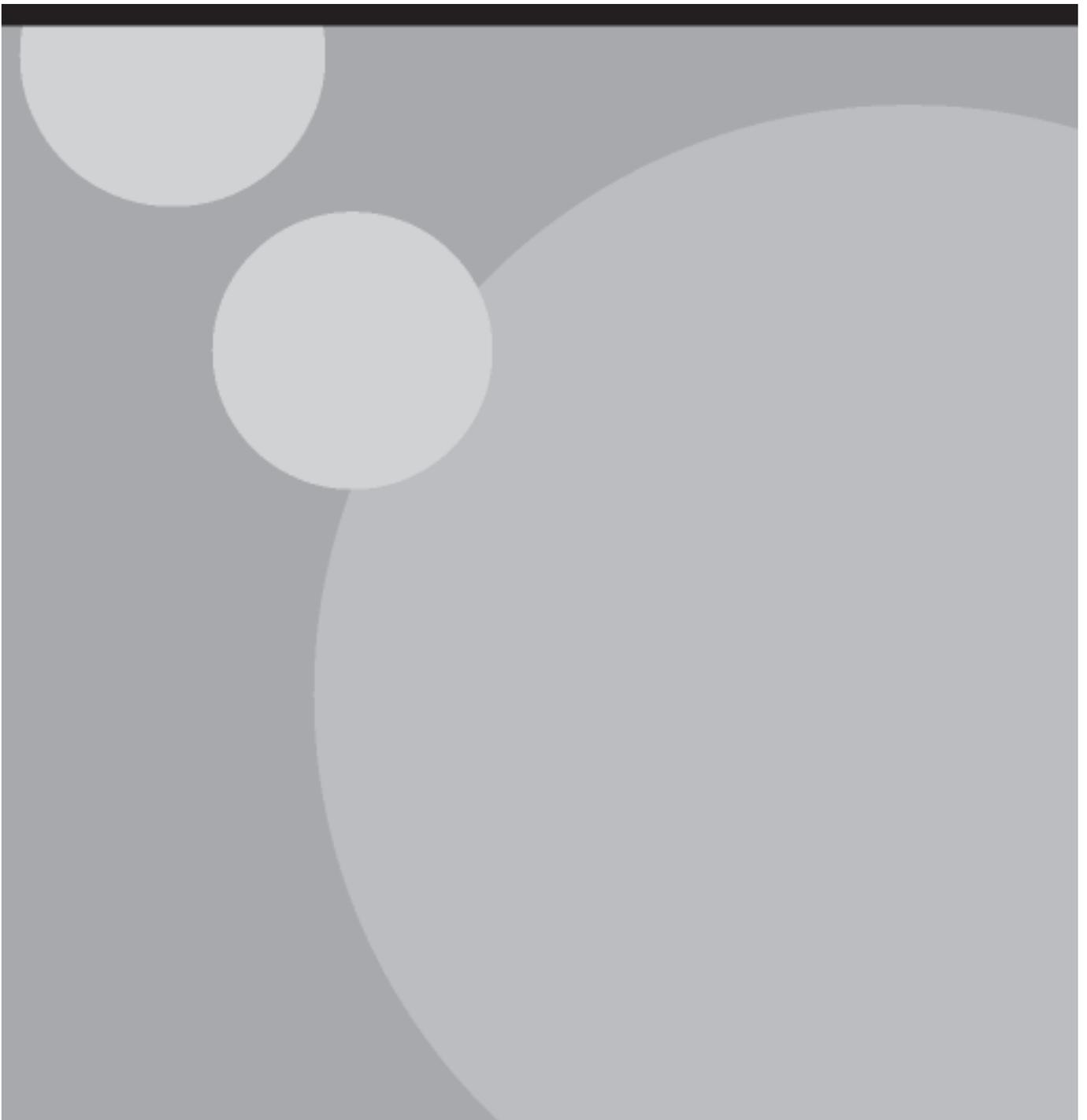




The role of condition information in the home buying and selling process

Research and cost/benefit analysis





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DTZ

September 2010
Department for Communities and Local Government

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1. Background

Communities and Local Government (CLG) commissioned Ipsos MORI in summer 2009 to undertake research into the role of condition information in the home buying and selling process.

As part of this exercise, Ipsos MORI commissioned DTZ to carry out a cost and benefit analysis into home condition information. In particular, the evaluation was to focus on the costs and benefits of condition information and the potential cost savings for consumers.

This involves three phases of interrelated work, but which have been carried out separately:

- Phase 1 - A literature review – to assess and investigate costs and benefits of supplying condition information upfront.
-
- Phase 2 - In-depth interviews with solicitors and lenders – to consider the relationship between condition and valuation.
-
- Phase 3 – Cost-benefit analysis model – to review the impact of a model put forward by CLG to stimulate the uptake of condition information on a voluntary basis.

This report goes on to outline the key findings from Phases 1 and 2. DTZ has issued a separate report for Phase 3.

1.1 Purpose of condition information

The introduction of the Home Information Pack (HIP) in August 2007 formed part of the Government's commitment to make the home buying and selling process in England and Wales more transparent, clear and consumer friendly.

A HIP includes a number of documents, however not all the components are compulsory.

A HIP must contain the following:

- an index
- a sale statement
- evidence of title
- an energy performance certificate
- standard searches and
- a property information questionnaire

In addition, it is up to sellers whether they chose to include a home condition report (HCR) as part of the HIP. Since July 2006 the HCR has been an optional, but strongly recommended, component of the HIP. The HCR contains information about the physical condition of a property, which sellers, buyers and lenders are expected to rely on. The HCRs are carried out by a certificated Home Inspector whose role it is to provide the report.

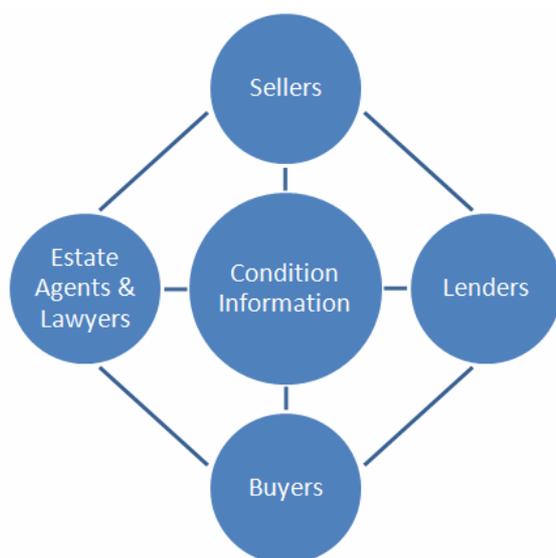
The objective behind the introduction of the HCR was to make the sales transaction process more transparent. It would give buyers upfront information about the property for sale at the start of the transaction process. The previous system was deemed to provide vital information too late in the day. An adverse survey which highlighted unexpected problems could cause an agreed sale to fall through.

The HCR is expected to address instances of imperfect information. In addition, the housing market in England and Wales has a relatively high rate of failed transactions. This is described as a negative externality where unsuccessful sellers also become unable to buy, which often leads to a 'chain effect' of fallen through transactions.

1.2 Rationale for intervention

The realisation of benefits and costs is dependent on how the behaviours of stakeholders have been impacted by the introduction of condition information and how in turn stakeholders impact on each other. The framework below illustrates the key stakeholders involved in the process of buying and selling a house:

Figure 1.1: Stakeholder involvement in house buying and selling



*The Green Book – Appraisal and Evaluation in Central Government*¹ states that government intervention is justified when market failures exist, i.e. - inefficiencies

¹ http://www.hm-treasury.gov.uk/d/green_book_complete.pdf

in the operation of a market or when there is inequality in outcomes. In terms of the housing market, condition information is designed to mitigate the inefficiencies arising as a result of imperfect information. The Green Book states:

Information is needed for a market to operate efficiently. Buyers need to know the quality of the good or service to judge the value of the benefit it can provide. Sellers, lenders and investors need to know the reliability of a buyer, borrower or entrepreneur.

This means that information needs to be fully available to stakeholders in the market, or market failure may occur. This is known as ‘asymmetry of information’, and can arise, for example, when sellers have information about the quality of a house that buyers do not have. The key elements of imperfect information and market inefficiencies underpinning the condition information and the relationships between stakeholders are outlined in Table 1.1 below.

Table 1.1: Market failure relating to upfront property condition information

Impact of addressing market failure	Description
Information provision	Condition information is designed to provide better information about the property by giving the buyer upfront information about its features and quality. The documentation is expected to benefit the buyers who receive early information about the condition of a property.
Impact of improved information	Condition information is designed to address risk being disproportionately distributed. It is expected to reduce the risk for buyers who can be faced with unexpected repair bills. It is also expected to work as a helpful tool for sellers to reduce the risk of a buyer pulling out later in the process, due to an unforeseen problem.
Outcomes of improved information	<ul style="list-style-type: none"> • Lower rate of transaction breakdown • Shorter average transaction duration • Cost savings to buyers and sellers

1.3 Methodology

Our approach reflects the complexity of the process of buying and selling a house and therefore assesses the costs and benefits for each stakeholder group.

The analysis draws directly on the following strands of research:

- desk research – provides the most relevant research studies and evidence on the impact (actual and potential) of home condition information. This exercise relies on available data and literature, providing both qualitative and quantitative findings
- one-to-one consultations – with the lender and conveyancer stakeholder groups in order to obtain a full picture of the role of condition information

DESK RESEARCH

The criteria for inclusion in the desk research exercise as specified by the client were as follows:

- focus should be on the role of condition information in the home buying and selling process in general, instead of specific policies or products, e.g. HIPs or HCRs
- focus should be on the market in England and Wales
- should aim to cover a wide selection of material, e.g. articles, research papers, government publications, etc
- need to also look for ‘grey literature’ that is not widely available or may be unpublished
- need to obtain any information on the costs and benefits, or advantages and disadvantages, of the introduction of the initiative and how this is viewed by the different types of stakeholder groups. This should include consumers (e.g. first time buyers and sellers in a chain), lenders, solicitors and conveyancers. Information collated can be quantitative or qualitative
- focus should be on the most recent research, e.g. in the last 3-4 years, but material outside this timeframe can be considered, especially if seminal

Excluded from the desk research was research with too much focus on stakeholders’ views as opposed to evidence, and research where the prime remit of the study was not condition information or HCRs. The literature considered as part of the desk research is outlined in Appendix 1.

ONE-TO-ONE CONSULTATIONS

Twelve in-depth telephone interviews were carried out across a sample of banks, building societies, solicitors and conveyancers, see Table 1.2:

Table 1.2: List of consultees

Respondents: in depth interviews	
Solicitors and Conveyancers	
	E&K Solicitors and Estate Agents
	Debenham Ottaway Solicitors
	Coodes Solicitors
	Bennett Griffin Solicitors
	Clarkes Solicitors
Banks/ Building Societies	
	Building Society Association
	Halifax
	National Australia Bank (on behalf of Clydesdale and Yorkshire Bank)
	Skipton Building Society
	Newbury Building Association
	Bank of Ireland (Bristol and West)
	Lloyds TSB

The views expressed are based on a small sample size – five solicitors and seven lenders. The findings therefore have to be treated with some care. However, the consistency and strength of views on the major research themes was reassuring.

Respondents were asked a series of questions on the relationship between condition and valuation and the availability of upfront condition information to inform valuations. The topic guide for the consultations is provided in Appendix 3. The main findings from these interviews are outlined in sections 3.1 and 3.2. These findings are based on the comments and views expressed by respondents, which also includes views on the use of condition information more generally.

2. Desk research

This section outlines the findings associated with providing and accessing condition information in the home buying and selling process. The findings are based on the desk review, described in Section 1.4, and include both quantitative and qualitative information. It highlights where incentives and disincentives exist, and it also provides a brief discussion of some of the key issues underpinning the efficacy of condition information in the market.

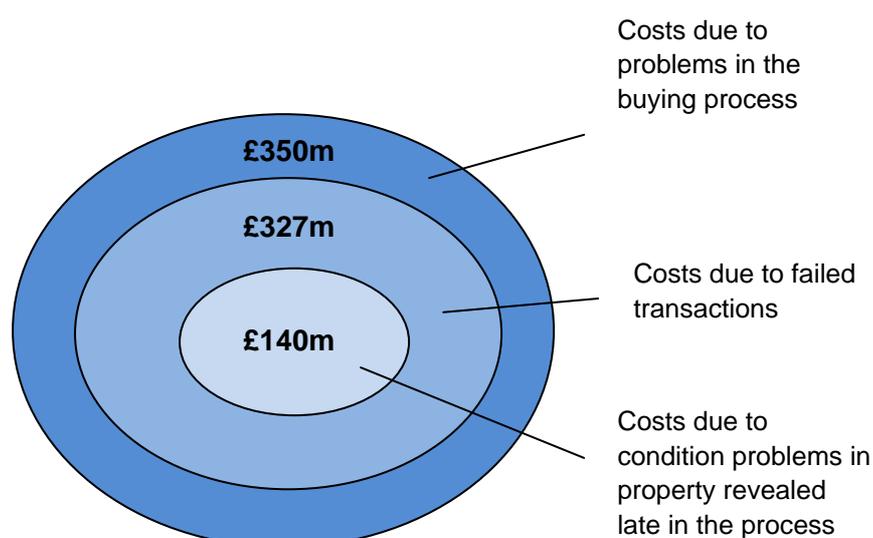
Given the tight criteria for the desk review, the literature found to be relevant did, in large, focus on HIPs and HCRs specifically and is heavily focused on CLG commissioned studies. Little information and data was available on condition information more generally. Therefore where quantitative values are listed these relate directly to a particular policy or product. The qualitative information is in some cases more generic and related to consumer behaviour.

Furthermore, the literature is based on a seller's model where condition information is provided upfront by the seller, and the findings should therefore be seen in this context, and do not necessarily translate to a buyer's model where a condition survey is commissioned by the buyer usually later in the process.

2.1 Benefits

Failed transactions cost consumers and other stakeholders a considerable amount each year. These could potentially be avoided costs resulting in significant cost savings if the number of failed transactions was reduced. It is estimated that £350m a year is currently lost due to problems encountered during the buying process,² with the total cost to consumers for failed transactions being around £327m. Research suggests that 43 per cent of failed transactions are due to problems revealed by condition or valuation surveys, and therefore the cost attributed to this could be around £140m³.

Figure 2.1: Costs of failed transactions



² Dixon, R, *Will the withdrawal of the HCR as a mandatory element of the HIP still make the pack worthwhile to the consumer?*, 2007

³ CLG, *Marketing of Residential Properties Regulations: Regulatory Impact Assessment – Annex on Costs/Benefits to Businesses and Consumers of the HIP with and without the HCR*, 2001

INFORMATION BENEFITS

Information benefits arise as consumers become more aware of the condition of a property prior to transaction; it increases the transparency in the buying and selling process and reduces the risk of unexpected faults and problems.

A study of 2003 showed that buyers welcome the transparency linked to the introduction of HIPs and condition information was considered as key to this transparency. In a strong market, buyers may be willing to offer an inflated value for a property, however, with repair and remedial costs being exposed some may feel that the property is simply worth less to them and they then consider their offer inflated⁴.

The 2008 trials show that once given the chance to spend time reviewing the condition information, buyers who took part in focus groups were relatively favourable towards condition information, saying in general that they added to the checks and balances of the decision-making process and that it provided useful information⁵.

CONDITION AND PRICING IMPACT

Research has also shown that when more information is available on the condition of the property this has an effect either on the contracted price of a property, where faults or problems become reflected in the price, or where repairs and alterations are undertaken by the seller.

A pilot in 2004 suggested that 3 per cent of sellers delayed marketing of their home while they undertook remedial work highlighted by the HCR, but 4.5 per cent said they would reduce the asking price as a result⁶.

A research report in 2008 showed greater condition impact and that where problems were identified in properties located in the trial areas, four in ten sellers stated that they planned to undertake work on their property as a result, while very few (2%) said they would reduce their asking price⁷. With 40 per cent stating that they would carry out repairs following the survey, a subsequent reduction in the number of fallen through transactions may occur. There would be less risk of uncovering problems late in the process and the condition of the house would more fairly reflect the house price and/or buyer expectations.

However, a survey of recent home buyers carried out by *Which?* suggests that the pricing impact is in fact larger and while sellers may not voluntarily lower their asking price the condition information becomes a bargaining tool for buyers to discount the price. The buyers' survey showed that 41 per cent of those who found a condition problem when viewing the house negotiated a reduction in the asking price and 10 per cent ensured that the problem was corrected⁸.

Furthermore, a quarter of the surveyed home owners found a problem in their house after they had moved in and on average they had to spend £2,500 to repair the

⁴ ODPM (Robertson and Whitehead), *Buyers' and Sellers' Perspectives of HIPs in Low Demand Low Value Housing Markets*, 2003

⁵ CLG, *Home Information Pack Area Trials – Research Report*, 2008

⁶ CLG, *Piloting the Home Condition Report*, 2004

⁷ CLG, *Home Information Pack Area Trials – Research Report*, 2008

⁸ 'The point of viewing', *Which?*, May 2008

faults. Of these 10 per cent stated that they had spent more than £10,000 on repairs and remedial work.

A quarter said that if they had known about the problems in advance they would have tried to renegotiate the price, and more than 10 per cent said they would not have bought the property at all.

PREVENTION OF FAILED TRANSACTIONS

If upfront property condition information was made available it is expected that the number of failed transactions would reduce due to the following impacts:

- buyers would be better informed on the real condition of the property before making an offer and, therefore, less likely to pull out due to adverse property condition being revealed later in the process
- a proportion of sellers would undertake alterations to their property to improve the condition and/or
- sellers would reduce the price to reflect the cost of the remedial work required for the new owners

The consequence is that the match between 'declared' property condition and the agreed contract price improves with less chance of disagreement arising between buyers and sellers due to misaligned views.

Both consumers and professionals have indicated that condition information would be a helpful tool to minimise the risk of fallen through transactions. However, there are some contrary views amongst estate agents. Research carried out on behalf of the National Association of Estate Agents (NAEA) found that 60 per cent of survey respondents who had a sale fall through said they did not feel the presence of condition information would have prevented the sale from falling through⁹. However, if one interprets this the other way round, this could be presented as a strong finding in favour of home condition information – *"40% of estate agents believe that home condition information could have prevented the sale falling through."*

Other research suggests that condition information does in fact help to prevent failed transactions. A Bristol pilot of sellers' information packs found that none of the transactions that failed did so due to an adverse survey or valuation, and there were some indications that condition information may have helped to reduce the number of failed transactions¹⁰.

Furthermore, in consumer focus groups, buyers and sellers who had sales fall through because of uncovered structural problems said that the presence of condition information would prevent such problems from occurring. Those who had not experienced such problems tended to agree with this point of view. These two groups were keen for condition information to be made mandatory, ensuring that all buyers have access to this information early in the home buying and selling process¹¹.

⁹ Dixon, R, *Will the withdrawal of the HCR as a mandatory element of the HIP still make the pack worthwhile to the consumer?*, 2007

¹⁰ CLG (Martin Hamblin), *Evaluation of a Pilot Seller's Information Pack: The Bristol Scheme – Final Report*, 2002

¹¹ CLG, *Home Information Pack – Consumer Focus Groups: Qualitative Research – Summary Findings*, 2007-2008

A survey of professionals found that 54 per cent believed that the inclusion of condition information would have reduced the number of failed sales¹². This shows that professionals within the industry endorse the inclusion of condition information and consider it an important element in reducing the number of transactions which fall through. In addition, a cost would be incurred for sellers for entering the market in the HCR model or similar, and this would put off home owners who are simply testing the market but who are not necessarily committed to selling.

2.2 Key issues

CREDIBILITY AND TRUST

Market and consumer benefits will only be attained if stakeholders find the condition information helpful, accurate and reliable and research shows that trust and opinions on condition information varies across stakeholder groups.

A pilot in 2004 showed that 88 per cent of buyers believed that the HCR accurately reflected the condition of the property, while 95 per cent found the report useful. The reason given by most buyers was that the report highlighted issues they would not have otherwise seen or considered. Sellers on the other hand had slightly less trust in the accuracy of the report with 78 per cent believing it was accurate, while 21 per cent felt the problems were overstated and 1 per cent felt they were understated¹³.

However, a number of participants indicated that when an estate agent is commissioned by the seller (either directly or indirectly) they may produce condition information that is biased to their client rather than the buyer. Therefore, the independence of the information has been questioned by buyers, given that the seller has paid for it¹⁴. In the 2004 Bristol pilot 36 per cent expressed doubts about the reliability of an HCR commissioned by the seller. In some cases buyers were advised by their conveyancers to get an independent survey of the property, due to the perceived lack of trustworthiness of the report¹⁵.

Buyers were also often advised by their solicitors to either undertake a home survey, to be aware of caveats or even to explicitly reject the HCR. Some participants of consumer focus groups stated that the condition information supplied as part of the HCR was not thorough enough to offer any real guarantee to buyers, many highlighting the disclaimer in the document¹⁶.

A survey of consumers carried out by Dixon found that only 47 per cent would rely on information provided in the HCR and 53 per cent would commission their own survey¹⁷. It is therefore paramount that condition information is delivered by a qualified surveyor or validated professional, that consumers recognise and who's

¹² Dixon, R, *Will the withdrawal of the HCR as a mandatory element of the HIP still make the pack worthwhile to the consumer?*, 2007

¹³ CLG, *Piloting the Home Condition Report*, 2004

¹⁴ ODPM (Robertson and Whitehead), *Buyers' and Sellers' Perspectives of HIPs in Low Demand Low Value Housing Markets*, 2003

¹⁵ CLG (Martin Hamblin), *Evaluation of a Pilot Seller's Information Pack: The Bristol Scheme – Final Report*, 2002

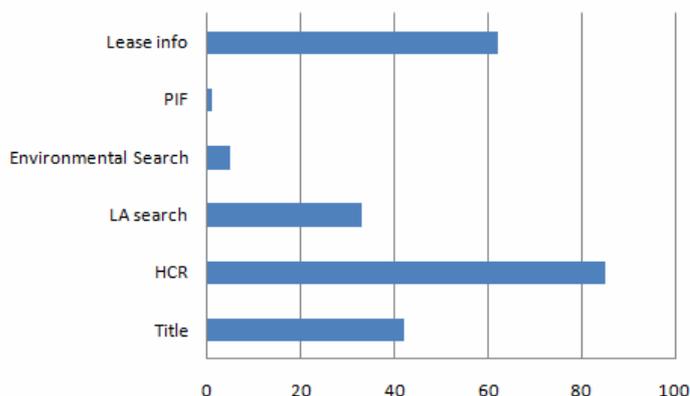
¹⁶ CLG, *Home Information Pack – Consumer Focus Groups: Qualitative Research – Summary Findings*, 2007-2008

¹⁷ Dixon, R, *Will the withdrawal of the HCR as a mandatory element of the HIP still make the pack worthwhile to the consumer?*, 2007

professional judgement they trust. Furthermore, the scope and standard of the report should be based on good practice in the industry.

A survey of lenders in 2006 found that the condition information would be the most useful element of the HIP to lenders (See Figure 2.2). The HCR in particular is likely to have an effect on the way lending decisions are made, according to the lenders surveyed.

Figure 2.2: Lenders' views on the usefulness of different elements of the HIP, % of total lending



Source: CML Survey (Wagstaff and Pannell 2006)

Notes: Figures represent % of lenders agreeing a particular element would be useful. The results shown are weighted to reflect lenders' share of mortgage lending.

Views have also been expressed in relation to the usefulness of condition information being provided without a property valuation. Many estate agents in the Bristol pilot did not favour this option. They felt that the value of the condition information would be greater if a valuation was included as this would make it more likely that lenders accepted it¹⁸.

SUBSTITUTION

Many stakeholders are concerned about the additional cost added to the process of home buying and selling in supplying condition information. Consumers will bear most of the additional cost of the survey fees associated with providing condition information. Under a compulsory system the net additional cost to consumers is estimated at around £220 million each year based on the cost of an HCR.¹⁹ However, savings from a reduction in the number of lenders' valuation surveys and in wasteful expenditure on failed transactions is projected to completely offset this additional cost, as calculated in the 2001 Regulatory Impact Assessment.

Under a voluntary system, it would appear from HIP area trials that the condition information supplied as part of the HCR has not substituted for property surveys, since:

- half of buyers (50%) had a mortgage valuation completed

¹⁸ CLG (Martin Hamblin), *Evaluation of a Pilot Seller's Information Pack: The Bristol Scheme – Final Report*, 2002

¹⁹ CLG, *Marketing of Residential Properties Regulations: Regulatory Impact Assessment*, 2001

- just over a third (38%) commissioned a home buyers report
- sixteen per cent ordered a full structural survey²⁰

Hence, it is essential that the key stakeholder groups accept the condition information as robust and become familiar with the process. Crucially, if lenders insist on a separate valuation the additional cost will not be offset by a reduction in the wasted expenditure. It is therefore essential for condition information to be of a standard and scope comparable to the home buyers report and that it is endorsed by lenders, solicitors, surveyors and consumers.

²⁰ CLG, *Home Information Pack Area Trials – Research Report*, 2008

3. Professional survey

3.1 Solicitors and conveyancers

A sample of approximately 40 firms was selected using in house contacts as well as Law Society searches from which five solicitors agreed to be interviewed via telephone using a semi-structured topic guide. Respondents were directly involved with conveyancing and came from offices spread throughout England.

While there were differing views between solicitors over some aspects of condition information, the key findings where there was general consensus have been covered below. These represent the views expressed, and do in some cases refer to more general views on condition information in the process of home buying and selling.

RELEVANCE OF INFORMATION

The solicitors who responded stressed that the information they required for conveyancing was very specific. Solicitors and conveyancers have a 'checklist' of requirements such as title deeds and local authority searches that are needed in order to carry out a transaction. These are standard requirements for any solicitor. In addition, some areas of England need additional environmental searches carried out: for example, flooding or mining searches. Overall, the solicitors questioned felt that they needed specific and relevant information in order to carry out a transaction on behalf of a client, and this was partially covered by the information contained within the HIP but not the HCR.

ACTING ON BEHALF OF THE BUYERS AND SELLERS

Solicitors and conveyancers are acting on behalf of the property buyers and sellers. As a result they are seeking information that is most relevant to their clients. Typically, where clients sought additional information on a property, respondents recommended that a home buyer's survey should be carried out as this was felt to provide enough condition information to buyers. Where there were particular concerns with a property, clients might then purchase a detailed structural survey. The role of the solicitor/conveyancer is to provide advice and guidance to his/her client. To do this they need the standard information, as described above, to carry out a transaction but other condition information is for the benefit of the buyer.

THE VALUE OF CONDITION INFORMATION

Respondents felt that condition information was very important to a buyer. Simple valuations will suffice for the lender but buyers often need more detailed information on a property, particularly where there are concerns or issues. In addition, the type of information collected by solicitors is often technical and not relevant to the buyer. Various suggestions were offered as to the type of information needed as a buyer. These included valuation information, structural condition information, council tax banding and general information on the local area.

CHANGING LEGISLATION

Comments were made over changing legislation and what needs to be collected and what does not. The Law Society provides a protocol for solicitors to follow but the legislation does change. Consequently the solicitors and conveyancers questioned, carried out their own searches rather than rely on other sources such as the HIP which, they believed may not be legally compliant given the ever changing legislation.

UNDERSTANDING AND AWARENESS

Respondents thought that buyers' awareness of valuation and survey products was low. It was felt that there was a degree of confusion as to what was needed for a sale to go through:

"The system is extremely confusing to clients who do not know whether to get an HCR, basic valuation or full survey."

"Customers have little understanding of the process. They will go for the least pricey option when it comes to conveyancing as they are already paying a substantial amount for the property."

"There is not full understanding of all the processes and products available. Quite a lot of confusion about what the best option is for them."

"Understanding over the process is poor, people are unsure of what is needed and what is not."

Most solicitors and conveyancers questioned made their clients aware of all the products available, including HCRs, home buyers surveys and other fuller surveys, to let their clients decide which option is best suited for them.

THE ROLE OF AUTOMATED VALUATIONS

Most solicitors felt that the valuation of a property was most useful for the lender rather than the solicitor. However, the principle of an automated service was appealing provided the solicitor or conveyancer could be assured of its robustness.

THE TIMING OF CONDITION INFORMATION

Solicitors and conveyancers agreed that condition information was important and useful for consumers but there were no strong views on when condition information should be made available. Generally, most respondents thought any information should be provided sooner rather than later but it was recognised that there would be an upfront cost which could dissuade people.

EVIDENCE OF FAILED TRANSACTIONS

From the responses, some solicitors reported failed transactions as a result of valuations and surveys. However solicitors and conveyancers thought that clients were more likely to negotiate price rather than pull out of a deal completely.

INTEGRATION OF PROPERTY CONDITION AND VALUATION INFORMATION

Solicitors and conveyancers were supportive of providing the buyers with as much relevant information as possible, including both valuation and home condition information in an integrated format:

“As much information as possible about the value and condition of the property.”

“Consumers need to know about the property and need to know whether the property is worth it. They should be told up front about any issues such as council tax banding, upfront costs and other legal issues associated with the property – however, this is not always possible.”

“The consumer should know about the condition of the property – will they need to spend a lot of money repairing something? What is the area like? What is the council tax banding and so on? In addition they also need to know the value of the property so they know what price they should go in for.”

“If HIPs are to be successful they need to include everything that is needed: home valuation, building condition, environmental searches (flood risk), mining searches, energy performance, etc. They need to be compulsory and carried out by professionals so they will be valid for lenders as well as buyers.”

3.2 Lenders

In total six lenders were selected to contact using DTZ's existing links with the sector. Respondents were professionals within the major banks and building societies who had direct experience of mortgage lending. In addition we spoke to a representative from the Building Societies Association. The key points raised are outlined:

THE TYPE OF INFORMATION REQUIRED

Respondents felt that the type of information required as a lender was again different from that required by solicitors and consumers. Lenders need basic valuation information in order to assess whether it is 'safe' to offer a mortgage. Any additional information on the condition of a property may be useful, particularly to a buyer, but it will only be useful to a lender if the condition of the property has an impact on the material value of the property.

THE IMPORTANCE OF CONCISE, TO THE POINT INFORMATION

Lenders felt that valuation information needed to be accurate but also concise and to the point. Lenders were not looking for lengthy reports on the condition of a property but basic information that could tell them immediately whether or not it was safe to lend to a customer.

THE VALUATION PROCESS

Most respondents carried out independent valuations via panels of surveyors who assessed the value of a property using a 'checklist' of requirements using the *RICs Red Book Valuation Standards* as a guide. It was felt that other methods of valuation would not be robust so valuations carried out by professional surveyors were preferred.

AUTOMATED VALUATIONS

Automated valuations were thought to be a useful tool but were only used by lenders for re-mortgages and where the loan to value ratio was low. The overall concept of an automated valuation is attractive to lenders as it allows quick valuation estimates. It was recognised by some respondents that the valuation process now involves more scrutiny and as a result automated services have been used less frequently.

THE IMPORTANCE OF CONDITION INFORMATION

Respondents felt that condition information was important to buyers but much less useful for lenders. In some cases, condition information would be used where the condition of a property affected the value of that property but otherwise condition information was not considered. It was highlighted that the condition information should be made compulsory to improve take-up as this would be very low in a voluntary system:

“If a valuation or condition survey is required very early on this will affect the price which can put people off. There is no way around this unless the condition information is made compulsory.”

In addition the information contained in HIPs does not include valuation information and consequently is not particularly useful for lenders. Lenders did however appreciate that mortgage valuations did not always cover the type of information that buyers should have access to.

UNDERSTANDING AND AWARENESS

Respondents thought that customers were aware of the valuation process and understood its purpose. However it was felt there was more confusion around the role of other products such as HIPs, home buyers reports and other more specific structural surveys:

“Consumers have a good understanding of the standard mortgage valuation process however there is less understanding over the other home and condition information that is available.”

THE TIMING OF CONDITION INFORMATION

Again, while there was no strong feeling from respondents over when the most appropriate time would be to receive condition information, lenders generally agreed that valuation information and condition information is required at an early stage in the buying/selling process but this may have a knock on effect on sales given that customers may have to pay for upfront surveys. Lenders prefer to have valuation information collected promptly and as a consequence, valuations tend to be brief and focused.

THE CURRENT ECONOMIC SITUATION

Some lenders noted that banks and building societies are more hesitant to offer mortgages and there is more inspection when it comes to valuations. The role of condition information during this time is perhaps more important than it has been previously where mortgage valuations have been sufficient. Lenders are now much more cautious so any additional security, perhaps in the form of more condition information, could be useful.

THE IMPORTANCE OF KNOWING THE SOURCE

Lenders also felt that it was extremely important to know who the valuation was carried out by. If not carried out by a reliable source then they would not be accepted. This is also associated with insurance cover and as a result most of the main banks and building societies have their own panel of surveyors who carry out valuations.

EVIDENCE OF FAILED TRANSACTIONS

Respondents felt that valuations were very important in the lending process and had some examples of where mortgage loans have fallen through as a result of a valuation being lower than the sale price. In addition, it was felt by some that valuations were now even more important given the economic situation.

INTEGRATION OF PROPERTY CONDITION AND VALUATION INFORMATION

From the perspective of the lenders more information for buyers is in principle, a 'good thing'. The inclusion of robust and trustworthy valuation information as part of a wider report containing condition information would also be helpful to the lenders.

"As much information as possible is useful for the consumer – condition information, valuation information and so on. The information contained in the mortgage valuation is not enough for a consumer."

"The Home Condition Report would be very helpful if it provided valuation information, but it doesn't so lenders have to get their own carried out."

"The information needed for a lender is very different from that required by a customer. However, ideally a combination of both requirements would come in a single report."

"In terms of getting a mortgage, consumers need to know about the different products available, repayments and whether they can afford it and if so, over what time period. In addition, the consumer also needs as much information about the actual house as they can get to make a judgement on whether it is value for money, whether they really need it and whether it is a safe and sound investment."

"Information on the condition and value of a property is very useful to a buyer. The buyer needs to know different information however – for example, a lender might want to know about structural information while a buyer will want to know more superficial information that is not relevant to the lender."

3.3 General comments from both industry groups

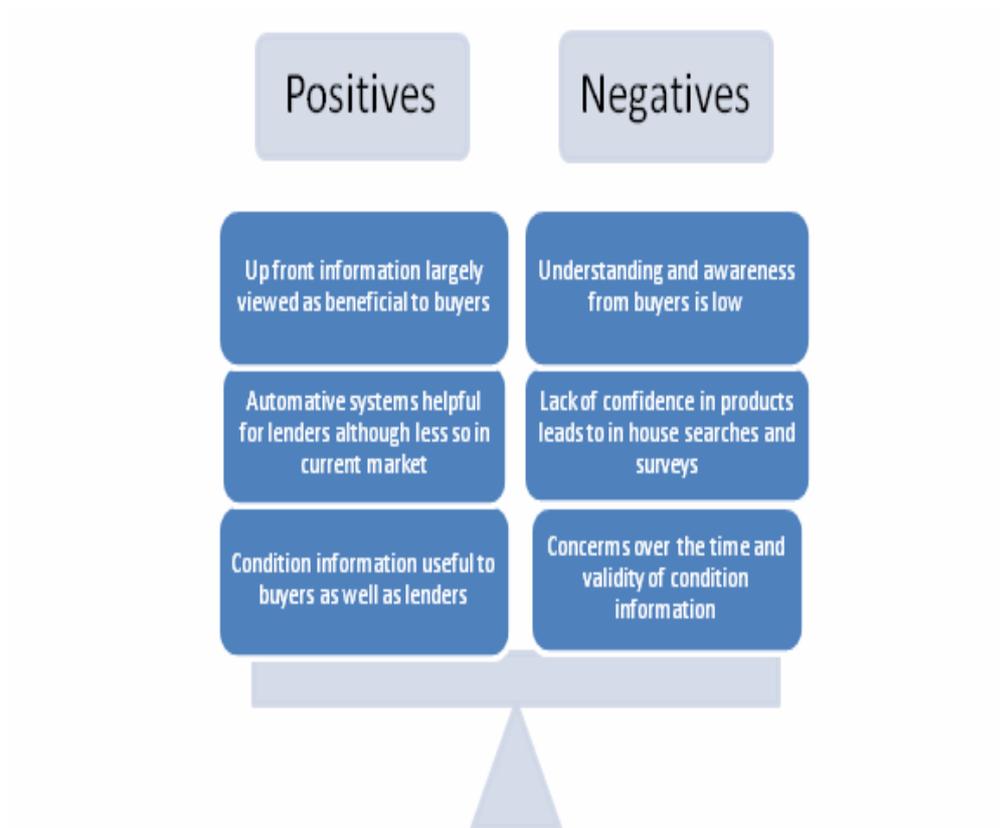
Although the nature of information collected by both solicitors/conveyancers and lenders differed, there were some common issues raised over condition information in general:

- condition information was thought to be useful to property buyers, providing a more detailed picture of a property and thus reducing the risk for the buyer
- while automated services were thought to be useful for remortgages and where the loan to value ratio is low, it was raised by both groups of users that automated valuations can only really be used where there are comparable properties nearby. This is not always the case so some properties will always need a survey carried out
- HIPs were thought to be lacking the information required by both lenders and solicitors. For example lenders need valuation information while solicitors often need additional search information specific to the local area, neither of which is provided in the standard HIP or home condition report. Overall feedback on the home condition report was fairly negative
- more than one respondent commented that the system in Scotland was more efficient in that more relevant information was included within the HIP, such as valuation information. It was also thought to be better in that information was compulsory so there was less confusion around what needs to be provided and what doesn't
- while all respondents thought some level of condition information was needed, there was also concern over how long this information would remain valid
- generally it was thought that condition and valuation information would be better provided as early as possible. However, both solicitors and lenders agreed that upfront information would involve an upfront cost which may dissuade people from selling
- respondents from both groups raised concerns over how information was collected. As a result many undertook their own searches and valuations to be confident of gathering the necessary information

3.4 Summary findings

The main findings from the in depth consultations are illustrated in Figure 3.1 below. Overall there were mixed feelings over the role of condition information. As a general concept both groups were positive about condition information and the importance it plays in the home buying and selling process. However, respondents were much more negative when talking about HIPs and specific reports and surveys such as the home condition report.

Figure 3.1: Findings from the in depth consultations



Appendix 1: Research considered in the desk review

Author	Title	Year
CLG, (Ipsos MORI)	Home Information Pack Area Trials – Research Report	2008
CLG	Improving consumer information in the HIP – summary of responses	2008
Which?	The point of viewing	2008
CLG	Home Information Packs, Consumer Focus Groups: Qualitative Research - Summary Findings	2007-2008
CLG	HIPs: housing market analysis	2007
Dixon, Robert BSc Thesis	Will the withdrawal of the HCR as a mandatory element of the HIP still make the pack worthwhile to the consumer?	2007
CLG	HIP Baseline Research: Consultation	2007
Justin Merritt	Still on the market? (HIPs), Property People No. 444	2004
CLG	Marketing of Residential Properties Regulations: Regulatory Impact Assessment – Annex on Costs/Benefits to Businesses and Consumers of the HIP with and without the HCR	2001
CLG	Piloting the Home Condition Report	2004
Office of Fair Trading	Estate Agency Market in England & Wales	2004
ODPM (Robertson and Whitehead)	Buyers and Sellers Perspectives of HIPs in Low Demand Low Value Housing Markets.	2003
ODPM (University of Stirling)	The Potential Impact of HIPs in Low Demand Low Value Housing Markets	2003
CLG (Martin Hamblin)	Evaluation of a Pilot Seller's Information Pack: The Bristol Scheme - Final Report	2002

Appendix 2: Topic guide for in-depth interviews

Preamble

The Department for Communities and Local Government has commissioned Ipsos MORI to undertake research to consider the relationship between condition and valuation, taking views from both lenders and consumers.

As part of this exercise, DTZ have been commissioned by Ipsos MORI to undertake depth interviews with industry stakeholders and we are seeking to consult with a number of lenders, solicitors and licensed conveyancers.

All views expressed will be treated in confidence and if used in reporting, will be done so anonymously. We will not report in any way that could identify an individual or organisation.

We would like to record this discussion to help us put together a note of the meeting. Do you have any objections to this?

Do you have any questions before we begin?

Questions

1. Could you introduce yourself and your role please?
2. **(For lenders only)** How is information for mortgage valuations currently gathered? Are there any plans to change this?
3. **(For solicitors and licensed conveyancers only)** What do you see as your role in the process? What advice do you give to consumers on valuations and condition information?
4. What is the nature of the information gathered for mortgage valuations and how is it used?
5. What are the strengths and limitations of this information?
6. What is the relationship between this information and property condition information?
7. What is your attitude towards using condition information as part of a mortgage valuation?
8. What is your view on the use of automated mortgage valuations? What are their strengths and limitations?
9. What other types of mortgage valuations are you aware of? Briefly, what are the strengths and limitations of each of these?

10. What are the opportunities and barriers of using condition information to inform automated mortgage valuations?
11. In your view, what information does a lender really need when providing a mortgage?
12. In your view, what is the information that a consumer would find the most useful when buying a home?
13. What is your view on consumers' understanding of the different products available when buying or selling a home, e.g:
- Mortgage valuation? (To what extent do you believe that the consumer views this as a survey? How do you advise them on this?)
 - Homebuyer's report?
 - Building survey?
 - Specialist survey?
 - Other(s)?
14. Which types of information do you believe consumers want in the home buying/selling process? When do they want this information? (i.e. at which stage in the home buying and selling process is it provided? Is this the best time for consumers/their solicitors and licensed conveyancers and lenders?)
15. Do you have any information of data on failed transactions due to valuation reports or any other reasons (e.g. refusing to lend full/any amount)? If yes, could this be shared with us?
16. Do you have anything else to add or qualify?

Many thanks for your cooperation

Home condition information cost benefit analysis

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Executive Summary

Background to cost-benefit analysis

CLG requested that DTZ undertake analysis of a voluntary system to increase the uptake of Home Buyer Surveys (or their equivalent). The focus was to be on the quantification of the costs and benefits of buyers procuring surveys direct from surveyors, rather than through their lender. Increased uptake scenarios were modelled on the basis of a potential price discount.

Benefit of condition information

The IM/DTZ research has confirmed that there is a strong case for government, working in partnership with intermediaries in the private sector to stimulate the increased uptake of condition information by consumers. This is based on the prevalence of information failure and the consequential lack of efficiency in the market mechanism. This results from buyers and sellers lacking the information to make the correct buy/sell decisions. The major issue relates to asymmetric information failure, where the information on property condition held by the seller is typically much greater than that held by the buyer.

Survey uptake – the base case

It is estimated that only 20 per cent – 40 per cent of buyers procure a Home Buyers Survey (or more detailed structural/technical survey). The corollary is that 60 per cent – 80 per cent of buyers rely solely on the mortgage valuation and their own assessment when viewing the property. In many cases this will not provide the range or depth of condition information required for the efficient operation of the market – especially for older houses and those in high risk areas relating to subsidence, flood risk, contamination, etc.

This is an extremely high figure and it begs the question as to why consumers are so reluctant to pay for condition information. Indicative costs for a combined mortgage valuation and Home Buyers Survey are c. £500 – 700, which represents only 0.3 per cent of the UK average house price of £200,000. Given that this is typically the largest such investment an individual normally makes in their lifetime, this is surprising.

Rationale for intervention

The rationale for intervention is based on the following observations:

- the existence of significant market failure compromising the efficiency of the market mechanism
- the deleterious effect this has in terms of the transaction process in terms of:
 - the transactions which go through which should not
 - vice-versa those that do not go through which should; and
 - the fact that the agreed match between house value and property condition frequently do not balance to the advantage/disadvantage of sellers or buyers
- the benefits which robust condition information can provide in addressing such problems

- the large proportion of buyers who do not avail themselves of such information – around 60 per cent – 80 per cent
- the interest, in principle, of the majority of buyers in accessing such information (c. 70%). This statistic is based on those who have had their 'eyes opened' and have actually paid for and used a condition information survey.

Description of model

Product offer – mortgage valuation and Home Buyer Survey (HBS) as a merged product (at present this is offered to the market by a range of different providers including lenders, surveyors and mortgage brokers)

Responsibility – buyer to initiate the survey

Timing – at time of mortgage valuation. This is assumed to be after a verbal offer has been made by the buyer.

Execution – 'professional surveyors' operating to a standard acceptable to mortgage lenders and RICS.

Buy-in – that there is the buy-in of the key stakeholders in the market mechanism – specifically mortgage lenders and RICS

Availability – universally available across England, but voluntary not mandatory.

Cost – key assumption is that a 'new product' combining mortgage valuation and HBS will be lower cost than the status quo model, where the majority of buyers go through their lenders.

Impact assessment

Three uptake scenarios have been modelled:

- high case – the total potential market of buyers interested, in principle, in property condition information – 70 per cent (a 40% increase on the current base of 30%)
- mid case – an intermediate estimate of uptake, which would result in the current base case increasing to 45 per cent (a 15% increase on the current base of 30%)
- low case – a minimal estimate of uptake, which would result in the current base case increasing to 35 per cent (a 5% increase on the current base of 30%)

IMPACT ON SURVEYOR FEES

Table 4.1 – Impact on surveyor fees for Home Buyer Surveys				
Systems	Total transactions p.a.	Take-up	Surveyor Fees per HBS	Total Fees p.a. (mid-point)
Current system	900,000	30%	£350 - £550*	£122m
<i>Alternative systems</i>				
High case	900,000	70%	£350-£550	£284m
Mid case	900,000	45%	£350-£550	£182m
Low case	900,000	35%	£350-£550	£142m
Note: * The actual charge to consumers under the current system via lenders lies in the range £550 - £700. However, we have assumed that the amount of fees going to the surveying profession would be reduced by £150 representing the handling and administrative charges of lenders.				

As the table highlights, the total value of surveyor fees will increase under all three scenarios:

- **low case scenario** – the surveying sector would gain £20m in fees per annum, representing a 16 per cent increase
- **mid case scenario** – the surveying sector would gain £60m in fees per annum, representing a 49 per cent increase
- **high case scenario** – the surveying sector would gain £162m in fees per annum, representing a 133 per cent increase

Given that our best estimate is that the outturn will lie somewhere between the low and mid case scenarios, the increase in surveyor fees is most likely to lie in the range £20m – £60m per annum.

IMPACT ON CONSUMER FEES

Consumer ‘savings’ are defined in terms of the average reduction in survey costs multiplied by the number of buyers paying for a survey under the low, mid and high case scenarios: see Table 2. The savings range from £47m under the ‘low case’ to £95m under the ‘high case’.

Table 2 – Impact on consumer fees				
Systems	Total transactions	Take-up	Cost Saving per Survey	Cost Saving (mid-point)
High case	900,000	70%	£150	£95m
Mid case	900,000	45%	£150	£61m
Low case	900,000	35%	£150	£47m

IMPACT ON LENDERS’ FEES

There is a direct inverse relationship between the value of cost savings to consumers and the value of lost income to the lending sector. Hence, under the ‘low case’ scenario lenders will suffer a reduction in net income of £47m, but offsetting this will be the elimination of their handling and administrative costs associated with the organisation of Level 2 surveys for 315,000 transactions.

IMPACT ON HOUSE PRICES AND REMEDIAL WORK

There is survey and anecdotal evidence that buyers often use property condition information to negotiate on price and/or secure remedial work by the seller prior to the exchange of contracts. This represents a benefit to buyers in that they are securing an outcome which more accurately matches house price to property condition. From the perspective of sellers this will be perceived as a cost.

DTZ has used the following assumptions for modelling the financial value of these benefits for buyers:

- twenty per cent of those having a survey (Home Buyers Survey or more detailed) negotiate on price and/or seek rectification of the identified problem through remedial works implemented by the seller
- £2,000 represents the average value of this benefit (combined house price reduction and/or the value of remedial works paid for by the seller)

Using this information allows us to calculate the benefit to buyers of having a Home Buyers Survey or equivalent: see Table 3.

Key Parameters	Low Case	Mid Case	High Case
% Uptake in surveys	5%	15%	40%
No. of additional surveys p.a. (base = 900,000)	45,000	135,000	360,000
% resulting in price negotiation and/or rectification of problem	20%	20%	20%
No. of Surveys resulting in price negotiation /rectification	9,000	27,000	72,000
Value to Buyers @ average of £2,000 per transaction	£18m	£54m	£144m

Other impacts

It has not been possible to quantify the impact of this model on transaction failure rates and average transaction duration, and this is excluded from the cost-benefit analysis. However, we believe that the impact of property condition information is more likely to increase the rate of transaction breakdowns and increase average duration, although the significance of this is debatable.

Conclusion

The success of such a voluntary model, as measured by its increased 'penetration' of the 40 per cent of potentially interested home buyers who do not purchase a Home Buyers Survey, will depend on three key variables:

- **Price differential** - the presence of a price differential between the lender survey route and the independent surveyor route, which is sufficiently material to influence buyer behaviour. Regarding the latter, it is not clear whether the price signals would actually be effective in changing home buyer behaviour. DTZ believes the most important

factor in constraining the uptake of condition information is information failure, not price per se. It is likely that the variation in price would have to be significant for there to be a substantive change in uptake (i.e. surveys are price inelastic).

- **Lender engagement** - the willingness of lenders to forego the commissioning of their own mortgage valuation report is critical to the new model. This would mean that the home buyer does not need to pay for a mortgage valuation twice: once through the lender and once through the 'new product' commissioned direct from a surveyor. Instead, the lender accepts the 'third party' valuation contained in the level 2 survey commissioned by the buyer. This 'saving' is essential if the model is going to work.
- **Buyer education** – although not articulated overtly by CLG, DTZ believe that one of the most important factors to underpin the success of the model will be information dissemination and the education of buyers directly and indirectly via intermediaries such as estate agents, conveyancers and mortgage brokers. Based on anecdotal feedback we believe that, in certain instances, this may be difficult to achieve due to the vested interests of intermediaries suppressing information which may compromise the conclusion of a transaction. Their goal is to achieve a fast turnaround with minimal delays, and condition reports could be seen as potential obstacles that may delay or terminate transactions.

To conclude, it is likely to be very difficult to generate a substantive uplift in buyer engagement with property condition information if the model operates on a voluntary basis.

1. Introduction

1.1 Preliminary research

On behalf of Communities and Local Government (CLG), DTZ was sub-contracted by Ipsos MORI in May 2009 to undertake research and analysis relating to the costs and benefits of upfront condition information and the potential cost savings for consumers.

Two pieces of research were conducted and have been issued to CLG as an Annex Report focusing on:

- a desk review of relevant literature
- in-depth interviews with solicitors and lenders

Alongside the findings from the Ipsos MORI (IM) research, this information was presented at a client meeting on 26 June 2009, prior to the development of the cost-benefit analysis. At this meeting CLG instructed the consultancy team to focus on the scope to increase the uptake of condition information by consumers on a voluntary basis. This information was presented as part of a summary report to the Working Group on 13 July 2009.

Based on feedback from CLG and the Working Group, a number of changes and enhancements were put through, which have been reflected in this Final Report.

1.2 Scope of work

Given the short timescale for this final piece of work, DTZ has focused its efforts on modelling potential scenarios resulting in the increased uptake of Home Buyer Surveys. It has not been possible to produce accurate quantitative measures for the key assumptions in this model. However, the quantitative modelling is helpful in providing an indication of the cost and benefit implications for both businesses and consumers. Also, the qualitative assessment provides a valuable insight into the pros and cons of the proposed model.

Clearly, to produce more robust quantitative cost-benefit impact data would require significant further work to review, validate and enhance this model through primary research.

2. Rationale for condition information

2.1 Benefits of condition information

The IM /DTZ research has confirmed that there is a strong case for government, working in partnership with intermediaries in the private sector, to stimulate the increased uptake of condition information by consumers. This is based on the prevalence of information failure and the consequential lack of efficiency in the market mechanism. This results from buyers and sellers lacking the information to make the correct buy/sell decisions. The major issue relates to asymmetric information failure, where the information on property condition held by the seller is typically much greater than that held by the buyer. However, this is not always the case i.e. the seller may be ignorant of significant problems such as dry rot. In this case both parties suffer from information failure equally.

If the buyer does not commission a survey to review property condition then the adverse consequences can be:

- the buyer may have unjustified positive or negative perceptions of the property in the absence of condition information, which results in either entering into a purchase contract when they should not or, conversely, backing out of a contract due to unfounded concerns
- in the case of the former the buyer enters into a formal contract which potentially overstates the true value of the property; and in the latter, the seller does not secure a sale when if the market was operating efficiently the transaction would have been concluded to the satisfaction of both parties

Clearly, it is in the interests of both sellers and buyers to have robust property condition information upon which to base the sales process. However, perversely, better informed buyers through an increased uptake of property condition surveys after verbal offers have been made, may actually lead to an increase in transaction breakdown and longer average transaction durations.

TRANSACTION BREAKDOWNS

The probability of the transaction breaking down before legal contracts are exchanged may be greater. This reflects potential downstream problems emerging on property condition before legal contacts are exchanged, which could result in buyers withdrawing their offer.

TRANSACTION DURATION

Alternatively, this survey information could result in delays and longer average transaction periods, while the buyer and seller negotiate trade-offs in the value of remedial work versus variations in the house price offer.

2.2 Uptake of condition information

Given the clear benefits to buyers of having accurate condition information it is surprising that the uptake of condition surveys by buyers is so low. DTZ did not manage to secure population level data, but survey sources suggest that the combined figure for Home Buyer Surveys and Full Structural Surveys could be as low as 20 per cent, with a high figure of c. 50 per cent. Sources include:

- anecdotal figures from surveying industry sources tended to give low figures of c. 15 - 20 per cent
- IM survey work, a report by the University of Plymouth and Which? give higher figures – see Figure 2.1

Figure 2.1 – Uptake of property condition surveys in the UK			
Sources	Home Buyers Survey	Specialist Survey*	Total
“Home Information Pack Area Trials” - Ipsos MORI for CLG – March 2008	38%	16%	54%
“The Role of Condition Information in the Home Buying and Selling Process: Findings from an Online Survey of Buyers and sellers” – Ipsos MORI for CLG – June 2009	32%	16%	48%
“Will the withdrawal of the Home Condition Report as a mandatory element of the Home Information Pack still make the pack worthwhile to the consumer?” – Robert Dixon, School of Environmental Design and Management, University of Plymouth -	27%	13%	40%
“The Point of Viewing” – Which? Report May 2008	-	-	< 50%
Note: * ‘Specialist Surveys’ have been defined to include structural surveys, involving a more detailed scrutiny of property condition than one would get in a Home Buyers Survey, usually involving structural / other engineering skills.			

DTZ believes that the survey data above represent the ‘high end’ of what the real figure is. This relates to the fact that there is considerable confusion amongst consumers as to what a ‘survey’ actually comprises, especially amongst new and inexperienced buyers. Therefore, it is quite possible that in some cases what they believe to be a ‘Home Buyers Survey’ is in fact a mortgage valuation. This view was expressed to us by a number of surveyors consulted.

The consequence is that the 50 per cent figure represents the upper limit, and the reality is that the formal survey percentage is likely to lie somewhere in the range 20 per cent – 40 per cent. This was the range used by ODPM in its 2001 Regulatory Impact Assessment¹, and it is the range adopted by DTZ in its cost-benefit modelling in Section 4 of this report.

¹ *Marketing of Residential Properties Regulations: Regulatory Impact Assessment* – ODPM, 15 Feb 2001.

Recommendation: further work is undertaken to determine whether CML or other industry sources have access to accurate population level data on the uptake of property condition surveys. This is a key building block for accurate market analysis and for the formation of government policy.

2.3 Implications of low survey uptake

The implication of the above analysis is that around 60 per cent – 80 per cent of buyers are relying on a mortgage valuation only, which does not provide the range or depth of condition information required for the efficient operation of the market. This is an extremely high figure and it begs the question as to why consumers are so reluctant to pay for condition information. Indicative costs for a combined mortgage valuation and Home Buyers Survey are c. £500 – 700, which represents only 0.3 per cent of the UK average house price of £200,000. Given that this is typically the largest such investment an individual normally makes in their lifetime, this is surprising.

Explanatory factors include:

Information failures:

- Buyers, especially first-time buyers, do not understand the range of potential property condition issues that can impact on the value of a house and/or their willingness to purchase it. These include flood risk, subsidence, contamination, structural defects, serious deterioration of the structure or services, etc.
- Buyers misunderstand what is contained in the mortgage valuation and believe that they are actually buying a survey which addresses condition information alongside the valuation. If a price of up to £500 is charged, then this is understandable.

Price sensitivity:

- Given the major sums involved in the house purchasing process and the variety of professional fees being paid to the lender, estate agent and solicitor, it is understandable that when given an option on surveys, the lowest cost option is often selected. Again, this is more likely to be a symptom of information failure, rather than an inability to pay. In other words, if the buyer was correctly informed they would evaluate their requirements differently and place a value on property condition information greater than or equal to the additional cost of a Home Buyers Survey or Structural Survey.

Notwithstanding the low uptake of condition information surveys, the IM June 2009 survey² identified significant consumer interest in such information:

- seventy per cent of all buyers felt that the condition information they received or commissioned, from any source, was 'fairly useful' or 'very

² *The Role of Condition Information in the Home Buying and Selling Process: Findings from an Online Survey of Buyers and sellers – Ipsos MORI for CLG – June 2009*

useful'. This suggests that if non-users of condition information are 'converted' to commissioning a survey, they will find this information helpful; and

- seventy-one per cent of those surveyed believe that home buyers should see condition information about the property when first viewing a property. This indicates that over two-thirds of buyers would like such information even if a significant proportion of them are not willing to pay for it

2.4 Conclusion

To conclude, the rationale for intervention is based on the following observations:

- the existence of significant market failure compromising the efficiency of the market mechanism
- the deleterious effect this has in terms of the transaction process in terms of:
 - the transactions which go through which should not
 - vice-versa those that do not go through which should; and
 - the fact that the agreed match between house value and property condition frequently do not balance to the advantage/disadvantage of sellers or buyers
- the benefits which robust condition information can provide in addressing such problems
- the large proportion of buyers who do not avail themselves of such information – around 60 per cent – 80 per cent
- the interest, in principle, of the majority of buyers in accessing such information (c. 70%). This is once they have had their 'eyes opened' and have actually paid for and used a condition information survey.

Size of target market for condition information surveys

Assuming a voluntary approach to encouraging home buyer uptake of condition information, there is a market potential of:

- Proportion of market interested in property condition information (once information failures have been addressed) 70%
- Proportion of home buyers commissioning condition information surveys 20% – 40%
- Estimated size of target market to address information failure 30% – 50%

3. Intervention model

3.1 Intervention options

To improve the uptake of property condition information to assist the market mechanism, the surveys can be conducted either by the buyer or the seller. The seller route has been pursued via HIPs and HCRs and there is a significant amount of information available on the pros and cons of this system. Rather than investigate this avenue further and its implications for either voluntary or mandatory take-up, CLG requested that Ipsos MORI and DTZ explore intervention options to stimulate the uptake of condition information surveys within the home buyer community.

3.2 Description of model

The model articulated by CLG is based on stimulating the market to increase the uptake of a combined mortgage valuation and Home Buyers Survey product (referred to in the industry as a 'level 2' survey). Transaction duration and failure rates are not considered as part of the analysis and are assumed to be unchanged for the purpose of this model (although as discussed in Section 2, they may actually increase). The objective is to exploit a perceived price differential between the cost of this product as offered by lenders and the cost of the product if buyers go direct to a surveyor. The latter option cuts out the 'middle man' and administrative handling costs of the lender and panel manager.

The key parameters of the model are:

- *Product offer* – mortgage valuation and Home Buyer Survey (HBS) as a merged product (at present this is offered to the market by a range of different providers including lenders, surveyors and mortgage brokers).
- *Responsibility* – buyer to initiate the survey.
- *Timing* – at time of mortgage valuation. This is assumed to be after a verbal offer has been made by the buyer.
- *Execution* – 'professional surveyors' operating to a standard acceptable to:
 - Mortgage lenders – the assumption is that if the integrity of the product is robust in terms of valuation, timeliness and reporting, then the mortgage lenders would adopt the 'new' product and use it as a replacement for its in-house mortgage valuation (this assumption has not been tested with the industry).
 - RICS in terms of execution of HBS (their own product has recently been rebranded as 'Home Buyers Report' – which used to be called 'Home Buyers Survey and Valuation Report'). Based on preliminary discussions with RICS the extent to which the product would be open to Home Inspectors to deliver along with RICS' members needs to be explored further.
- *Buy-in* – that there is the buy-in of the key stakeholders in the market mechanism – specifically mortgage lenders and RICS.

- *Availability* – universally available across England, but voluntary not mandatory.
- *Cost* – key assumption is that a ‘new product’ combining mortgage valuation and HBS will be lower cost than the status quo model, where the majority of buyers go through their lenders. Although we do not have hard data, our anecdotal evidence suggests that this price differential may pertain, and we have estimated this in our modelling in Section 4. However, it is a complex process to estimate such differentials given the wide range of organisations offering surveys, the lack of consistency in the scope of surveys and the wide price differentials for surveys of the same specification. To determine robust price differentials would require detailed research across the industry.

3.3 Key assumptions

As described above, the key assumptions that will determine the success of this model are:

- **Price differential** - the presence of a price differential between the lender survey route and the independent surveyor route, which is sufficiently material to influence buyer behaviour. Regarding the latter, it is not clear whether the price signals would actually be effective in changing home buyer behaviour. As discussed in Section 2, we believe the most important factor in constraining the uptake of condition information is information failure, not price per se. It is likely that the variation in price would have to be significant for there to be a substantive change in uptake.
- **Lender engagement** - the willingness of lenders to forego the commissioning of their own mortgage valuation report is critical to the new model. This would mean that the home buyer does not need to pay for a mortgage valuation twice: once through the lender and once through the ‘new product’ commissioned direct from a surveyor. Instead, the lender accepts the ‘third party’ valuation contained in the level 2 survey commissioned by the buyer. This ‘saving’ is essential if the model is going to work.
- **Buyer education** – although not articulated overtly by CLG, DTZ believe that one of the most important factors to underpin the success of the model will be information dissemination and the education of buyers directly and indirectly via intermediaries such as estate agents, conveyancers and mortgage brokers. Based on anecdotal feedback we believe that, in certain instances, this may be difficult to achieve due to the vested interests of intermediaries suppressing information which may compromise the conclusion of a transaction. Their goal is to achieve a fast turnaround with minimal delays, and condition reports could be seen as potential obstacles that may delay or terminate transactions.

To conclude, it is likely to be very difficult to generate a substantive uplift in buyer engagement with property condition information if the model operates on a voluntary basis. We have modelled different scenarios in Section 4 to allow for this. In short, a mandatory system focused on sellers not buyers, and which includes both valuation and condition information is likely to be the most effective route.

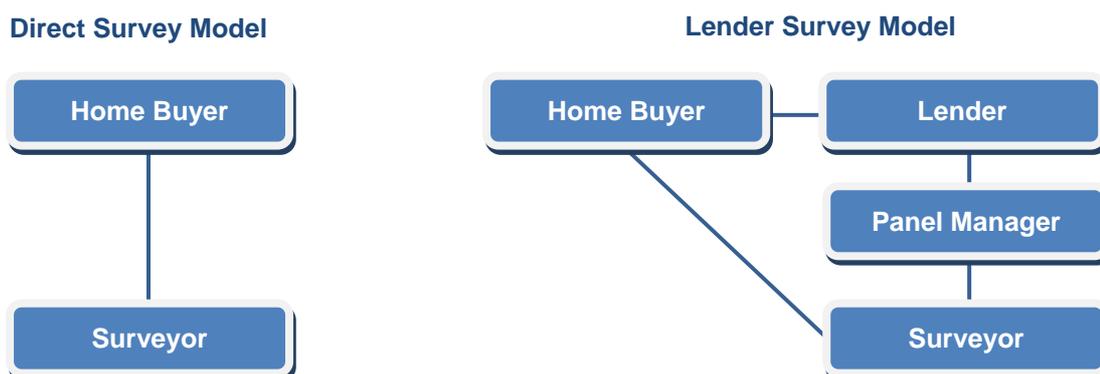
4. Cost-benefit modelling

This section undertakes some indicative economic modelling work to consider the potential size of impact of a move away from the current system where the majority of buyers³ commission their condition information surveys via their lenders. The assumption is that the lenders are providing the level 2 combined mortgage valuation and HBS at a cost that is higher than what the home buyer could obtain elsewhere due to the lender's administration fee and panel costs.

DTZ's consultations from within the industry suggest that there may be an element of management and administration handling costs being imposed by the three tier system operated by lenders which is higher than a direct commission between the buyer and surveyor: see Figure 4.1.

If this option were to be pursued, further research would be required to confirm the extent, if any, of potential cost savings to buyers from the 'direct survey model' route. However, for the purpose of this exercise, CLG wished to explore the implications of this change in the purchasing relationship.

Figure 4.1 – Procurement routes for property condition surveys



Recommendation: further work is undertaken to determine comparative price information for:

- *Lender commissioned surveys* – mortgage valuations and level 2 surveys
- *Directly commissioned surveys* – the cost of a combined level 2 survey

4.1 Current system

Proportion of buyers without property condition survey information - The current system largely involves the mortgage valuation and HBS conducted through the lender. Based on our interpretation of the evidence reviewed in Section 2, our indicative estimate is a current take-up rate of around 20 per cent - 40 per cent for property condition information, which is the range we have used in our modelling.

³ DTZ did not identify population level data which specifies the proportion of buyers which source their condition information surveys via lenders as opposed to other routes such as direct with surveyors. Industry opinion was that the majority of surveys were commissioned via lenders in England.

Estimation of market potential - results from MORI's consumer survey (2009) suggests a reasonable maximum demand figure for this information is around 70 per cent. Seventy-one per cent of consumers said that home buyers should see information about the property when they are buying or viewing it, and 70 per cent said that they found survey/condition information to be useful in informing their decisions overall about the property.

This gives us a figure for 'latent' demand of around 30 per cent – 50 per cent, i.e. this represents the maximum size that the market for this type of product could grow to if everyone who, in principle, valued the use of survey/condition information actually purchased it.

Cost of Level 2 survey - the cost of a mortgage valuation and home buyer's report varies between lenders. By considering figures from a number of lenders, including Northern Rock, Alliance & Leicester and Lloyds TSB, a reasonable range would appear to be £500-£700 on an average property (price around £200,000 to £250,000).

4.2 Proposed new system

The proposed new system on which we were asked to model impact would involve home buyers purchasing the mortgage valuation and HBS product directly from surveyors. The belief is that by making the product cheaper, i.e. removing the administrative handling costs of lenders and the panel managers, consumers may be more willing to buy this information due to its lower cost.

We assume that this valuation/survey would be carried out professionally (by qualified surveyors), have RICS endorsement, was supported by the lending industry, although was a voluntary rather than a mandatory requirement.

Cost of Level 2 survey – figures obtained from a number of surveyors, including Allied Surveyors and Colleys, suggests that the cost of a valuation/survey is around £350-£550.

Estimation of cost saving under new system - given the costs supplied above for obtaining this through lenders, this suggests that there could be a mark-up in the order of £100 – £150 to cover administration and handling fees, which does not seem unreasonable. We would therefore expect the saving of consumers obtaining the product directly from surveyors to be up to £150.

Health Warning: the above figures on price differentials are indicative only. Further detailed research is required to provide more robust and evidence-based data on the relative survey costs and the extent of a price differential, if any.

It is important to point out that the costs of the directly commissioned surveys excludes search costs, i.e. costs for the consumer in undertaking this purchase directly themselves by searching for suitable suppliers, agreeing contracts, etc. It also assumes that the supplier will be of a similar quality and take a similar period of time to undertake this exercise than under the current system. Therefore, for some consumers, it is likely that a marginal price differential versus the additional administrative time involved may be insufficient to encourage them to commission a property condition survey.

4.3 Impact assessment

High case scenario – as argued above, the maximum additional proportion of consumers who would be likely to obtain the product lies in the range 30 per cent – 50 per cent. For the purposes of modelling we have therefore taken 40 as our ‘high case’ scenario (i.e. the mid-point of the range). In reality this is a theoretical maximum which is very unlikely to be achieved, but it does provide a ceiling on the size of potential impact.

Low case scenario – we have also modelled impacts for minimal impact (the ‘low case’), which we think is appropriate at 5 per cent additional impact. This should be near to zero as it should provide a floor on the size of impact. We believe this figure is reasonable given the problems of information failure discussed in Section 2, and our view that the demand for property condition information is relatively price inelastic.

Mid case scenario - our final scenario represents a mid case between these two extremes. It seems reasonable to have this at around 15 per cent. However, to achieve this figure would require a successful awareness raising campaign, with both the public and private sectors working together to address this challenging communications issue.

Assessment of likely outturn: attainment of the ‘mid case’ scenario is very challenging and would require a sea-change in attitudes throughout the industry, buy-in from lenders and professional intermediaries, supported by a major communication campaign supported by both government and the representative bodies of the intermediaries in the private sector. In reality therefore, the ‘mid case’ is more of a practical maximum and all we can say at this stage is that uptake is likely to lie somewhere between 0 per cent – 15 per cent.

Recommendation – if this model is to be considered further, then the key assumptions on uptake should be tested with consumers through a robust quantitative survey. This will enable more accurate estimates of low, mid and high case scenarios to be developed.

Calculation of population size – the number of relevant transactions was obtained from Bank of England data. We took a five-year average of new mortgages (excluding re-mortgages) for England from 2004-2008. This provided a figure of 1.1 million. Results from MORI’s consumer survey (2009) imply that around 19 per cent of properties are bought with NHBC cover⁴. These homes also need to be excluded from the analysis. This provides a total population figure of around 900,000 relevant residential transactions in a typical year.

⁴ DTZ is awaiting population level data from NHBC on properties with NHBC cover, but this was not available by the date of report issue.

Impact assessment – DTZ has categorised the impact of this model into three groups:

- impact on surveyor fees
- impact on consumer fees
- impact on house prices and remedial work

It has not been possible to quantify the nature of this model on transaction failure rates and average transaction duration, and this is excluded from the cost-benefit analysis. However, as discussed in Section 2 we believe that the impact of property condition information is more likely to increase the rate of transaction breakdowns and increase average duration.

IMPACT ON SURVEYOR FEES⁵

Table 4.1 estimates the impact on surveyor fees under the three alternative scenarios. In simplifying these calculations, for clarity, we are assuming that all customers currently are going through lenders to obtain their surveys and, under proposed plans, that none will. In practice, consumers do obtain surveys independently currently and some consumers will still obtain their valuation/survey through their lender under the new system. However, we are making the assumption that these effects balance out each other when looking at the costs and savings comparatively.

Table 4.1 – Impact on surveyor fees for Home Buyer Surveys				
Systems	Total transactions p.a.	Take-up	Surveyor Fees per HBS	Total Fees p.a. (mid-point)
Current system	900,000	30%	£350 - £550*	£122m
<i>Alternative systems</i>				
High case	900,000	70%	£350-£550	£284m
Mid case	900,000	45%	£350-£550	£182m
Low case	900,000	35%	£350-£550	£142m
Note: * The actual charge to consumers under the current system via lenders lies in the range £550 - £700. However, we have assumed that the amount of fees going to the surveying profession would be reduced by £150 representing the handling and administrative charges of lenders.				

As the table highlights, the total value of surveyor fees will increase under all three scenarios:

- **low case scenario** – the surveying sector would gain £20m in fees per annum, representing a 16 per cent increase
- **mid case scenario** – the surveying sector would gain £60m in fees per annum, representing a 49 per cent increase
- **high case scenario** – the surveying sector would gain £162m in fees per annum, representing a 133 per cent increase

Given that our best estimate is that the outturn will lie somewhere between the low and mid case scenarios, the increase in surveyor fees is most likely to lie in the range £20m – £60m per annum.

⁵ 'Surveyor fees' under the current system represent the fees going to organisations charging consumers for property condition surveys, which includes mortgage lenders, solicitors/conveyancers and surveyors.

IMPACT ON CONSUMER FEES

Consumer ‘savings’ are defined in terms of the average reduction in survey costs multiplied by the number of buyers paying for a survey under the low, mid and high case scenarios: see Table 4.2. The savings range from £47m under the ‘low case’ to £95m under the ‘high case’.

Table 4.2 – Impact on consumer fees				
Systems	Total transactions	Take-up	Cost Saving per Survey	Cost Saving (mid-point)
High case	900,000	70%	£150	£95m
Mid case	900,000	45%	£150	£61m
Low case	900,000	35%	£150	£47m

IMPACT ON LENDERS’ FEES

There is a direct inverse relationship between the value of cost savings to consumers and the value of lost income to the lending sector. Hence, under the ‘low case’ scenario lenders will suffer a reduction in net income of £47m, but offsetting this will be the elimination of their handling and administrative costs associated with the organisation of Level 2 surveys for 315,000 transactions.

IMPACT ON HOUSE PRICES AND REMEDIAL WORK

There is survey and anecdotal evidence that buyers often use property condition information to negotiate on price and /or secure remedial work by the seller prior to the exchange of contracts. This represents a benefit to buyers in that they are securing an outcome which more accurately matches house price to property condition. From the perspective of sellers this will be perceived as a cost.

As summarised in Table 4.3, two sources have been identified which quantify the value of these benefits: the first is a survey commissioned by BBG Surveyors in 1999 and the second is Which? Report published in 2008.

Table 4.3 – Impact on house prices and remedial work		
Source	Negotiation on Price (with Home Buyers Survey)	Unexpected Repair Bills (without Home Buyers Survey)
“Home Valuations and Surveys” – BBG Surveyors, Oct 1999	<ul style="list-style-type: none"> • 20% of buyers who had a survey renegotiated the house price • c. 9% saved > £1,000 	<ul style="list-style-type: none"> • 18% facing unexpected repair bills • 8% of cases, repair bill > £500 • 3% of cases, repair bill > £1,000
“The Point of Viewing” – Which? Report, May 2008 (sample of 504 members of the public who had bought a house in the previous five years – Jan 2008 the survey date)	<ul style="list-style-type: none"> • > 20% of buyers identified problems through a survey, which they failed to spot themselves • Of these buyers, 54% either negotiated on price and/ or secured remedial work from the seller • This equates to c. 12% of buyers who renegotiated 	<ul style="list-style-type: none"> • 25% of buyers experienced problems with the condition of their house after moving in • £2,500 was the average cost of putting these problems right • For 10% of new home owners spent > £10,000

	on price and/or secured remedial work from the seller (note: this is likely to underestimate the 'negotiation %' as the 12% figure excludes those who will use a survey report to negotiate even when there are no 'unidentified' problems).	
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Drawing upon these results, DTZ has used the following assumptions for modelling the financial value of these benefits for buyers:

- twenty per cent of those having a survey (Home Buyers Survey or more detailed) negotiate on price and/or seek rectification of the identified problem through remedial works implemented by the seller
- £2,000 represents the average value of this benefit (combined house price reduction and/or the value of remedial works paid for by the seller).

Using this information allows us to calculate the benefit to buyers of having a Home Buyers Survey or equivalent executed: see Table 4.4.

Key Parameters	Low Case	Mid Case	High Case
% Uptake in surveys	5%	15%	40%
No. of additional surveys p.a. (base = 900,000)	45,000	135,000	360,000
% resulting in price negotiation and/or rectification of problem	20%	20%	20%
No. of Surveys resulting in price negotiation /rectification	9,000	27,000	72,000
Value to Buyers @ average of £2,000 per transaction	£18m	£54m	£144m

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