are not exposed to a fully competitive market and consumers are unable to influence competition. The structure of the market, level of supply, low consumer satisfaction and a lack of customer protection are all contributing factors. The remedies outlined in this submission would empower consumers and stimulate competition, which is essential for the market to operate efficiently.

# References

- i** Lend Lease (2006).
- ii** *Barker Review of Housing Supply, Final Report*. HM Treasury (2004). Section 6.28.
- iii** *Barker Review of Housing Supply, Final Report*. HM Treasury (2004). Section A.31.
- iv** *Barker Review of Housing Supply, Final Report*. HM Treasury (2004). Section A.29.
- v** Barratt Homes, David McLean Homes, Fairview New Homes, Morris Homes, North Country Homes, Persimmon Homes, Rialto Homes, Westbury Homes and Wilson Connolly.
- vi** *Customer Satisfaction Survey Results*. House Builders Federation (2007).
- vii** *Barker Review of Housing Supply, Final Report*. HM Treasury (2004). Section 6.13.
- viii** *Barker Review of Housing Supply, Final Report*. HM Treasury (2004). Section A.33.
- ix** *Better Homes and Neighbourhoods*. RIBA (2007).
- x** *Take care when buying a new build house*. The Guardian (28<sup>th</sup> March 2007).
- xi** *Regulation of the New House Building Market in Scotland*. Scottish Consumer Council (2005).
- xii** Section 61 defines applicable goods as only moveable property as opposed to heritable property.
- xiii** *Stewardship and Responsibility: A Policy Framework for Private Housing in Scotland*, The Final Report and Recommendations. Housing Improvement Task Force (2003). Paragraph 226.
- xiv** Sale of Goods Act 1979 (sections 13 and 14).
- xv** *Customer Service – A Code of Conduct*. House Builders Federation (2006).
- xvi** *Reputation and regulation*. National Consumer Council (2006).
- xvii** *Take care when buying a new build house*. The Guardian (28<sup>th</sup> March 2007).
- xviii** *Barker Review of Housing Supply, Final Report*. HM Treasury (2004). Box 6.1.