

Home buying and selling

A Market Study

February 2010

OFT1186

© **Crown copyright 2010**

This publication (excluding the OFT logo) may be reproduced free of charge in any format or medium provided that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as crown copyright and the title of the publication specified.

CONTENTS

| <i>Chapter</i> | <i>Page</i> |
|---|-------------|
| 1 Executive Summary | 4 |
| 2 Introduction | 13 |
| 3 The market for home buying and selling | 19 |
| 4 Choice and competition in home buying and selling | 49 |
| 5 Regulation, the positive licensing debate and enforcement | 98 |
| 6 Ancillary services | 122 |
| 7 The home buying and selling process | 146 |
| 8 Home buying and selling in Scotland | 170 |
| Annexes | |
| A Summary of the applicable laws | 205 |
| B Estate Agency chains and affinity groups | 209 |
| C Ancillary service fees in the USA | 212 |
| D Consumer protections, Ancillary services | 217 |
| E The traditional process for buyers and sellers | 219 |
| F List of consultees and contributors | 225 |

1 EXECUTIVE SUMMARY

- 1.1 In 2007 there were 1.6 million residential property transactions in the UK with a total value of £361 billion. The recent economic downturn has seen a sharp decline in the number of homes being bought and sold. Transactions fell in 2008 and again in 2009 but began to climb in the second half of 2009, with over 60 per cent of transactions taking place in the final two quarters.
- 1.2 We believe that there are approximately 14,500 traditional residential estate agent offices in the UK. The traditional estate agency market, excluding fees for ancillary services, was worth approximately £4.2 billion in 2007, falling to £2.1 billion in 2008, mainly because of the large drop in transactions.
- 1.3 Consumer satisfaction with traditional estate agents has improved in recent years. We found that 12 per cent of consumers were dissatisfied with the service provided by their estate agent, down from 2004 when we found dissatisfaction among sellers and buyers of 26 and 28 per cent respectively.
- 1.4 Consumers do not often blame traditional estate agents for problems which may arise when buying or selling a home. For many consumers, traditional estate agents provide a good service and they are happy with the face to face contact and traditional package for selling their home. It remains the case, however, that there isn't a great deal of choice for consumers who may prefer different, and cheaper, ways of buying and selling a home.
- 1.5 In recent years, Internet portals have transformed the way people search for a home. But behind the portals the market is still dominated by traditional estate agents, whose business practices and charging structures have remained largely unchanged over the years.

Price competition between traditional estate agents remains weak and commission rates are sticky – this means that as property prices rise during booms, in real terms, so too do estate agents fees.

- 1.6 There are a number of market features which are behind the weak price competition: predominantly consumer preferences and behaviour; the pricing structure and form of contracts that predominate in the market; and the lack of innovation by traditional estate agents, coupled with the lack of significant penetration by alternative business models.

We believe that the best way to tackle the lack of price competition is to promote and encourage new business models which may provide choice and put pressure on the traditional model.

Promoting competition and innovation

- 1.7 Some new business models have emerged in the UK, such as online estate agents and private seller websites, but, to date, uptake has been limited. In the US, by contrast, there are reports that alternative brokerage models had grown to represent approximately 15 per cent of transactions in 2006.
- 1.8 Our consumer research explored attitudes to alternative business models and found that over a quarter of sellers (27 per cent) who used a traditional estate agent had considered using an alternative selling method. While this is still a minority of sellers, online estate agents and other alternative models are generally quite small scale and relatively new, so even this level of awareness and interest is significant and represents an important change since our 2004 study.
- 1.9 Legislation, however, has not changed. The definitions of estate agent which trigger a raft of regulation are over 30 years old and do not easily accommodate new business models which may not, in fact, pose risks for consumers. Regulation for these new models could safely be lighter and the current legislation may be preventing, or discouraging, innovation.

The definition of estate agent in the relevant legislation dates from 1979. This legislation may be hindering the development of new business models and should be updated as soon as possible.

- 1.10 Selling homes privately has become less popular in recent years. This may, in part, be because the major Internet property portals are now such an important feature of marketing homes but remain unavailable for private sellers or platforms dedicated to providing services for private sellers.

Accessing Internet portals

- 1.11 Our survey of estate agents showed that almost all estate agents depend on the major property portals and rate them as important to their business.
- 1.12 In the past, we have received representations from new entrants without a traditional high street presence about problems accessing the major property portals. During our study, however, we found that most online estate agents now list property on all the major portals.

We do not believe that there is currently a need to intervene to ensure that online estate agents are able to access the major Internet property portals. This is an area we will be monitoring closely in the future.

- 1.13 On the other hand, many private seller websites and classified advertising websites are not able to access the major portals. We believe that there is a prospect of a market solution to this issue. In particular, if some of the regulatory barriers discussed earlier are removed, it seems clear that there is the opportunity for new players to provide a solution.

We think there is space for new players to enter the portal market and provide platforms for private sellers. We think there is potential for such new players to have the necessary scale to overcome network effects and the brand to overcome the issues of trust which currently persist in most online markets.

- 1.14 An alternative to a major player in the portal space taking advantage of the opportunity to provide a missing service, and so increasing trust in new online alternative business models generally, would of course be entry into online estate agency by a trusted brand. Large, well-known

traditional estate agents have not migrated across to the online model. It may, however, simply be a matter of time before one does and its competitors follow.

HIPs

- 1.15 We received mixed views about the necessity and value of compulsory HIPs in their current form. Criticism tends to focus on the cost imposed on sellers and the requirement to have a HIP in place before a home is marketed, which is said to create delay. On the positive side, there is some indication that HIPs help buyers make decisions about a property.
- 1.16 It is hard to see either a significant positive, or negative, impact of HIPs in their current form. Nevertheless, HIPs make information available to prospective buyers early in the process, and some buyers said they found the information useful and that it influenced their decisions, so it could be argued that HIPs in their current form have a positive impact.
- 1.17 Concerns were raised with us about the price estate agents charged sellers for HIPs. We would expect any gap between wholesale and retail prices to reduce over time, as consumers become more familiar with HIPs and as direct sales become more common. If retail prices remain high, HIPs providers will more actively market themselves directly to sellers which will put pressure on the margin estate agents can charge.

We believe that significant price differentials between what estate agents are able to charge sellers for HIPs and the wholesale price is likely to be a temporary phenomenon.

Addressing conflicts of interest

- 1.18 At present, estate agents may receive a fee or commission for referring prospective buyers to other service providers (for example solicitors or mortgage advisors), provided they disclose to the seller the existence of

such fees and commissions if the buyer makes an offer.¹ The prospect of additional income may give the estate agent a financial incentive to prefer some buyers over others. For example, a £350 fee paid to an estate agent for introducing a buyer could significantly alter the agent's incentives to recommend to a seller that they accept that particular offer:

| | Competing Buyers | |
|-------------------------------|------------------|----------|
| | Buyer 1 | Buyer 2 |
| Offer | £160,000 | £175,000 |
| Commission rate | 1.60% | 1.60% |
| Fee for Selling House | £2,560 | £2,800 |
| Fee for mortgage introduction | £350 | |
| Potential income | £2,910 | £2,800 |

- 1.19 In the above example, the agent would be better off persuading the seller to accept the offer from Buyer 1, even though Buyer 2 might offer £15,000 more. There is a risk that the agent either fails to pass on Buyer 2's offer, persuades the seller that Buyer 1 is a more secure prospect than Buyer 2, or, if faced with an offer from Buyer 1 only, persuades the seller to accept that offer rather than hold out for a higher price.

We recommend that, as part of its work on the future of estate agency regulation, Government consider further whether the potential for conflicts of interest should be removed, including a ban on such payments.

Comparing Scotland and England and Wales

- 1.20 Strictly speaking, in England and Wales, there is no 'transaction' at all at the point when a seller accepts an offer. There is only the potential for a transaction at a verbally agreed price. Until exchange of contracts, either side can pull out without being liable to the other for losses incurred.

¹ See Annexe D for a list of the main duties of estate agents to disclose referral fees to sellers.

- 1.21 A buyer may try 'gazundering' a seller by proposing a revised and reduced offer just before the transaction is due to become binding on both parties. A seller may 'gazump' a buyer by accepting a later better offer, or may decide at the last minute to raise the price they are willing to accept.
- 1.22 Failures in chains of transactions involve wasted costs for buyers, sellers and service providers, and stress and wasted time for both buyers and sellers. Our consumer research suggests that 46 per cent of sellers believed that their most recent transaction was part of a chain.
- 1.23 We have compared the home buying and selling process in England and Wales to that in Scotland - there are reasons to think that consumers in Scotland may be more satisfied with the process and that it has some advantages. The key differences between England and Wales and Scotland are: an earlier commitment by the parties in the process; and the Scottish Home Report, which includes a seller commissioned survey.
- 1.24 Some stakeholders told us that they believed the key to improving the process in England and Wales would be to introduce a point earlier in the process where parties make a binding commitment, for example, to mandate written offers and acceptances which are intended to be binding on the parties. We have considered the possible costs and benefits of such a change. The practical difficulties of bringing about such a change may be significant - success is likely to depend on the detail of any new process and the willingness of buyers and sellers in England and Wales, and their professional advisers, to accept the change.

It is not possible to quantify, with certainty, the costs and benefits of introducing a point of earlier commitment in the process for buying and selling a house in England and Wales, but it is clear that the potential benefits might be substantial.

Improving enforcement of existing legislation

- 1.25 We believe that serious misconduct by estate agents is best dealt with by efficient enforcement and penalties which are high enough to deter. The current regime has a range of sanctions that can be imposed. New sanctions currently due to be piloted will add to these powers.
- 1.26 We believe that the OFT could make enforcement of existing legislation more effective. As a result of this study, we have set out a programme of work to use OFT resources more effectively by working better with our Trading Standards enforcement partners, industry bodies and the redress scheme operators.

We will work to improve co-ordination between Trading Standards, OFT and the Ombudsmen for a more rapid, prioritised response to complaints about estate agents which raise serious concerns.

- 1.27 Despite the raft of legislation and rules already in place, some stakeholders have argued that estate agents are too lightly regulated, and that a 'positive' licensing regime should be introduced. Proposals vary from a basic registration scheme through to a regulatory regime similar to those in place for financial services, involving entry requirements and conduct of business rules.
- 1.28 We have considered carefully the arguments for and against introducing a dedicated regulatory regime for estate agents, and have weighed the potential costs of doing so against the risks consumers face in this sector, the evidence we have of consumer harm, and the likely success of a licensing approach in preventing such harm.

Our view is that there is not a strong case for introducing more regulatory structures and rules in this sector.

Shop around, negotiate on fees, and be informed

- 1.29 The detriment to consumers from failing to shop around and negotiate on estate agents' fees could be in the region of between £280 million

and £570 million (on the basis of 2008 and 2007 transaction volumes and house prices, respectively). There are important messages coming out of this work around how consumers can best inform, protect and empower themselves in this market.

1.30 Buyers need to recognise that the estate agent acts for the seller and not for them. In our survey, 53 per cent of buyers in England and Wales thought that the estate agent was acting equally for them and for the seller, and a further six per cent thought that the estate agent was acting mainly for them.

1.31 Sellers should shop around when choosing how to sell their property, and should seek to negotiate the structure and level of fees before agreeing to a contract.

There has been an increase in shopping around in recent years; nonetheless 64 per cent of sellers in our survey in England and Wales did not negotiate a lower fee.

1.32 There is some evidence to suggest that sellers in the US negotiate much more than consumers in the UK. According to the National Association of Realtors, 78 per cent of US sellers attempted to negotiate fees, of whom 70 per cent claimed they were successful in doing so. Our survey found that only a third of UK sellers that used an estate agent had managed to negotiate a lower fee.

Sellers who successfully negotiate commissions pay, on average, 1.4 per cent, while those who do not pay, on average, 1.8 per cent.

1.33 Both sellers and buyers should be aware that they can, if they wish, ask the agent for direct contact with the individual buyer or seller on the other side of the transaction. Better communication between all parties should help prevent information problems from jeopardising the transaction.

Thank you

1.34 As part of this study we have interviewed consumers via focus groups, conducted a large scale consumer survey, surveyed and spoken to estate agents and Trading Standards. Many industry and consumer groups, representatives from consumer redress schemes and individuals have been generous with their time and advice. We have consulted Government departments in England and the devolved administrations. We are grateful for all of these contributions to our work.

2 INTRODUCTION

Background to the report

2.1 In 2004 the OFT carried out a market study into the estate agency market in England and Wales (the 2004 study) concluding that price competition was not working well. The 2004 study found that consumers were not happy with the services that they received from estate agents and that price competition between estate agents was limited. We made a number of recommendations designed to encourage estate agents to provide better services and more competitive fees.²

2.2 In the five years since the 2004 study there have been a number of developments:

- the introduction of the Consumer Protection from Unfair Trading Regulations Act 2008 (CPRs)
- the introduction of Home Information Packs (HIPs) in England and Wales and Home Reports (HRs) in Scotland
- some small scale entry by low-cost, internet-based operators, and some failed attempts at entry
- the development of property portals as an important internet-based front end to the home buying and selling process
- the requirement for estate agents to:
 - belong to an independent approved ombudsman redress scheme under the Consumers, Estate Agents and Redress (CEAR) Act 2007

² Estate Agency market in England and Wales OFT693, published March 2004.

- comply with the Money Laundering Regulations 2007,³ and
- calls by a range of stakeholders (for example, the Carsberg Review)⁴ for the Government to consider introducing a registration or positive licensing scheme for estate agents.

2.3 In December 2008 we proposed to carry out another study. After consulting with interested parties on scope, we formally launched this study in February 2009.

Report scope

2.4 This study set out to assess:

- the level of competition between estate agents on price and quality
- the extent to which new business models, including Internet-based models, have taken off in recent years
- whether the existing regulatory framework provides the right balance between protecting consumers who are buying or selling a home and ensuring that the market remains open to competition and innovation, and
- the relationships between estate agents and ancillary service providers such as mortgage brokers, surveyors, solicitors and other professional advisors.

³ Before Money Laundering Regulations 2007 estate agents had to comply with Money Laundering Regulations 2003, which came into effect in 2004

⁴ Carsberg Review of Residential Property: Standards, Regulation, Redress and Competition in the 21st Century, published June 2008 - see www.rics.org/site/download_feed.aspx?fileID=1647&fileExtension=PDF

- 2.5 The study covers the whole of the UK, while recognising that significant differences exist between the home buying and selling process in England, Wales and Northern Ireland and the process in Scotland.
- 2.6 Many estate agents provide residential letting services alongside residential sales, but residential lettings were excluded from the scope of this work. Similarly, this study does not cover purchases or sales of overseas property.
- 2.7 While the study considers the supply of ancillary services, our main focus has been on the role of the estate agents and not on related markets. For example, while we have considered the supply of financial and mortgage advice services from third parties through the estate agent, we do not address the wider market for the supply of financial and mortgage advice services.

Evidence and research

- 2.8 When we launched this study, we invited written submissions from interested parties which highlighted for us the concerns and interests of different stakeholders. During the course of the study we consulted widely with a broad range of stakeholders, including estate agents, key trade and professional organisations and Government. A full list of consultees and contributors can be found at Annexe F.

Consultation with stakeholders

- 2.9 There were three rounds of stakeholder consultation: pre-launch, when we consulted on the scope of the study; post launch when we invited submissions from interested parties; and pre-publication of the final report, mainly through meetings with key industry and self-regulatory bodies and with Government departments.
- 2.10 We published much of our research in November 2009, in advance of final publication of this report. This research comprised a number of discrete projects and information gathering exercises, which are outlined below.

Surveys of consumers

- 2.11 The purpose of the consumer surveys was to examine consumer experience of service provision for the buying and selling of properties across the UK, including high and low points of the process, satisfaction with professionals, extent of 'shopping around' for services, awareness of protection frameworks and complaint mechanisms and potential conflicts of interest, and how open buyers and sellers were to pursuing alternative routes to market.
- 2.12 The OFT commissioned both a Qualitative survey and a Quantitative survey. The survey work was carried out in April and May 2009 by GfK NOP on behalf of the OFT, with subsequent work to analyse the results.
- 2.13 The Qualitative survey consisted of a series of five focus groups across the United Kingdom - one each in Scotland, Northern Ireland, Wales, North of England and London - involving people who had bought or sold a property between April 2007 and April 2009. In addition, twenty individual in-depth interviews provided detailed case studies. The results of this Qualitative research were published in draft form in November 2009.⁵
- 2.14 The Quantitative consumer survey covered both buyers and sellers, but excluded buyers who had bought a newly built home that had not yet been lived in. The survey was carried out by telephone. The results of this Quantitative research were published in draft form in November 2009.⁶
- 2.15 We also commissioned GfK NOP to find consumers currently selling or buying a home and who were willing to participate in an online diary exercise. The objective here was to record experiences of consumers while they were engaged in the process, rather than looking back after

⁵ See www.of.gov.uk/shared_of/reports/property/Qualitative-Report.pdf

⁶ See www.of.gov.uk/shared_of/reports/property/quantitative-consumer-survey.pdf

the event. The diaries were completed by 42 individuals comprising 21 planning to both buy and sell a home, nine planning to sell only and 12 planning to buy only.

Survey of estate agents

- 2.16 The purpose of the survey was to obtain information about the industry as well as estate agent views. Between 12 August and 7 September 2009 13,849 invitations were sent out to estate agent branches. Responses were received from 798 (a response rate of six per cent). The results of this survey were published in draft form in November 2009.⁷
- 2.17 In addition, OFT officials visited a total of six estate agent branches, spending a day or more with the estate agents at each branch, to gain some first hand experience of the home buying and selling process from the perspective of the estate agent.

Survey of local authority Trading Standards Services

- 2.18 This survey collected information on the nature of complaints, investigations and enforcement actions taken by local authorities. It also asked about the efficacy of current legislation in protecting consumers, and the steps taken to raise awareness of regulations among consumers and estate agents.
- 2.19 Between 22 June and 24 July 2009, we surveyed all local authority Trading Standards Services (TSS). Of the 198 TSS we contacted, we received responses from 78 (39 per cent). The results of this survey were published in draft form in November 2009.⁸

⁷ See www.of.gov.uk/shared_of/reports/property/estate-agents-survey-report.pdf

⁸ See www.of.gov.uk/shared_of/reports/property/Trading-Standards-Survey.pdf

Report structure

- 2.20 Chapter 3 of this study examines the market for residential property in the UK, before considering the markets for estate agency and other services important for home buying and selling.
- 2.21 Chapter 4 discusses competition and choice in the market for estate agency services, relative to the characteristics of a well functioning market. This chapter also looks at market structure, the nature of competition and consumer behaviour, and the level of new entry and innovation, as well as possible remedies including regulatory remedies to stimulate competition and innovation.
- 2.22 Chapter 5 considers existing regulation and enforcement. It discusses the extent of customer satisfaction, the main categories of complaint, and whether complaints reflect serious sources of harm. It also addresses the debate around whether a 'positive licensing' or 'active regulation' regime would be in the best interests of consumers, and considers ways in which enforcement might be improved.
- 2.23 Chapter 6 discusses the supply of ancillary services. It looks at the importance of ancillary services to estate agents, the impact of referrals on choice and competition, and how referral fees may affect estate agent behaviour. It discusses whether existing consumer protections are sufficient to address problems that might result from the payment of such fees to estate agents, and considers possible remedies.
- 2.24 Chapter 7 looks at the home buying and selling process, focussing on England and Wales. It sets out the costs or symptoms of the existing process, in terms of failures and delays, and considers the underlying problems. It goes on to consider possible remedies, in the context of systems and conventions elsewhere, and while recognising the option value to individuals of the existing system.
- 2.25 Chapter 8 considers the home buying and selling process in Scotland, first to ask how well the Scottish market is working in its own right and second as a basis for comparison with England and Wales.

3 THE MARKET FOR HOME BUYING AND SELLING

Summary

In 2007 there were 1.6 million residential property transactions in the UK with a total value of £361 billion. The recent economic downturn has seen a sharp decline in the number of homes being bought and sold. Transactions fell in 2008 and again in 2009 but began to climb in the second half of 2009.

We believe that there are approximately 14,500 traditional residential estate agent offices in the UK. The traditional estate agency market, excluding fees for ancillary services, was worth approximately £4.2 billion in 2007, falling to £2.1 billion in 2008, mainly because of the large drop in transactions.

There has been a great deal of innovation around Internet property portals with the emergence of large, popular sites such as Rightmove. The effect of the emergence of property portals has been positive in increasing the information available to sellers, buyers and, indeed, estate agents themselves, as well as reducing search costs for buyers.

The portals represent enhanced shop windows rather than a fundamental shift in the market. Behind the portals the market is still dominated by traditional estate agents, whose business practices and charging structures have remained largely unchanged over the years.

A major market development has been the entry of online estate agents. Online estate agents are generally cheaper than traditional estate agents, although as with other online sectors there is a trust issue. The number of private sales in recent years has declined. Private sellers and private seller platforms do not have access to the major property portals.

In the UK, Internet based alternatives to traditional estate agents have been slow to take off. In the US, by contrast, there is some evidence that alternative brokerage models had grown to represent approximately 15 per cent of transactions in 2006.

The residential property market

Housing stock

- 3.1 In 2007 there were 26.7 million dwellings in the UK.⁹ Of these, 18.5 million (70 per cent) were owner occupied. This level of owner occupation has remained stable since 2001/02. Regional data show that owner occupation is slightly lower in Scotland (65 per cent) and slightly higher in Wales and Northern Ireland (73 per cent in each).
- 3.2 Sixty eight per cent of households were owner occupied in 2008. Of these, 46 per cent owned their homes outright, while the other 54 per cent had a mortgage outstanding.¹⁰
- 3.3 According to CLG's 2007 / 2008 report on housing in England, 88 per cent of owner-occupiers in England had freehold, five per cent had leasehold and seven per cent had leasehold of a flat.¹¹ These rates have remained relatively constant for more than a decade.
- 3.4 Since 1991 net housing supply in England has increased by less than one per cent each year,¹² with a net increase of 207,500 dwellings between April 2007 and April 2008.¹³ Chart 3.1 shows the change in net dwellings from 1998 to 2007.

⁹ CLG Housing statistics Table 101 Dwelling stock: by tenure, United Kingdom (historical series), Dec 2009

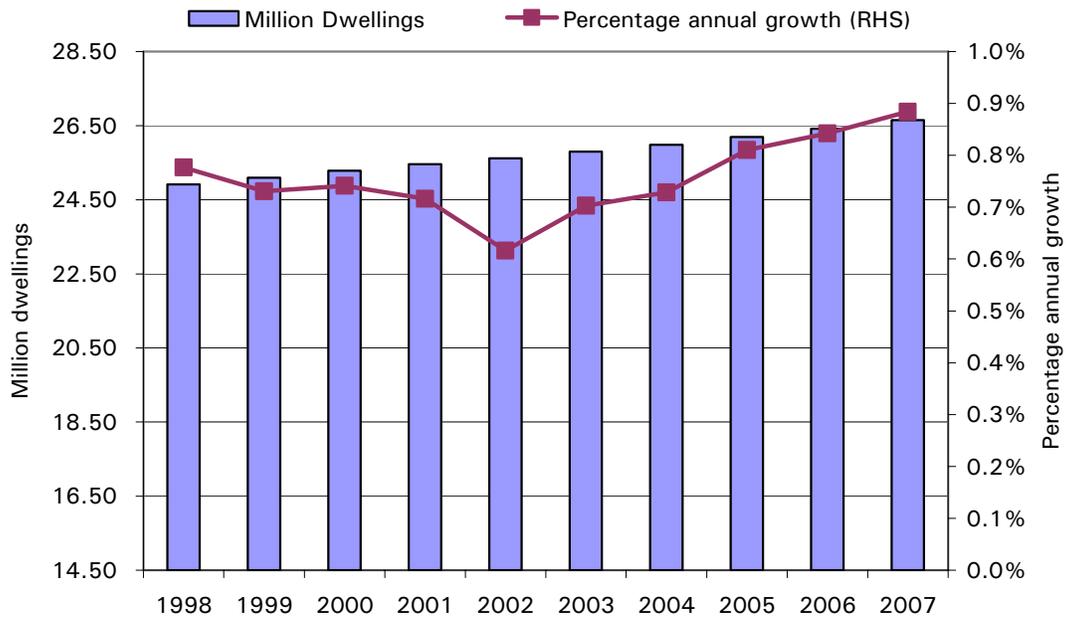
¹⁰ CLG Housing Statistics Table 804 Household characteristics: household type, by tenure, 2008

¹¹ Based on results from their Survey of English housing 2007/2008

¹² This rate of increase declined steadily from an average of 1.7 per cent in the 1950s before levelling off in the 1990s at about its current value.

¹³ CLG Housing Statistic Table 101 Dwelling stock: by tenure, United Kingdom (historical series) – see www.communities.gov.uk/documents/housing/xls/table-101.xls.

Chart 3.1: Changes in net dwellings, 1998 to 2007



Source: OFT analysis of CLG figures

3.5 Communities and Local Government (CLG) projections of household numbers predict an annual growth in England from 2006 to 2031 of 252,000 households, with average household size falling from 2.32 people in 2006 to 2.13 by 2031.¹⁴

3.6 The bulk (74 per cent) of household growth in these projections is driven by a projected growth in the population. Other drivers include the rate of household formation and marital status composition.

Market size

3.7 In 2007 there were 1.6 million residential property transactions in the UK where the property was worth more than £40,000, with a total

¹⁴ CLG Housing Statistics Table 401: Household estimates and projections, United Kingdom, 1961-2031

value of £361 billion.¹⁵ The recent economic downturn has seen a sharp decline in the number of homes being bought and sold. Transactions fell by 43 per cent to 0.9 million in 2008,¹⁶ and market value fell by 45 per cent to £199 billion.¹⁷ Transactions fell again in 2009 to 859,000 but began to climb in the second half of the year, with over 60 per cent of transactions taking place in the final two quarters.¹⁸

3.8 There is considerable regional variation in the fall in transactions from 2007 to 2008. In Northern Ireland transactions declined by 61 per cent, in England and Wales there was a 45 per cent reduction and in Scotland the fall was 33 per cent. In terms of value, Northern Ireland fell by 68 per cent, Scotland declined by 31 per cent and England and Wales by 45 per cent.¹⁹

3.9 First time buyers represent a significant proportion of the property market and together with property investors generally account for about a third of purchases.²⁰

House prices

3.10 According to the Nationwide House Price Index (HPI), the average price of residential property fell each month from £186,044 in October 2007

¹⁵ HM Revenue & Customs National Statistics – Table 16-2, Property Transactions in the UK

¹⁶ It is worth noting that, from HMRC: 'When property prices are rising (falling), however, the movements in transactions will display a small upward (downwards) bias, as even when total transactions are completely static there will be a boost to or decline in the published figures due to very low-priced transactions crossing the £40,000 threshold'.

¹⁷ HM Revenue & Customs National Statistics – Table 16-2, Property Transactions in the UK

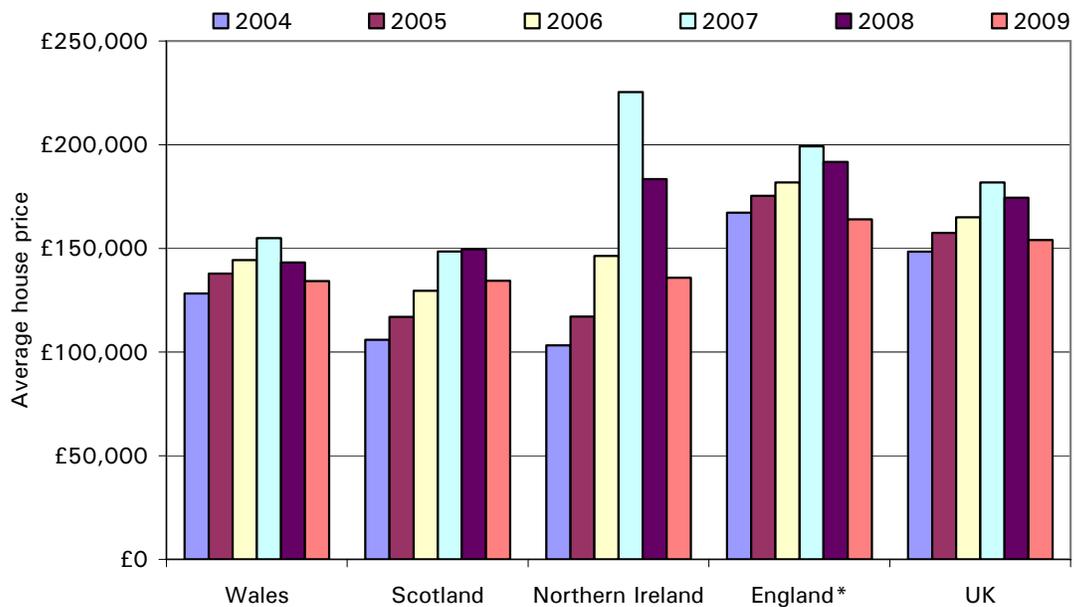
¹⁸ CLG Housing Statistics Table 530 Housing market: number of residential and non-residential property transactions with a value of £40,000 or more, UK

¹⁹ HM Revenue & Customs

²⁰ Which? essential guide 'Buy, Sell and move House' page 7

to £147,746 in February 2009, a decline of over 20 per cent in 16 months.²¹ The largest monthly drop was observed in May 2008 when prices fell by three per cent. Since then prices have begun to increase, reaching a level of £162,103 in December 2009.

Chart 3.2: House prices 2004 – 2009²²



*For England, the 2009 figure is for Q1.

Source: Nationwide HPI, Q2

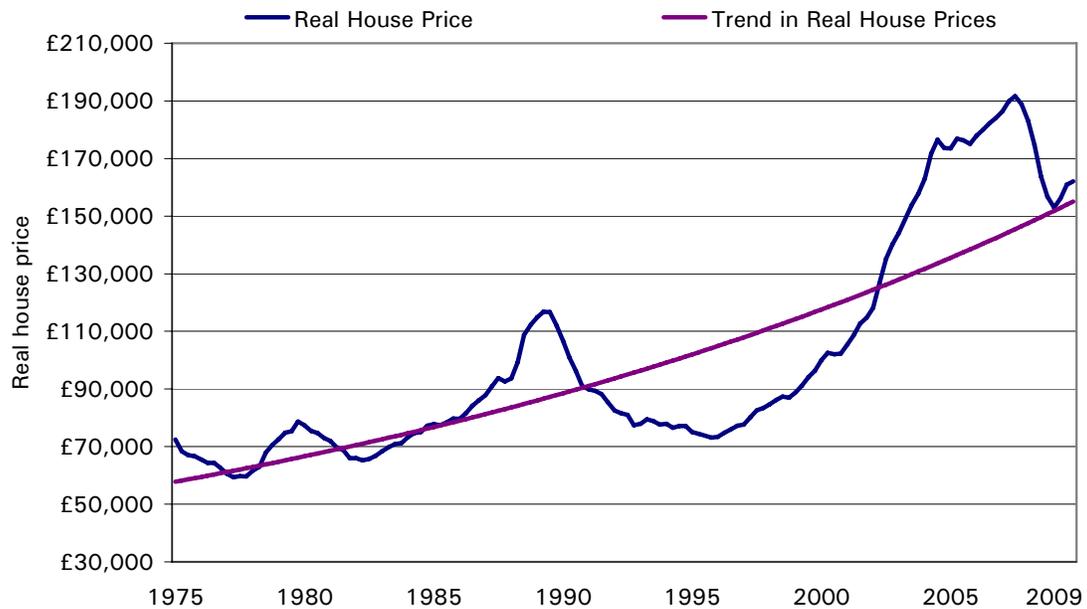
3.11 Prices in each country have followed a similar pattern since 2004, with significant growth until 2007, followed by a substantial decline. Northern Ireland has experienced the most volatility in prices.

²¹ Nationwide monthly house price index

²² Nationwide regional house price index

3.12 Real house prices exhibit a long run upward trend. Before they began to fall in 2007, real house prices had grown by 187 per cent since 1977. Even after the recent fall, they were still 143 per cent higher than in 1975.

Chart 3.3: Real house price trend²³



Source: Nationwide Building Society

The property transaction

3.13 The table below provides a break down of the costs of moving from a £150,000 home to a £200,000 home:

²³ Nationwide real house price index

Table 3.4: Typical cost of moving home²⁴

| Nature of Cost | As a Seller | As a Buyer |
|---|--------------------|-------------------|
| Estate Agency Fees | £2,400 | |
| Home Information Pack | £350 | |
| Seller's Solicitor Fees | £550 | |
| Stamp duty (at 1% of full purchase price) | | £2,000 |
| Buyer's Solicitor fees* | | £950 |
| Land registry fee | | £150 |
| Homebuyer Report | | £500 |
| Removals | | £550 |
| SUB-TOTAL (excl. VAT) | £3,300 | £4,350 |
| TOTAL (excl. VAT) | | £7,650 |

* Includes third party fees such as local authority search fees, drainage search fees and environmental search fees as well as bankruptcy search, land registry search and electronic transfer fees

How homes are sold

3.14 There are various reasons why people decide to buy or sell homes. Some may need to move home to another region of the country because of work. Others may move within the local area, perhaps to a larger house to accommodate a growing family. Empty nesters and retirees may want to downsize. In addition to those wanting to move from one home to another, there are first time buyers, who may be moving out of rented accommodation, and properties being sold because of divorce, death, or other reasons.

3.15 Having made the decision to sell, the home owner has to decide how to sell their property. There are a number of alternative routes: through a

²⁴ OFT Survey of Estate Agents, 2009 (Chart 3.8, page 19). Figure of 1.6 per cent. Stamp duty is one per cent for a home costing £200,000. Homebuyer Report costs is an average for different locations from Rightsurvey.co.uk. Solicitor, land registry and HIP costs from Haynes Home Buying and Selling Manual.

traditional estate agent, an online estate agent, an auction or selling it privately either through the internet or local advertising options. We define a traditional estate agent as an agent with a high street presence. Online estate agents do not have premises, but market properties solely over the internet. Internet property portals list details of homes for sale by most estate agents, and have also become an integral part of the market.

- 3.16 In England and Wales, 87 per cent of home sellers in our consumer survey chose to go through a traditional estate agent, 11 per cent sold privately and two per cent used an online estate agent. Less than one per cent said that they used an auction to sell their property.²⁵
- 3.17 Most sellers have their property under offer before making an offer on a new property.²⁶ In other words, home movers generally get their sale underway before making an offer on a property.

Two-sided markets

- 3.18 The home buying and selling market, with the exception of privately sold homes, is a two-sided market. A two-sided market is characterised 'by a platform serving (at least) two groups of customers, such that the participation of at least one of these groups raises the value of participation for the other(s)'.²⁷ In this case, estate agents are the platforms, while sellers and buyers are the customers on either side. Similarly, property portals represent such platforms, with estate agents and buyers as the two groups of customers. The fact that estate agents (as platforms) are paid by sellers and do not charge buyers and property portals (as platforms) charge estate agents to list properties, but allow

²⁵ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.1, page 19)

²⁶ Haynes Home Buying and Selling Manual estimates that 80 per cent of sellers have their property under offer before making an offer on a new property.

²⁷ OECD, Policy Roundtables, Two-sided Markets, December 2009, p.136.

buyers to view for free, does not mean that these are not two-sided markets. It is not uncommon that pricing incentives and practices are such that two-sided platforms charge those on one side and subsidise those on the other.²⁸

- 3.19 While there are several distinctive features which could be considered when analysing a two-sided market, we point out two features that are of most relevance to the estate agency and property portals markets. First, two-sided markets give rise to 'network effects' and 'externalities'. A network effect means that the value of a product or service increases as more people use it. Here, the presence of extra buyers in the market benefits sellers, and attracting extra sellers benefits buyers. An economic transaction gives rise to an externality when it has an effect (positive or negative) which is not taken into account by those within the transaction. In such a case, prices do not reflect the full costs or benefits in production or consumption of a product or service. In the home buying and selling market, a positive externality accrues to a buyer if a platform reduces its price, thereby attracting more sellers to that service. Network effects may give rise to 'chicken-and-egg' issues, as discussed in Chapter 4.
- 3.20 A second important feature of a two-sided market is whether it is a 'single-homing' market or a 'multi-homing' market. In single-homing markets users on one side of the market will only choose to use one intermediary, due to lack of choice, switching costs, or other related reasons. In a multi-homing market, users can choose to use several intermediaries. In the estate agency market, most sellers agree a contract with a single agent, but buyers will generally search for homes through several agents. This means that the buyer side of the market is multi-homing, while the seller side is single-homing. However, most estate agents list on several property portals, meaning that the property portal market is multi-homing on both sides.

²⁸ For example, free newspapers are funded by advertising, as are free-to-air television channels. A shopping centre may charge rent to retailers while providing free parking to customers.

Traditional estate agent services

- 3.21 Traditional estate agents, with a high street presence, may provide a range of services including: property valuations; asking price recommendations; promotional services; viewings; screening of buyers; negotiation; a range of ancillary services; and liaison between the parties.
- 3.22 Our consumer survey found that sellers who had chosen to use a traditional estate agent did so mainly because they valued their experience, knowledge and capability; because it was easier than alternatives; or because they thought it would attract more buyers.²⁹
- 3.23 The property transaction is between an individual buyer and an individual seller. Estate agents provide a service bringing buyers together with sellers and supporting transactions through to completion. The estate agent's client is the seller and not the buyer. Estate agents charge sellers, on average, 1.6 per cent of the property sale value.³⁰
- 3.24 The legal definition of what constitutes estate agency work is very wide and even if an individual does not call him/herself an estate agent he/she may be seen to be one in law when doing certain things.³¹ In broad terms, by law an estate agent is someone who:
- introduces and/or negotiates with people who want to buy or sell an interest in land (such as freehold or leasehold property) in the UK
 - does this as part of a business, and
 - acts on instructions from a client.

²⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.6, page 26)

³⁰ OFT Survey of Estate Agents, 2009 (Chart 3.8, page 19)

³¹ Section 1 of the Estate Agents Act 1979. See also The Estate Agency Guide (OFT031) 2008.

3.25 The law also only requires an individual to do things for the purpose of, or with a view to, introducing a client to a buyer or seller in order for him to be acting as an estate agent. It is not necessary for the individual to actually introduce the client to a buyer or seller in order to fall within the legal definition of estate agency work.

Estate agent contracts

3.26 In England and Wales, there are three main types of contract between estate agents and property seller. According to our survey of estate agents, two-thirds of sellers (67 per cent) choose sole agency agreements,³² with an additional 15 per cent using sole selling rights. Ten per cent used a multi-agency contract, three per cent used joint agency and two per cent used joint sole agency.

³² OFT Survey of Estate Agents, 2009 (Chart 3.13, page 24)

Table 3.5: Summary of estate agent contracts

| Agreement | | Summary |
|----------------------------|-----------------------|--|
| Single agency contracts | Sole agency contracts | A single estate agent retains the exclusive right to sell the property for a certain period of time. The seller has to pay commission to the estate agent if contracts are exchanged to a purchaser introduced by the estate agent (or introduced by another agent) in that period or with whom the estate agent had negotiations. However, seller may sell privately without paying commission. |
| | Sole selling rights | Estate agent has sole selling rights for certain period. Estate agent is entitled to commission if contracts are exchanged during that period (even if the property is sold privately). If contracts exchanged afterwards, commission is payable if the property sold to a purchaser introduced by the estate agent or with whom the estate agent had negotiations during that period. |
| Joint sole agency contract | | Two or more estate agents act as sole agents and split the commission if one of them is successful. |
| Multi agency contract | | More than one estate agent instructed to sell the property at the same time. Commission is paid only to the estate agent that finds a buyer. |

Source: OFT

3.27 Some sellers may choose to involve more than one estate agent. This is generally more expensive and typically costs 2.0 - 3.5 per cent of the sale price.³³ Having several agents can help increase the exposure of the property in two distinct ways:

- Sellers sometimes instruct more than one estate agent under a multi agency agreement to find a buyer on their behalf. Only the estate agent that finds a buyer earns a commission, with agents competing to find a buyer.

³³ Which? Essential guide 'Buy, Sell and move house' (page101).

- Estate agents acting for a seller under a joint sole agency agreement cooperate to market the property, and share the commission if the property is sold.

The estate agency market

3.28 We noted in our 2004 study that estimates of the total number of estate agency offices in the UK vary widely. At that time we estimated that the number in England and Wales was just below 11,000. Since 1 October 2008 it has become compulsory for an estate agent to belong to a redress scheme. Based on membership of redress schemes,³⁴ we now believe that there are approximately 14,500 residential estate agent offices in the UK.³⁵

3.29 Traditional estate agents fall into three main groups; estate agency chains, affinity groups and those operating independently. The market is highly fragmented. Chains with 50 offices or more represent less than 25 per cent of the market, as shown in Annexe B. Since 2004, most of the growth in the sector has come from small chains and independents.³⁶

3.30 The estate agency market, excluding fees for ancillary services, was worth approximately £4.2 billion in 2007, falling to £2.1 billion in 2008,³⁷ mainly because of the large drop in transactions. The average price of houses sold declined by just four per cent.

3.31 During the recent trough in the market, estate agencies have been laying off staff rather than shutting branches or closing down entirely. According to our survey of estate agents, responding firms had on

³⁴ The Property Ombudsman Scheme and the Surveyors Ombudsman Service

³⁵ Assuming 90 per cent compliance with requirement to belong to a redress scheme

³⁶ Key Note Estate Agency Market Report 2008, Using Estate Agency News data

³⁷ Assuming 87 per cent of the market use estate agents and pay commission of 1.6 per cent, the average commission paid in our survey of estate agents, 2009 (paragraph 3.23, page 18)

average six full-time employees in 2007, five in 2008, and four in 2009.³⁸

- 3.32 A Key Note report published in 2008 estimated that fees earned from mortgage and insurance services, both earned in-house and fees for referring customers to third-party providers, amounted to £1.5 billion in 2007. This represents approximately 20 per cent of total estate agency revenues from residential sales.³⁹

Internet property portals

- 3.33 Internet property portals have become a central part of the UK residential property market. Most buyers use these portals as a starting point when searching for a property.
- 3.34 The large majority of estate agents use a property portal site often or very often, according to our survey of estate agents,⁴⁰ while about 40 per cent reported that over half of their sales were the result of leads generated by property portals.
- 3.35 There are four main property portals: Rightmove, Zoopla, Findaproperty and Primelocation. According to Estateagenttoday.co.uk, analysts Hitwise and Comscore estimate that Rightmove had a market share of between 59 per cent and 77 per cent.⁴¹
- 3.36 Rightmove, launched in 2000, is reported to be the leading UK property portal, with a market share of more than 50 per cent according to

³⁸ OFT Survey of Estate Agents, 2009 (Paragraph 3.9, page 11)

³⁹ Key Note - Estate Agents Market Report, 2008

⁴⁰ OFT Survey of Estate Agents, 2009 (Chart 3.16, page 27)

⁴¹ *Rightmove on top as portal wars continue to hot up* – Estate Agent Today, 6 February 2009,

propertyportalwatch.com,⁴² and was rated as important by 84 per cent of respondents to our estate agent survey that use property portals.⁴³

- 3.37 Propertyfinder.com was launched in 1995, and was purchased in 2005 by Australia's number one property portal, Realestate.com.au, and News International. It was purchased again in 2009 by Zoopla, a smaller portal, and subsequently rebranded as Zoopla.
- 3.38 FindaProperty.com, launched in 1997, was acquired in 2004 by Associated Press (owners of the Daily Mail) and is now managed by The Digital Property Group (TDPG), a wholly-owned subsidiary of the Daily Mail. TDPG also operates Primelocation.com. In December 2009, TDGP purchased Globrix, a real estate search engine.
- 3.39 After these four, the rest of the property portal market is quite fragmented. In June 2009, we identified more than 50 property portals covering national and international properties offering sales, holiday lets and long-term rentals. At least 18 of these primarily deal with residential property sales in the UK.
- 3.40 Most property portals charge a monthly subscription fee to estate agents. Property search engines, such as Globrix and Nestoria, do not charge monthly fees to estate agents for listings, but generate income by charging for each qualified enquiry (pay by lead), offering upgrade packages, and selling advertising space, among other things.
- 3.41 Rightmove, Findaproperty, Zoopla and Primelocation all state that they accept listings from estate agents, letting agents and new homes developers, with Propertyfinder stating that users must comply with NAEA guidelines and codes. However, none accept listings from private seller platforms or from private sellers themselves. A private seller

⁴² Property Portal Watch - *Battles within UK big four portals*

⁴³ No other Internet portal was considered important by more than 50 per cent of respondents from England and Wales.

platform has complained to us about being excluded from listing properties with these portals.

3.42 Table 3.6 presents annual revenue figures for some of the main property portals.

Table 3.6: Annual revenue for property portals⁴⁴

| Portal | Revenue £m |
|----------------|-------------|
| Rightmove | £74,046,000 |
| TDPG | £17,109,086 |
| Propertyfinder | £4,707,966 |
| Fish4Homes | £1,388,806 |
| Globrix | £320,865 |
| Home.co.uk | £34,399 |

3.43 Table 3.7 provides an overview of the four main UK property portals:

Table 3.7: Overview of four main UK property portals⁴⁵

| Portal | Share of total viewings per cent | Ownership | Market share per cent (based on number of visits and time spent on the portals). |
|--------|----------------------------------|-----------|--|
| | | | |

⁴⁴ From 2008 annual reports of each company. Rightmove, Nestoria and Fish4homes are for the year ending 31 December 2008, Homeco is for the year ending 31 December 2007, Globrix and Propertyfinder are for the year ending 30 June 2008, and Digital Property Group is for year ending 30 September 2008.

⁴⁵ *Rightmove on top as portal wars continue to hot up* – Estate Agent Today, 6 February 2009,

| | | | |
|----------------|----|--|---|
| Rightmove | 31 | Largely controlled by institutional investors | 59-77 |
| Propertyfinder | 17 | REA Group | Remaining market share split between them |
| Findaproerty | 16 | The Digital Property Group (TDPG) subsidiary of the Daily Mail | |
| Primelocation | 11 | | |

Alternative ways of selling a home

- 3.44 Using a traditional estate agent is not the only way to sell a home. Alternative routes are available, including selling privately without an estate agent, using an online estate agent or selling by auction.

Private selling

- 3.45 According to our consumer survey, 11 per cent of home sellers chose to sell the property themselves.⁴⁶ Private sellers market the property either through word of mouth, undertaking local advertising, putting up 'for sale' boards or using websites set up for this purpose.
- 3.46 Although the cost of selling privately is relatively low as the estate agent commission is avoided, it may take the seller time and effort to arrange the marketing and to show people around.
- 3.47 Estate agency legislation does not apply to private sellers. A private seller does, however, have duties and obligations to a buyer under general law. In addition, a private seller needs a Home Information Pack before marketing the property, and must be able to supply one on request to a potential buyer.

⁴⁶ Countrywide say that no more than one per cent choose to sell a property themselves. Our consumer survey (page 79) reports that seven per cent of buyers bought from a private seller.

- 3.48 A sole agency contract with an estate agent, the most common type of contract, does not preclude a seller from also trying to sell their home privately without paying commission.⁴⁷

Private seller websites

- 3.49 There are websites available to help private home sellers market their own property, such as thelittlehousecompany.co.uk and houسلadder.co.uk. Fees vary depending on the level of service, ranging from free to £200 or more. Some websites offer premium packages, for example, an 'all-in-one package' including advertising on many websites and the provision of a Home Information Pack.
- 3.50 These private seller platforms do not have access to the larger property portals, such as Rightmove and Primelocation, although some offer homes for sale on smaller portals such as home.co.uk or [fish4homes](http://fish4homes.com). Most of the sites offer links to recommended surveyors and other ancillary services.
- 3.51 Private sellers can also place classified advertisements on websites that are not necessarily dedicated to the sale of property, including eBay and Loot.com. The cost of placing a classified advert varies from £35 to £100.

Online estate agents

- 3.52 A major market development since our 2004 study has been the entry of online estate agents without the expense of a shop window. Online estate agents are generally cheaper than traditional estate agents, although as with other online sectors there is a trust issue.⁴⁸ Sellers uncomfortable with the concept of an online estate agent say this is

⁴⁷ Unlike sole selling rights, when commission is payable when contracts are exchanged during the period the estate agent has sole selling rights even if the property is sold privately.

⁴⁸ Findings from OFT consumer surveys on Internet Shopping

because of worries about communication and the lack of face-to-face contact.⁴⁹

- 3.53 Online estate agencies are more than simply a platform for sellers that market their own property. They usually offer a menu of options, including arranging valuations, conducting viewings and conducting negotiations. Our survey of sellers found that two per cent of properties were sold by online estate agents.
- 3.54 The online estate agents we reviewed offered a range of different services. Some of these were included in the initial fees and others were offered as optional extras. In all cases, as for the traditional estate agency services, there was a visit by a consultant to take photos, prepare floor plans, and so on. The arrangements for viewings differed between agents. Some offered accompanied viewings and others stated that the seller must conduct the viewings. Some would recommend where to obtain ancillary services and some offered to arrange the HIP.
- 3.55 Pricing options range from fixed fee to a traditional percentage commission, with some online estate agents offering a combination of fixed and percentage fees. Completion fees generally vary from zero to one per cent of the selling price plus VAT, while upfront marketing fees vary from £0 to £699.⁵⁰

Auctions

- 3.56 There are a little under 200 auction houses that sell homes in the UK. Repossessed homes may be sold at auction, businesses and housing associations may sell residential properties at auction, and the route may appeal to individual consumers who want to sell by a particular date.

⁴⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.3, page 23)

⁵⁰ Based on survey of online estate agents' websites

- 3.57 Anecdotally the use of auctions is growing. However, only one out of the 255 sellers in our consumer survey had sold their home at auction. The consumer group Which? in 2008 estimated that just under two per cent of residential transactions in the UK are conducted by auction.⁵¹
- 3.58 The process usually involves the auction house valuing the property for a guide price. The auction house will compile details of the property for their catalogue, generally published about three weeks before the auction. The auctioneer charges a fee, for example two and a half per cent of the sale price achieved, and may also charge a catalogue fee of between £300 and £1,000.⁵²
- 3.59 Buyers are usually obliged to pay a deposit on the day of 10 per cent and the remaining 90 per cent must be paid within 28 days, although some auction houses may accept smaller deposits or allow more time for completion.⁵³ The contract is binding and failure to pay the remainder will result in a loss of the deposit. Auctioneers may also charge a buyers premium of up to one and a half per cent of the sale price. Many buyers obtain a mortgage valuation and instruct a solicitor and surveyor on the property prior to purchase. If the buyer fails to win the auction, the valuation, survey and legal fees will have been wasted.
- 3.60 Property auctions are more common in some other countries than they are in England and Wales. In Australia and Ireland, for example, auctions are used for a wide range of properties. The auction process overseas is broadly similar to the procedure used in England and Wales.

⁵¹ Which? Buy, Sell and Move House, 2008

⁵² Haynes Home Buying and Selling Manual

⁵³ Which? Buy, Sell and Move House

Other professional services

Home Information Packs

3.61 Home Information Packs (HIPs) were introduced at the end of 2007 and are compulsory for most homes being sold in England and Wales.⁵⁴ It is the duty of the person responsible for marketing the property to have in his possession or control a home information pack and to supply it on request to a potential buyer.⁵⁵ From 6 April 2009, a number of documents, including the EPC, must be included in the HIP before or at the first point of marketing.

3.62 The HIP must include an index, a sale statement, evidence of title, an Energy Performance Certificate, standard searches, a Property Information Questionnaire and a copy of the lease if it is a leasehold property. It can also contain optional items such as a Home Condition Report.

- the Index lists the documents contained in the HIP and provides a checklist for sellers, buyers, estate agents and enforcement authorities
- the Property Information Questionnaire (PIQ) needs to be completed by the seller and it provides a checklist of simple information about a property such as gas and electricity safety, flood risk information, and so on
- the Energy Performance Certificate (EPC) gives home owners, tenants and buyers information on the energy efficiency and carbon emissions of the property.

⁵⁴ There are a number of exclusions, for example where the property is not marketed. See Directgov website

⁵⁵ Subject to limited exceptions (Section 156 (4) Housing Act 2004).

- Standard searches consist of:
 - a local land charge search
 - a local authority search
 - a drainage and water search.

3.63 A HIP costs anywhere from under £200 to over £450, depending on provider and size of the property. Sellers can, if they choose, compile a HIP themselves.⁵⁶ The only part which neither they nor their estate agent can do is the EPC, and this can be purchased separately. According to our consumer survey, 57 per cent of sellers who used either a traditional or an online estate agent had their estate agent compile their HIP or used a HIP provider referred by their estate agent.⁵⁷ Estate agents typically receive a fee from HIP providers for referring a seller to them, which can range from £30-£90.⁵⁸

Mortgage and insurance services

3.64 Most home buyers need a mortgager, and many use the services of a mortgage broker or other financial adviser to obtain one. There are a number of insurance products which home buyers may purchase. These include payment protection insurance in relation to their mortgage, title indemnity insurance, as well as products not directly related to the home buying transaction, such as home and contents insurance.

3.65 Some estate agents employ in-house financial advisors or brokers, others refer buyers to third-party financial services. Alternatively, a buyer can shop around for financial advice. According to our consumer survey roughly one in six home buyers who bought their home through a

⁵⁶ Haynes Home Buying and Selling Manual

⁵⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.21, page 41 and Chart 5.22, page 42)

⁵⁸ OFT Survey of Estate Agents, 2009 (Table 3.26, page 38)

traditional or online estate agent obtained financial advice either from the agent's in-house service or from a service referred by the agent.⁵⁹ According to our estate agent survey, an agent will generally receive a fee ranging from £50-£250 from a financial advisor or a broker for referring a client to them.⁶⁰ Other sources suggest that the fee can be considerably higher.

- 3.66 The majority of homes are bought with a mortgage. Fifty-five per cent of owner-occupiers in 2007-2008 had a mortgage outstanding. In addition, 69 per cent of owner-occupiers who owned their homes outright had bought them with a mortgage.⁶¹
- 3.67 The financial crisis that began in 2007 has dramatically curtailed the availability of credit. The total value of new mortgage lending in 2008 was £253 billion. Current forecasts estimate that it decreased in 2009 to £141 billion, a fall of 44 per cent.⁶² The biggest mortgage lenders are HBOS, Abbey, Lloyds TSB, Nationwide and Northern Rock.⁶³
- 3.68 Buyers failing to obtain the necessary finance is a major reason for transactions falling through. According to our consumer survey, 38 per cent of sellers in England and Wales who had experienced a failed transaction said that this was the reason.⁶⁴ Of those buyers who had

⁵⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.67, page 89 and Table 6.68, page 90)

⁶⁰ OFT Survey of Estate Agents, 2009 (Table 3.26, page 38)

⁶¹ CLG Survey of English Housing 2007/2008

⁶² Council of Mortgage Lenders Forecast

⁶³ Mintel – Secured Lending Products, Finance Intelligence, 2009

⁶⁴ OFT Quantitative Consumer Survey Report, GfK 2009 (Table 5.47, page 67). The prospective buyer withdrawing or buying another home was the only reason listed more often (45 per cent).

experienced a failed transaction, 11 per cent said that their inability to obtain a mortgage was the reason.⁶⁵

Provision of surveys

3.69 There are three main types of survey, and each serves a different purpose:

- **Mortgage Valuation:** this survey is for the mortgage lender, although for many buyers it is the only survey conducted. Once the offer is accepted, the mortgage valuation is conducted by a surveyor recommended by, or approved by, the lender. The valuation report tells the lender how much the property is worth, and until it has been obtained, the lender will not release the funds and contracts cannot be exchanged. The mortgage valuation is generally organised by the lender and costs around £150 - £300, depending on location and price of the property⁶⁶
- **Home Buyer Report:** this survey, which replaced the home buyers survey and valuation in January 2009, is for the buyer's benefit. It reports on defects in the property, its condition and its value. If conducted, it is done in addition to the mortgage valuation and costs about £350-£500, depending on location and house price,⁶⁷ and
- **Building Survey:** this type of survey, previously known as a Structural Survey or Full Survey, provides a more detailed report than the Home Buyer Report. Like the Home Buyer Report, it is done for the buyer's benefit. It is recommended for older properties and those

⁶⁵ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.94, page 116). Another buyer making a higher bid (17 per cent), withdrawal after a survey (14 per cent), withdrawal for personal reasons (12 per cent) and problems elsewhere in the chain (12 per cent) were listed as more common reasons for failure.

⁶⁶ Allied Surveyors for a house price between £150,000 and £400,000

⁶⁷ Allied Surveyors

in need of work, or simply for peace of mind. It may cost in the region of £700-£1,000.⁶⁸

- 3.70 A buyer can seek a surveyor independently, or can use one recommended by either their mortgage lender or estate agent. Our consumer survey indicates that 35 per cent of buyers who used a traditional or online estate agent were referred to a surveyor by the vendor's estate agent. Fifty-six per cent of these ended up using the referred surveyor.⁶⁹ Respondents to our estate agents survey typically received a fee in the region of £25-£80 for referring a client to a surveyor.⁷⁰
- 3.71 Mortgage lenders may also refer buyers to panels of surveyors. Lenders form surveyor panels because they want to ensure that a property provides sufficient security for the loan that they extend. The lender may require the buyer to use a panel surveyor.
- 3.72 At the national level, the surveying market is highly fragmented, and no firm has a particularly high market share. However, it is clear that the market for survey provision is likely to be local although we have not looked at local markets in detail, and the degree of concentration in these local markets may vary widely.

Conveyancing services

- 3.73 Home buyers and sellers require legal services, to check that no one else has legal rights over the house, to perform local authority, bankruptcy and other searches. Primarily, a legal professional is required for conveyancing.

⁶⁸ Haynes Home Buying and Selling Manual

⁶⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.67, page 89 and Table 6.68, page 90)

⁷⁰ OFT Survey of Estate Agents, 2009 (Table 3.26, page 38)

- 3.74 Conveyancing is the legal process by which ownership of a property is transferred from the seller to the buyer. It can be done by either a solicitor or a licensed conveyancer - a lawyer specifically trained in property law but not qualified as a solicitor or barrister. Licensed conveyancers are regulated by the CLC (Council for Licensed Conveyancers) in England and Wales.
- 3.75 The fee for conveyancing can be expressed either as a fixed amount or as a percentage of the price of a property. On average it will cost about £750 to a buyer and £550 to a seller,⁷¹ but this depends on the value of the property and on whether it is leasehold property, in which case it is more expensive.
- 3.76 At present there are about 1,000 licensed conveyancers. Approximately 97 per cent of the market for conveyancing is accounted for by solicitors, with licensed conveyancers accounting for the remaining three per cent.⁷²
- 3.77 Twenty per cent of buyers that used an estate agent and 29 per cent of sellers that used an estate agent used a solicitor or licensed conveyancer that was referred to them by the seller's estate agent,⁷³ according to our consumer survey. Respondents to our estate agent survey stated that solicitors or conveyancers paid them, on average, £140-£190 for referring a customer.⁷⁴

⁷¹ Haynes Home Buying & Selling Manual

⁷² Centre of European Law and Politics Report on the Conveyancing Services Market to DG Competition Conveyancing Report - December 2007

⁷³ First percentage worked out from OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.67, page 89 and Table 6.68, page 90), and second percentage is from OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.21, page 41 and Chart 5.22, page 42)

⁷⁴ OFT Survey of Estate Agents, 2009 (Table 3.26, page 38)

3.78 Based on an average cost of conveyancing to a buyer of £750, and to a seller of £550, we estimate that the conveyancing market value in 2007 was around £2.08 billion, falling to £1.17 billion in 2008. We expect it to fall slightly again for 2009, to about £1.05 billion due to a further decline in transactions.⁷⁵

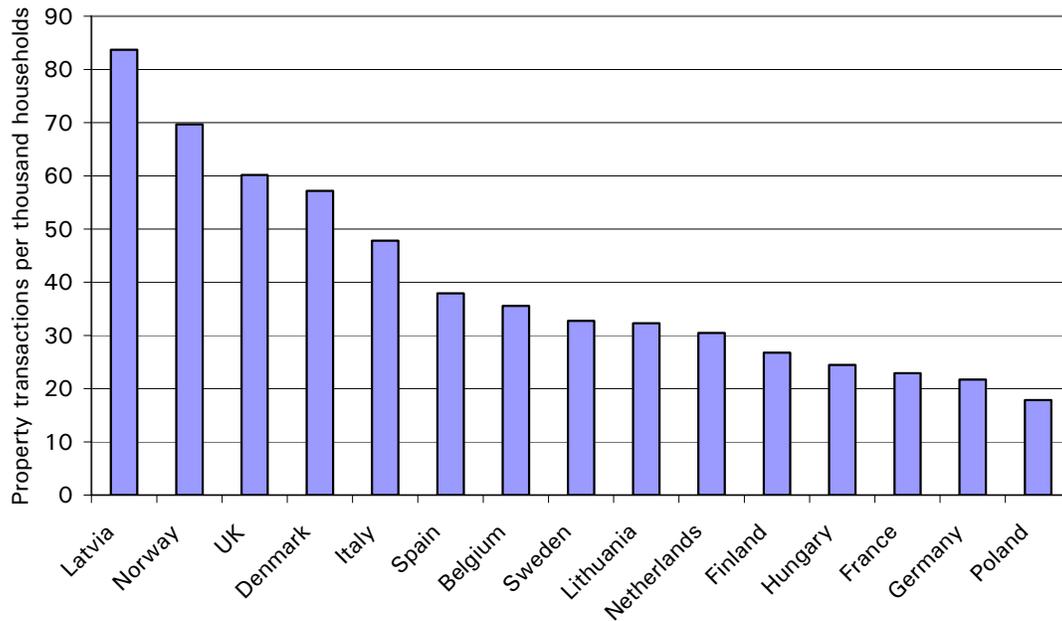
International comparisons

3.79 Compared to other European countries in 2006, the United Kingdom had a high number of property transactions, relative to the number of households in the country. Of the countries we looked at only Latvia and Norway had a higher annual rate of transactions per household than the UK, and the UK rate of 60 transactions per thousand households is 50 per cent higher than the average of 41.⁷⁶

⁷⁵ £1,300 multiplied by the number of housing transactions in each year.

⁷⁶ 2006 is the most recent year for which we have enough international data to make these comparisons. Recession will likely have had varying effects across countries. Current comparisons could be very different.

Chart 3.8: Property transactions per thousand households⁷⁷

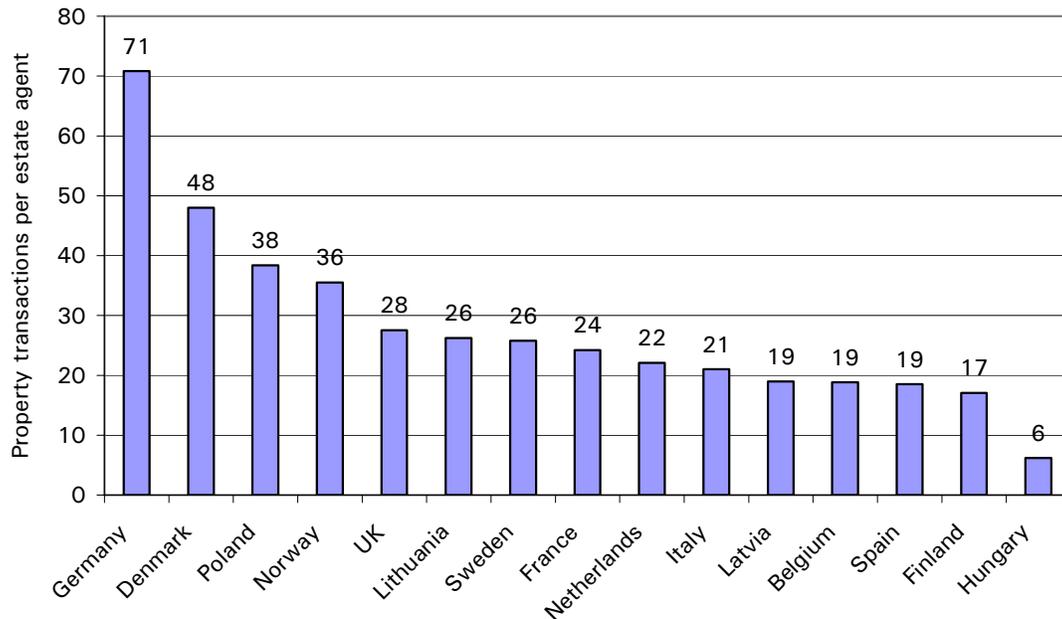


Source: UK Number from CLG, 2006. All other Numbers from CEPI, 2006

3.80 The UK also had an above average number of transactions per estate agent in 2006 compared to other European countries, with 26.33 transactions per estate agent. The chart below shows that Germany had the highest number of transactions per estate agent, with just under 71, and that Hungary with just 6.2 had the lowest. Excluding these outliers, the chart shows that each of the countries we looked at had a comparable number of transactions per estate agent to the UK.

⁷⁷ UK number is 2006 number from CLG, others are all 2006 numbers from CEPI. It should be noted that these figures don't account for varying responses to the economic downturn.

Chart 3.9: Property transactions per estate agent⁷⁸



Source: UK estate agent number based on estimate made on Page 29, using ONS Annual Business Inquiry to estimate for 2006. All other numbers from CEPI, 2006.

3.81 Differing legal systems and levels of home ownership mean that the home buying and selling process varies internationally. The conveyancing process also varies, with many countries in the EU requiring consumers to engage a notary in order to ensure that procedures are complied with. Inevitably, procedures, regulation and policy will be focused on the specific needs of the country in question. These factors limit meaningful cross-country comparisons of residential property transactions.

3.82 The use of an estate agent in the property transaction is common in most of the countries we considered and they generally appear to carry out the same basic functions of marketing the property and matching the parties to a transaction. The extent to which the estate agent provides

⁷⁸ UK number of estate agents in 2006 is based on estimates of the current number, using the difference in the ONS Annual Business Inquiry estimates of the total number of people employed in the sector in 2006 compared to 2009. Other numbers are from CEPI.

other services varies from country to country. Some countries, such as Austria, France, the Netherlands, Portugal, Slovakia, Slovenia and Spain, include legal services as part of the estate agent's package. In France and Belgium buyers and sellers have the option of using a notary. A notary is legally qualified and carries out conveyancing work, but can also act as an estate agent for a seller. In some European countries, such as Sweden and Denmark, estate agents play an active legal role as the conveyancer, but in a significantly less regulated way to a notary. In countries such as Portugal, Spain, Austria and the USA estate agents will also be responsible for drafting the sales contract, usually by amending a standard contract to meet the needs of the particular property transaction in question. These practices differ from England and Wales, where all aspects of conveyancing are carried out by a separate qualified solicitor or conveyancer.

- 3.83 The notary system appears to be more expensive than the estate agency process in England and Wales. For example, in France sellers are required to pay separate fees to a notary for both the estate agency work and legal services carried out, at approximately four to 10 per cent and two to eight per cent of the property price, respectively.⁷⁹ Cost differences between countries are discussed further in Chapter 4 of this report.
- 3.84 In the USA, Canada and the Netherlands it is common for the buyer and seller to each have their own agent. Such arrangements seek to avoid the possible conflicts of interest that may arise when only one agent is used, and the interests of the buyer and seller may be better protected when separate agents are engaged.

⁷⁹ Centre of European Law and Politics Report on the Conveyancing Services Market to DG Competition Conveyancing Report - December 2007

4 CHOICE AND COMPETITION IN HOME BUYING AND SELLING

Summary

Although concentration and barriers to entry are low, competition between traditional estate agents does not deliver the full range of consumer benefits that we might expect. The market is characterised by sticky commission rates leading to commission fees rising on the back of property prices. This is likely to result in excess entry and falling productivity as prices rise.

The predominant flat percentage commission structure is not necessarily optimal in terms of aligning the agent's incentives with the seller's best interest, but other pricing structures (for example, unbundled pricing) are rare. We observe that some new entrants offer more flexible and innovative pricing structures.

The internet has dramatically reduced the significance of the high street shop front and has made it much easier for both buyers and sellers to access local property price information. We might expect this to lead to some disintermediation in this market, for example the emergence of a greater range of business models from full service estate agency to low cost offerings and private seller platforms.

The definitions of estate agent which trigger a raft of legislation are over 30 years old and do not easily accommodate new business models which may exclude activities which pose significant risks for consumers.

We found that most online estate agents now list property on all the major portals so we do not believe that there is currently a need to intervene to ensure that online estate agents are able to access the major Internet property portals. This is an area we will be monitoring closely in the future.

We think there is space for new players to enter both the on-line estate agency market and the portal market and provide platforms with the necessary scale to overcome network effects and the brand to overcome the issues of trust which currently persist in most on-line markets.

Competition in a well-functioning market

- 4.1 In general, markets function well where consumers are well-informed and able to search for good deals, where entry and potential entry impose competitive constraints on incumbents, and where innovation that benefits consumers is rewarded by increased market share.
- 4.2 In a well-functioning market, we would expect estate agents to compete on price, as well as on other aspects of their offer, such as reputation or local presence. In our 2004 study, the OFT found a lack of strong price competition in the market, with sticky commission rates which were not responsive to changes in market conditions, or were not reflective of cost differences, or both. We examine whether this remains the case.
- 4.3 We would also expect to see innovation in the services offered by estate agents, driving continuous improvement in consumer experiences over time. We assess the extent to which estate agency has developed in recent years, for example, in response to changing market conditions and the impact of the internet.
- 4.4 Given the wide variety of sellers and properties in this market, we would expect to observe a range of alternative models for buying and selling property, from basic listings or execution-only services to traditional full-service models, with private seller and low cost models imposing a competitive constraint on traditional estate agents. We assess the extent of barriers to entry for alternative models.
- 4.5 Consumer behaviour is a key determinant of how well a market functions. Given that selling their home is the largest transaction that most consumers will ever make, we would expect consumers to think carefully about their route to market and about the costs of the transaction. We examine the extent to which consumers shop around and negotiate before signing contracts with estate agents.
- 4.6 In a well-functioning agency market, we would expect that contracts would be designed such that agents' incentives are well aligned with the interests of their clients. We assess how far the flat percentage fee

structure prevalent in the industry provides the right incentives for estate agents to act in sellers' best interests.

Competition between estate agents

Market structure

- 4.7 The market for home buying and selling is still dominated by traditional estate agents. Our survey of sellers found that 87 per cent used a traditional estate agent,⁸⁰ a similar proportion to those surveyed for our 2004 study. In fact, traditional estate agents appear to be used more now than they were in 1979, when the Price Commission's survey of sellers found that just 73 per cent used an estate agent, while 25 per cent of homes were sold privately.⁸¹
- 4.8 We found that 11 per cent of sellers sold privately, while auctions were very rarely used (at least for private individuals selling their own home).⁸² Online estate agents are still at the fringe of the market, with only two per cent of sellers choosing to use one.⁸³
- 4.9 At a national level, concentration in the estate agency market is low. The largest estate agent, Countrywide, accounted for less than 10 per cent of Land Registry transactions in 2008.⁸⁴ By number of offices, the proportion of the market accounted for by the five largest firms is only

⁸⁰ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.1, page 19)

⁸¹ Price Commission (1979), 'Charges, Costs and Margins of Estate Agents', paragraphs 2.18 and 2.24. Of the 25 per cent who sold privately, 14 per cent by personal contacts, nine per cent through private newspaper ads and two per cent using private 'for sale' boards or posters.

⁸² Only one of our 255 respondents reported using an auction. OFT Quantitative Consumer Survey Report, GfK 2009 (Paragraph 5.1, page 19)

⁸³ Our survey of buyers showed a similar breakdown.

⁸⁴ Based on Countrywide's submission to this study, April 2009.

16 per cent, while for the ten largest firms this figure is just under 21 per cent.

- 4.10 Franchising and branding is quite common among traditional estate agents. For example, Countrywide uses 37 local and national brands, while nine per cent of their offices are franchised.
- 4.11 Although national chains exist, competition in this market is essentially local. Our survey of estate agents found that 74 per cent of offices typically offered properties for sale within a five-mile radius.⁸⁵ When asked what factors they considered most important in attracting sellers, the vast majority agents thought 'local knowledge of the market' was important or very important.⁸⁶ Among sellers, 23 per cent of respondents that used an estate agent gave location as a reason for choosing their estate agent.⁸⁷

Entry and expansion by traditional estate agents

- 4.12 It would appear that estate agency is a sector with relatively low barriers to entry for traditional estate agents. Relevant barriers to entry in this market could include sunk costs, government regulation, economies of scale, consumer loyalty, local market knowledge and network effects.⁸⁸
- 4.13 Sunk costs of entry are low, as all a traditional estate agent has to do is rent some office space, while for online estate agents even this is not a necessity. Advertising costs represent the only significant sunk cost in the industry. In relation to government regulation, estate agents do not

⁸⁵ OFT Survey of Estate Agents, 2009 (Table 3.2, page 11)

⁸⁶ OFT Survey of Estate Agents, 2009 (Table 3.3, page 13)

⁸⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.10, page 31)

⁸⁸ Other potential barriers to entry in markets can include control of resources, intellectual property, research and development costs and vertical integration. These seem of limited relevance to the estate agency market.

have to apply for a licence, as they do in a number of other countries. Any economies of scale in the industry would not appear to be so large as to effectively deter entry.

- 4.14 Our survey of estate agents found that nine per cent had been established in their current location for two years or less, though the majority (69 per cent) had been there for over ten years,⁸⁹ potentially reflecting the importance of local knowledge and reputation in the market. However, the now widespread use of property portals by estate agents listing properties and their common use as a first step in searching for property by buyers means that local incumbency advantages are becoming less important.
- 4.15 Consumer loyalty does not appear to be very important, as selling a property is something which most consumers undertake rarely. Our consumer survey found that 15 per cent of sellers chose their estate agent because they had used them before, with a further 10 per cent choosing an estate agent on the recommendation of an acquaintance.⁹⁰
- 4.16 As outlined in Chapter 3, the estate agency market is a two-sided one, with the estate agent acting as the intermediary between the sellers and buyers on each side of the market. This is of particular relevance in, at least, two respects. First, the importance of network effects (that is, the more properties an estate agent handles the more attractive that agent becomes to buyers and so to sellers) means that a 'chicken-and-egg' problem can emerge. An estate agent who cannot attract a sufficient number of sellers to list with him will not be attractive to buyers, who may not bother to check his shop window or website. However, the emergence of property portals, on which almost all estate agents list their properties, may effectively have shifted some of the importance of network effects and the resulting 'chicken-and-egg' problem to the portal level, where a portal with few properties listed is unlikely to be popular

⁸⁹ OFT Survey of Estate Agents, 2009 (Paragraph 1.2, page 3)

⁹⁰ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.10, page 31)

with buyers.⁹¹ Hence, the 'two-sidedness' of the market at the estate agent level has been reduced. Conversely, the importance of being able to list on the major portals has almost become a prerequisite for a successful estate agency.

- 4.17 A second aspect of two-sided markets that is worthy of mention is the extent of single- and multi-homing on each side of the market. In the estate agency market, the majority of sellers single-home (through signing single agency contracts), while most buyers will consider properties listed by several estate agents. The fact that sellers tend to single-home this does not give rise to 'bottleneck' issues. While buyers have to go through the estate agent the seller chooses, there are no direct financial costs to the buyer resulting from this. However, there may be costs in terms of having to buy through an estate agent who provides poor quality service. We would expect buyer and seller incentives to be aligned here (in that both would want a smooth process) which would mitigate such concerns. Also, buyers do have a choice in which house to bid on and can avoid specific estate agents which again should mitigate such concerns.
- 4.18 The market for portals involves multi-homing on both sides, as both estate agents and buyers will generally use a number of portals. In general, multi-homing allows for greater competition and consequential pressure on price, quality and service.⁹² However, multi-homing does not mean that one platform cannot emerge as a market leader or even establish a dominant position. Markets with strong network effects may be vulnerable to 'tipping' towards a particular platform.⁹³ To the extent that listing with more than one portal is costly for estate agents, they may wish to single-home if there is one portal that is viewed by all

⁹¹ Assuming he can list on a popular property portal, even an estate agent with a small number of properties on his books can now reach a large number of buyers.

⁹² OECD, Policy Roundtables, Two-sided Markets, December 2009, page 138.

⁹³ OECD, Policy Roundtables, Two-sided Markets, December 2009, page 138.

buyers, even if buyers continue to multi-home by viewing listings on more than one portal.

- 4.19 In assessing the likely barriers to entry by a single-office traditional estate agent, we asked existing estate agents what they would see as the main hurdles to setting up a new estate agent. 'Establishing reputation and winning business from existing local estate agents' and 'attracting sufficient sellers' were the two main reasons given – by 55 and 57 per cent, respectively.⁹⁴ As further evidence that estate agents themselves perceive entry as relatively easy, almost two-thirds (60 per cent) expected that a new estate agent office could make a profit within two years of opening, with only two per cent expecting this to take longer than five years.⁹⁵
- 4.20 We expect that the recent downturn in the housing market to have induced a significant number of exits from the market. Stakeholders told us that 2,500 estate agents have exited since 2007, but they also said that the ease of entry and expansion means that numbers will increase as the housing market recovers.⁹⁶

The process of competition

- 4.21 As outlined in Chapter 3, the services supplied by estate agents generally include a valuation, a recommendation on the appropriate level of asking price, advertising of the property, conducting viewings, negotiating on the seller's behalf, recommending providers of ancillary services and liaising with the buyer and others involved in the process.
- 4.22 Valuations are often conducted for free by an estate agent before the seller has decided to use that estate agent. Once a seller has decided which estate agent, or a number of agents to use, a contract is signed.

⁹⁴ OFT Survey of Estate Agents, 2009 (Chart 3.4, page 14)

⁹⁵ OFT Survey of Estate Agents, 2009 (Chart 3.5, page 15)

⁹⁶ Submission to this study from a large estate agents group, April 2009.

Contract types are discussed in more detail below, but will include, among other things, how the fee is calculated, for example, a flat fee or, more commonly, a percentage of the achieved price, how long the property is to be marketed with that estate agent and what form the marketing will take, for example, which property portals or publications will be used.

- 4.23 The extent to which consumers shop around in a market before deciding which service or product to purchase and from whom is often one of the most important determinants of the intensity of competition between suppliers. In this market, sellers choose how to sell and, where they choose to use an estate agent, which one(s) to use. Our Quantitative Consumer Survey found that, of those sellers who used an estate agent, 67 per cent said that they had 'shopped around'.⁹⁷ Of those who shopped around, most (87 per cent) compared three or more agents.⁹⁸
- 4.24 In assessing what factors estate agents competed on when trying to attract sellers to list with them, both our Quantitative Consumer Survey and our survey of estate agents provide evidence on what factors are important to sellers in choosing an estate agent.
- 4.25 When sellers who had used a traditional or online estate agent were asked what made them decide to use the estate agent they chose, the main decision factors were found to be reputation (30 per cent), professionalism (29 per cent) and the size of their fees (28 per cent).⁹⁹
- 4.26 According to our survey of estate agents, the most important factors estate agents compete on are local reputation and quality of service, with 73 per cent and 57 per cent of respondents respectively, rating these factors as 'very important' in attracting clients. In contrast,

⁹⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.8, page 29)

⁹⁸ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.9, page 30)

⁹⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.10, page 31)

competitive fee levels were only rated as 'very important' by 17 per cent of respondents while willingness to negotiate on fees was rated 'very important' by just nine per cent.¹⁰⁰

4.27 Given the size and importance of the transaction, it is not surprising that sellers' main focus when choosing an estate agent would be on maximising the sale price of the property, rather than on minimising the commission paid to the estate agent, since the effect on the seller's financial well-being of variations in the former far exceed variations in the latter. In terms of the evidence on sellers' sensitivity to fees, we found that, of those who had used a traditional estate agent, 92 per cent had compared fees, with 88 per cent having found it easy to do so.¹⁰¹ However, just 23 per cent of those who compared fees chose the agent who offered the lowest fees.¹⁰²

4.28 It had been put to us that less scrupulous estate agents may compete for business by giving a higher valuation, or recommending a higher asking price, than they thought realistically achievable. The extent to which estate agents may have incentives to use overly optimistic valuation to, in effect, 'bid' for sellers' business is not at all clear cut. While we agree that consumers are likely to choose an estate agent based on their assessment of how successful that agent may be in achieving a good price, it also seems likely that, with much more information available to consumers on local prices from the property portals, they have a good idea of at least a broad range of realistic asking prices. Only 18 per cent of sellers actually chose the estate agent who gave the highest valuation.¹⁰³ It is also not clear that agents would benefit - setting an unrealistically high asking price may well extend the

¹⁰⁰ OFT Survey of Estate Agents, 2009 (Chart 3.3, page 13)

¹⁰¹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.12, page 32)

¹⁰² OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.13, page 33)

¹⁰³ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.14, page 34). It could well be the case that some of the valuations received by sellers were quite similar.

time that the property is on the market and may increase the amount of effort that the estate agent must exert in soliciting offers at this level or in convincing the seller to accept a bid below this level.

- 4.29 Although sellers may not be primarily focussed on fees when choosing an estate agent, we found that almost a third (32 per cent) of those who had used an estate agent believed that the fees they had paid to their estate agent represented slightly or very poor value for money.¹⁰⁴ This suggests a degree of sensitivity to price, at least after the fact. The main reasons given by sellers on why they did not consider that they had received good value for money, included a perception that the estate agent had not earned his fee (38 per cent), hadn't done much to earn it (28 per cent) or had given poor service (22 per cent).¹⁰⁵

Contractual and incentive issues

- 4.30 Sellers have a number of different types of contracts to choose from when they decide to instruct an estate agent, or more than one estate agent, to market their property. The principal contract types in common use are described in Chapter 3. In this section we look at how well these contracts align the estate agent's incentives with those of his client, the seller.

Flat commission rates

- 4.31 As noted above, the predominant form of contract is one where the estate agent is remunerated by a commission payable on exchange but paid on completion, and where the commission rate is a given percentage of the achieved sale price.
- 4.32 'No sale, no fee' contracts clearly give the agent a powerful incentive to close a deal – it is not sufficient merely to solicit offers, unconditional exchange must take place before the agent is entitled to payment.

¹⁰⁴ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.42, page 62)

¹⁰⁵ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.43, page 63)

- 4.33 Furthermore, a percentage commission (rather than a flat fee) provides the estate agent with some incentive to achieve the highest possible price for the seller. In practice, however, this incentive is weakened once the estate agent has achieved an offer within an acceptable range to his client but below the maximum achievable, since achieving a higher price becomes increasingly costly to the estate agent. For example, if the estate agent valued the property at £200,000, it might prove quite easy to find a buyer willing to pay £180,000. If the estate agent's contract awards him one and a half per cent of the sale price, then he will receive £2,700 if this offer is accepted. His return on the extra effort needed to sell the house for £20,000 more would be only £300. This relatively small additional commission may not be sufficient to compensate the estate agent for the extra effort needed to either persuade the buyer to raise his offer substantially, or to find an alternative buyer. Instead the estate agent might prefer to concentrate on soliciting an offer on one of his other properties or on attracting more sellers to list with his agency.
- 4.34 This misalignment of incentives was empirically tested in two recent academic studies using US data. Levitt and Syverson (2008)¹⁰⁶ and Rutherford, Springer and Yavas (2005)¹⁰⁷ both use very large data sets derived from Multiple Listing Service (MLS)¹⁰⁸ databases. In both cases the authors observed sales by estate agents of their own properties as well as sales where estate agents acted for clients. In each case they find robust empirical evidence that, controlling for property characteristics and market conditions, estate agents achieve a higher price for their own property. Levitt and Syverson (2005), using a data set of almost 100,000 sales between 1992 and 2002 in suburban Cook

¹⁰⁶ Levitt, S.D., and C. Syverson (2008) 'Market Distortions when Agents are Better Informed: The Value of Information in Real Estate Transactions', *The Review of Economics and Statistics*, Vol. 90(4), pp.599-611.

¹⁰⁷ Rutherford, R.C., T.M. Springer and A. Yavas (2005) 'Conflicts between principals and agents: evidence from residential brokerage', *Journal of Financial Economics*, Vol. 76, pp.627-665.

¹⁰⁸ A Multiple Listing Service, or 'MLS', is a local or regional joint venture between real estate brokers who pool and disseminate information on the properties they are marketing in the area.

County, Illinois, find that estate agents achieve prices that are, on average, 3.7 per cent higher than comparable properties. Rutherford et al (2005), using data on almost 500,000 sales between 1998 and 2002 in a large metropolitan area of Texas, find that, on average, estate agents selling their own property achieve a price premium of approximately 4.5 per cent.

4.35 Given the prevalence of flat rate commission contracts, it is not unreasonable to expect the same effect to be present to some degree in the UK market. If the effect were of the same order of magnitude (resulting in sales at three to five per cent less than the full achievable sale price) then this would imply considerable detriment for sellers in the UK. On the basis of an average UK property price of between £174,415 (2008 average) and £181,810 (2007 average)¹⁰⁹ this implies an average detriment to individual sellers of between £7,276 and £7,575 per transaction.¹¹⁰ Using the transactions volumes for the relevant years, collectively this could amount to between £5.7 billion and £10.5 billion of seller detriment annually.¹¹¹

4.36 Of course a property sold at undervalue benefits the buyer who obtains the property at below its fully achievable market value, so the net consumer detriment figure will be somewhat lower than the detriment to sellers. Nonetheless, in a market where buyers differ in their willingness to pay for a particular home, it is unlikely that the detriment to sellers is completely offset by the gains to buyers. Markets work well when the buyer who is willing to pay the highest price purchases the good in

¹⁰⁹ Nationwide House Price Index.

¹¹⁰ Taking the selling price as 96 per cent of the achievable price.

¹¹¹ The extent to which this detriment is due to the actions or advice of estate agents is not clear. Estate agents do have some discretion over how, and how energetically, they market a property and often have a role in negotiating on the sellers behalf, as well as in advising the seller and, indeed, often in advising the buyer too. However, the final decision is the seller's. Also, the seller detriment is likely to be lower than this estimate, as some sellers will be willing to accept a slightly lower price to achieve a speedy sale.

question. There will be net consumer detriment to the extent that the estate agency market fails in this matching function.

- 4.37 It is worth asking whether there are other forms of contract that better align the interests of estate agents with their clients. In principle, a stepped commission rate contract would provide a stronger incentive on the estate agent to achieve a higher price. For example, a seller could offer an agent one per cent for achieving a sale below the asking price, and a much higher percentage for achieving a sale at or above the asking price. This form of contract of course would be more complicated in that it would require the consumer to carry out both an accurate assessments of the mechanics of the contract and the accuracy of the initial asking price and consumer confusion around complex contracts is a cause for concern.¹¹²
- 4.38 Stepped commission rates may be an attractive option for confident consumers, but there are many who struggle to evaluate even the basic flat percentage commission contracts. Research in marketing and behavioural economics has shown that many consumers do not process price information completely and accurately.¹¹³ In other words, many sellers may not realise that one and a half per cent (a very small percentage) of £200,000 amounts to £3,000 (a not insubstantial amount of money). This, alongside the fact that the use of percentage commission rates encourages the use of pricing points, was one of the reasons behind our recommendation in our 2004 study that estate agents express their charges in both percentage and absolute terms.¹¹⁴

¹¹² The OFT has recently announced a study into some of the problems consumer face in evaluating contracts see the market study page on the OFT's web site and 'consumer understanding of contracts'.

¹¹³ See, for example, Morwitz, V.G., E.A. Greenleaf and E.J. Johnson (1998), 'Divide and Prosper: Consumers' Reactions to Partitioned Prices', *Journal of Marketing Research*, Vol. 35(4), pp.453-463.

¹¹⁴ Estate Agency Market in England and Wales, OFT Market Study Report 2004 (paragraphs 4.58 and 4.59, pages 52-53)

This recommendation has been implemented in the Property Ombudsman's Code of Practice for Residential Estate Agents, which requires that all fees be 'expressed as an actual amount plus VAT'. Where the fee is 'a percentage of the selling price, the 'actual' amount should be based on the asking price' but adjusted once the selling price is determined.¹¹⁵

- 4.39 The incentive properties of flat percentage commission rates are not very different from those of flat fees conditional on sale – in both cases the over-riding incentive is to find an offer acceptable to the seller, and then close that deal; the incentive for the estate agent to hold out or exert extra effort and marketing costs in pushing for a higher offer is weak. It is possible that the prevalence of flat percentage commission rates in this market has less to do with the incentive properties of the contract than with many consumers' inability to correctly evaluate the true cost. We do not, therefore, regard flat percentage commission rates as an optimal outcome in this market, and would welcome the development of alternative charging structures, to which we return below.

Conflicts of interest

- 4.40 Where the estate agent acts for the seller but also has a relationship with a buyer, this can give rise to conflicts of interest. The most obvious example is where the agent himself, or someone closely related, wants to buy the home in question.
- 4.41 There are other, less obvious situations in which conflicts of interest can arise. For example, a conflict of interest arises where an estate agent stands to earn referral fees from the sale of ancillary services (for example, conveyancing) from a particular buyer – this gives the agent a financial incentive to prefer that buyer over others.
- 4.42 Another example arises where a prospective buyer is also selling their own property through the estate agent. In this case the agent may have

¹¹⁵ See Clause 3h of the Code.

an incentive to prefer that buyer, since it will increase his chances of completing the second deal.

- 4.43 In the relevant legislation, conflicts of interest are dealt with through an obligation on the agent to disclose any such conflict to the seller, who can then decide whether to terminate the relationship and appoint another agent. Where such conflicts cannot be dealt with by banning the agent from acting for different parties, or banning would be disproportionate, this may be the only feasible regulatory response.
- 4.44 It is also worth highlighting that conflicts of interest are a problem for agency relationships specifically, rather than for intermediaries more generally. A conflict of interest arises when one party engages an agent to act solely on their behalf, but that agent has incentives which conflict with that duty. A neutral intermediary, however, has a different role. For example, ebay provides a service to both buyers and sellers but is not engaged by either side to act on their behalf. A neutral intermediary in a two-sided market must look to the needs of both sellers and buyers but has no specific agency duty to either side. The distinction between sellers' agents and neutral intermediary platforms is one we return to later in this chapter.

Multi-agency and joint sole contracts

- 4.45 A multi-agency contract is one where more than one estate agent is instructed to market a home at the same time. Only the agent who finds a buyer is paid commission. A joint sole agreement is similar to multi-agency, but all agents are entitled to commission, regardless of who sells the home. Multi-agency and joint sole agency commission rates are typically higher than sole agency rates, generally in the region of two to three and a half per cent.¹¹⁶
- 4.46 Multi-agency agreements give agents a stronger incentive than joint sole agency to find a buyer, since each agent stands to earn the higher

¹¹⁶ Which? Buy, Sell and Move House, page101.

commission payment in full, but only if they get in first and find the buyer. However, the incentive to solicit a higher offer is extremely weak – an agent who has a credible buyer has a strong incentive to persuade the seller to accept that offer, before another agent comes up with a competing offer. The returns to increased effort to solicit a higher offer are low if not negative at that point.

- 4.47 In joint sole agency agreements, the agents share the commission regardless of who finds the buyer. This provides the agents with a weak incentive to put effort into finding a buyer – they stand to gain even if the other agent does the work – but a better incentive to hold out for a higher offer.
- 4.48 A joint sole agency arrangement may be problematic from a competition point of view, as it involves estate agents cooperating and agreeing a common fee structure. However, individual agents must still compete to be included in a sellers' joint sole agency contract on the basis of price – each agent unilaterally quotes a joint sole agency rate, and the seller can choose, say, two agents at the lower end of the fee spectrum before agreeing with them a common rate.
- 4.49 Comparing the prevalence of the different types of contracts, we find that sole agency has been by far the most common type of contract in recent decades:
- from our survey of estate agents (2009) we found that 67 per cent of sellers signed sole agency contracts, 15 per cent chose a sole selling rights agreement, 10 per cent agreed a multi-agency contract, three per cent decided on joint agency and two per cent agreed to joint sole agency agreements¹¹⁷
 - from our sellers survey in our 2004 study we found that 75 per cent of sellers had a sole agency agreement with their estate agent, 15 per cent had a sole selling rights agreement and three per cent

¹¹⁷ OFT Survey of Estate Agents, 2009 (Chart 3.13, page 24)

signed a multiple agency contract. The remaining seven per cent didn't know what type of contract they had with their estate agent¹¹⁸

- in 1979 the Price Commission found that 46 per cent of sellers had a sole agency agreement, 21 per cent signed sole selling rights contracts, 27 per cent had a multiple agency agreement, three per cent had a joint sole agency agreement and three per cent had sub-agency contracts.¹¹⁹

4.50 We expect the increased use of the internet to advertise properties to further reduce the use of multi-agency and joint sole agency contracts. Traditionally, engaging more than one agent was primarily done to bring the property to the attention of a greater number of buyers. However, estate agents' use of their own websites and in particular of property portals has made it much easier for buyers to search across several estate agents without having to visit their offices or register with them.

Pricing

4.51 The way estate agents charge has not changed significantly in recent years. The predominant fee structure is that sellers are charged a percentage of the selling price, which is paid on completion.¹²⁰ Our surveys of both sellers and agents indicated that about three quarters of

¹¹⁸ Estate Agency Market in England and Wales, OFT Market Study Report 2004 (paragraph 3.23, page 23)

¹¹⁹ Price Commission Examination – Estate Agents, 1979,, Table 2.4, p.18. Also, note that a 'sub-agency' contract was an agreement whereby a single estate agent would have a contract with the vendor, but was allowed to appoint one or more other agents to co-operate with the sale. A sub-agent who is instrumental in the sale would share the commission with the principal agent. These types of agreement no longer appear to exist.

¹²⁰ Estate agents are generally entitled to commission once contracts are exchanged but are paid out of the proceeds of sale on completion.

transactions are still paid for this way.¹²¹ We note that earlier research by the Royal Institute of Chartered Surveyors (RICS), which informed the Carsberg Report,¹²² found that 38 per cent of sellers were paying flat fees; our research suggests that the use of flat fees is considerably less widespread.

4.52 In terms of the level of fees, our survey of sellers found that the fees actually paid by sellers were around 1.6 per cent.¹²³ Similarly, our survey of estate agents found that standard fees before negotiation averaged 1.6 per cent in early 2009, with similar rates being reported for 2007 and 2008.¹²⁴

4.53 The distribution of standard fees that estate agents quoted is presented in Chart 4.10. We find that the vast majority (93 per cent) of agents quote between one and two percent, which is very similar to our findings in 2004.¹²⁵ Again, as in 2004, we find clear evidence that estate agents use pricing points in their standard quoted fees, with a large majority of estate agents' fees clustering at one, 1.25, 1.5, 1.75, and two per cent.¹²⁶

¹²¹ This figure is 75 per cent based on the estate agent survey (OFT Survey of Estate Agents, 2009, Table 3.7, page 17) and 78 per cent based on the sellers survey (OFT Quantitative Consumer Survey Report, GfK 2009, Chart 5.16, page 36).

¹²² ComRes Report for RICS, Consumer Detriment in Domestic Property Transactions, Report 1, May 2008, page 6

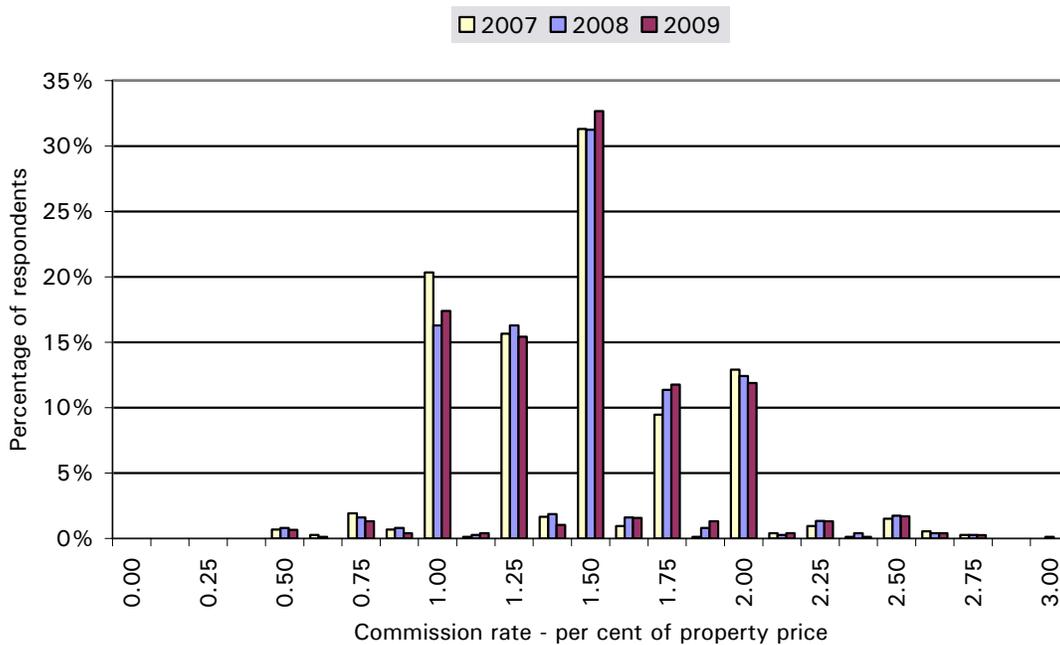
¹²³ OFT analysis of data collected for the Quantitative Consumer Survey.

¹²⁴ OFT Survey of Estate Agents, 2009 (Paragraph 3.23, page 18)

¹²⁵ 2004 figures are based on those sellers who did not negotiate.

¹²⁶ Estate Agency Market in England and Wales, OFT Market Study Report 2004 (Figure 4.1, page 43)

Chart 4.10: Distribution of estate agents' standard fees before negotiation



Base: 765 estate agents

Source: OFT Survey of Estate Agents, 2009

4.54 We looked at regional variation in the fee rates charged by estate agents, as we might expect to observe lower commission rates in regions where house prices are higher relative to the cost of living. Our survey of estate agents found that England has somewhat higher commission rates than the rest of the UK, while Wales has higher average commission rates than Northern Ireland.¹²⁷ As outlined in Chapter 8, some aspects of the service, for example, some of the marketing costs, are paid upfront, so commission rates in Scotland cannot be compared directly with those in the rest of the UK. There was little apparent regional variation in commission rates across the English

¹²⁷ OFT Survey of Estate Agents, 2009 (Chart 3.8, page 19)

regions, which is perhaps surprising in the light of significant regional variations in property prices.

4.55 Table 4.11 presents the average commission rate paid by sellers for a number of property price bands.

Table 4.11: Average commission rate by property price band

| Value of property | Mean commission rate | Implied fee taking the mid-point property value |
|---------------------|----------------------|---|
| Less than £100,000 | 1.6 | £800 |
| £100,000 - £199,999 | 1.8 | £2,700 |
| £200,000 - £299,999 | 1.6 | £4,000 |
| More than £300,000 | 1.3 | £4,550 |
| All property values | 1.6 | £2,880 |

Base: 227

Source: OFT Consumer Survey, GfK 2009

4.56 This shows that, although there is some decline in commission rates for higher value properties, estate agents typically earn larger fees in absolute terms for selling higher value homes. For example, based on the figures in the table, an agent might earn £2,700 on the sale of a £150,000 home but £4,000 on a £250,000 home.

4.57 Estate agents told us that it can cost more to sell a higher valued property,¹²⁸ with the main reasons relating to the extra and more

¹²⁸ The question gave the example of a property valued at £500,000 compared to one valued at £150,000.

expensive marketing required, the fact that a 'more tailored service' is required and the need for more customer interaction with sellers.¹²⁹ Nonetheless, it seems likely that there is a degree of cross-subsidisation in this market. While this degree of cross-subsidy is perhaps of limited concern in itself, the existence of cross-subsidy provides some further indication of a lack of strong price competition in the market for estate agency services.

- 4.58 On the issue of stickiness (commission rates not changing as property prices rise and fall) over the property cycle, an obvious point to make is that commission rates do not appear to have changed significantly since our 2004 market study. Then our survey of sellers found that the average fee paid was 1.45 per cent. The average house price now is almost 20 per cent higher,¹³⁰ while commission rates remain at a similar level – 1.6 per cent on average. In fact, not only has the mean level of commission rates not changed much, but the distribution has changed very little too. Comparing Figure 4.10 with the equivalent Figure 4.1 in our 2004 study reveals a striking similarity. Data on fees and average sale prices supplied by one of the leading estate agent firms confirms that there is a high degree of stickiness in commission rates. In the period covered, average sale prices fluctuated by over 20 per cent, while average commission rates changed by just 0.1 of a percentage point.
- 4.59 It has been put to us that looking only at the standard commission rates quoted by estate agents fails to capture the effect that different market conditions are likely to have on the actual commission rate paid after sellers have negotiated. In 2004, our consumer survey found that sellers who did not shop around or negotiate paid a commission rate of 1.58 per cent on average, while those who both shopped around and negotiated paid 1.36 per cent on average.¹³¹ Our 2009 consumer survey

¹²⁹ OFT Survey of Estate Agents, 2009 (Chart 3.9, page 20).

¹³⁰ Increase in the Nationwide House Price Index between Q3 2003 and Q2 2009.

¹³¹ Estate Agency Market in England and Wales (2004) (Paragraph 4.49, page 50).

found that those who did not negotiate paid a commission rate of 1.76 per cent on average, while those who did negotiate paid 1.44 per cent.¹³² Given our sample sizes and the nature of the data collection, these are very similar commission rates applying under very different market conditions and more than five years apart.

- 4.60 This stickiness in commission rates has also been observed in a number of other countries. The international comparisons annexe of our 2004 study¹³³ noted the sticky nature of estate agent fees. The average fees quoted in the more recent German survey and the responses to our international survey for this market study were broadly similar to those presented in the 2004 report, confirming that fee structures and rates do not seem to change much in response to changes in market conditions. In the US, the Federal Trade Commission (FTC) and the Department of Justice (DOJ) points to several studies that find that commission rates are correlated negatively with house prices, but that generally the actual commission fee earned increases slightly with house prices. Overall, they conclude that commission fees are fairly inflexible.¹³⁴

International comparisons

- 4.61 Internationally, the commission fee is almost always charged as a percentage of the sale price. However, which side in the transaction pays the fee varies from country to country. In England and Wales it is only the seller who pays the estate agent. In Spain, although the seller pays the commission, the cost is often shifted to the buyer via the contract they enter into. In the US, there are usually two separate agents: the seller's agent, the 'listing agent', values the property, conducts the marketing activities and viewings and negotiates for the

¹³² OFT analysis of survey responses.

¹³³ 2004 Main Report paragraph 4.49, page 50

¹³⁴ Report by the Federal Trade Commission and the Department of Justice, 'Competition in Real Estate Brokerage Industry', April 2007.

seller, while the buyer's agent, the 'cooperating agent', finds a suitable property for the buyer. Listing agents are paid a flat fee or commission or a combination of both. Cooperating agents are paid a proportion of the fee or paid by the buyer directly. The overall cost of the transaction in terms of total fees paid to both brokers is, on average, in the region of 5 per cent.¹³⁵ In the Netherlands, where each party is also separately represented, the seller and buyer each pay their agent separately.

4.62 The level of commission paid in different countries is not directly comparable for a number of reasons. First, there are many differences in the home buying and selling process in different countries. Second, there are also major differences in the services supplied by estate agents and analogous service providers in other countries. For example, in Denmark, the Netherlands and Australia, marketing of the property is charged separately to the agent's commission. In some countries, legal services are included in the agent's package. Third, given that estate agents generally charge on the basis of a percentage of the sale price, comparing costs across countries implies comparing property prices across countries, which is not straightforward.

4.63 Nonetheless, the percentage commission rate in the UK appears to be at the lower end of the spectrum. However, as outlined above it is very difficult to directly compare these prices across such disparate and heterogeneous markets. Furthermore, we note that a number of the markets with which the UK might be compared are not free of problems themselves. For example, the DOJ and FTC have investigated a number of cases of exclusionary behaviour and pointed out numerous examples of anti-competitive regulation and legislation in US real estate agents markets.¹³⁶

¹³⁵ Report by the FTC and the DOJ, 'Competition in Real Estate Brokerage Industry', April 2007, page 39.

¹³⁶ As outlined in the Government Accountability Office report. 'Real Estate Brokerage: Factors that may effect price competition', August 2005; and in a report by the DoJ and the FTC, 'Competition in Real Estate Brokerage Industry', April 2007.

The effect of consumer behaviour

- 4.64 We compared the mean level of fee paid by those who shopped around with those who did not but found no statistically significant difference between the two. This is somewhat surprising, as our 2004 study found that the shopping around effect was significant - shopping around was found to reduce the average level of fees paid by sellers by 11 per cent.¹³⁷
- 4.65 Willingness to negotiate is also important in markets where contracts are (or can be) formed on the basis of bilateral bargaining. Our survey found that a third of sellers that used an estate agent had managed to negotiate a lower fee with their chosen estate agent,¹³⁸ which is similar to our findings in 2004¹³⁹ and broadly consistent with the finding from our survey of estate agents that 28 per cent of vendors had successfully negotiated a below-standard fee.¹⁴⁰
- 4.66 The nature of the data collection on this survey means that we could only conduct limited statistical analysis of the difference in average fee rates for these two groups of sellers. However, we have been able to conclude that the difference in the mean fees rate paid is significant,¹⁴¹

¹³⁷ 2004 Main Report paragraph 4.49, page 50

¹³⁸ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.11, page 32)

¹³⁹ 2004 Report, Annexe A, Consumer Survey, paragraphs 5.16 and 5.17.

¹⁴⁰ OFT Survey of Estate Agents, 2009 (Paragraph 3.25, page 19)

¹⁴¹ Because these data were mistakenly rounded to the nearest integer and the size bands for the two questions were not identical, it would not be correct to compare the two means directly, even though they are statistically significant at the 95 per cent level of confidence.

with those sellers who did negotiate paying commission of 1.4 per cent, while those who did not paid 1.8 per cent.¹⁴²

- 4.67 There is some evidence to suggest that sellers in the US shop around less but negotiate more than their UK counterparts. According to the National Association of Realtors,¹⁴³ 67 per cent of home sellers only contacted one agent before selecting one to assist with their home selling, but 78 per cent of sellers attempted to negotiate fees, of whom 70 per cent claimed they were successful in doing so. Since our survey results suggest that the returns to negotiation are greater than the returns to shopping around, it appears that shopping around alone may not be sufficient for sellers to make significant savings.¹⁴⁴
- 4.68 Our estimates of the gains to negotiation from our quantitative consumer survey provide a way of estimating the consumer detriment associated with the weakness of price competition in this market. As outlined above, where sellers successfully negotiate lower fees they pay a commission rate of 0.4 percentage points less on average. This implies that the detriment to consumers from failing to shop around and negotiate could be in the region of between £280 million and £570 million (on the basis of 2008 and 2007 transaction volumes and house prices, respectively).

Profitability

- 4.69 In our 2004 market study, the OFT conducted a financial analysis of estate agents' profitability and found no evidence that they were making excessive profits over the property cycle. Periods of high profitability

¹⁴² This is a statistically significant difference. The difference between the mean commission rates is statistically significant at the 95 per cent level, although it should be noted that the size-bands that the data were recorded in were relatively broad which potentially reduces variance.

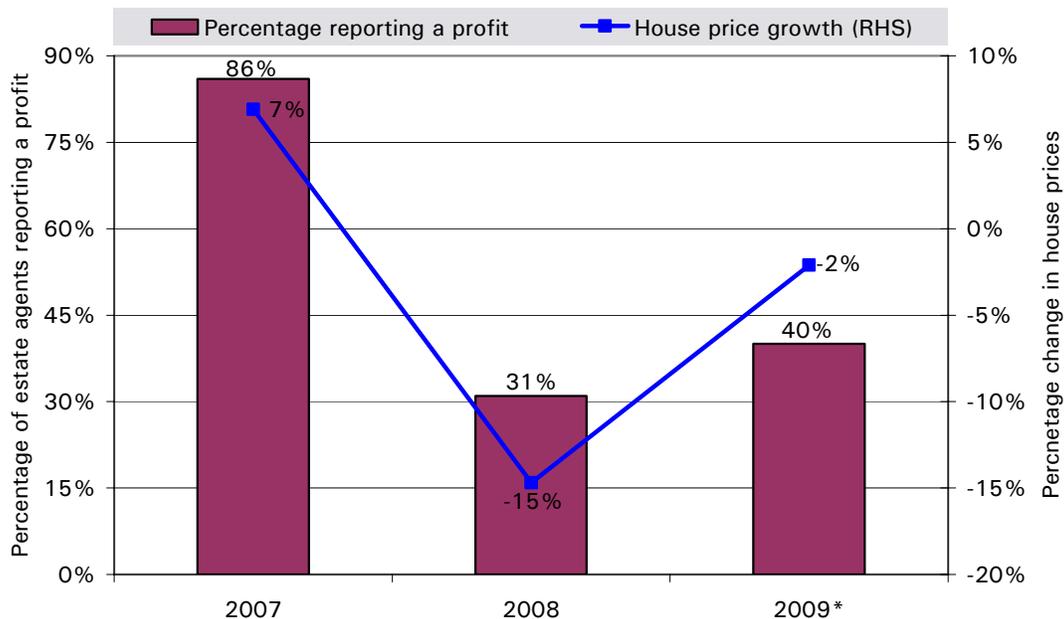
¹⁴³ Profile of Homer Buyers and Sellers 2008 – National Association of Realtors

¹⁴⁴ Indeed, the Consumer Survey for our 2004 study found that those who both shopped around and negotiated made the largest savings. See paragraph 4.49 of the 2004 report.

during periods of house price growth were followed by periods of lower profitability or losses when the housing market cooled.

4.70 This pattern is still evident. Chart 4.12 compares the percentage of estate agents reporting a profit with changes in average house prices over the same period.

Chart 4.12: Estate agents' profitability and the property price cycle



* Estate agents' responses for 2009 cover the period January to June, while the house price change is for Q1 and Q2.

Source: OFT Survey of Estate Agents (2009) and Nationwide House Price Index

4.71 A number of estate agents provided us with data on their revenues and profits over a longer period. Again, comparing these with changes in house prices does not suggest that the sector displays high levels of profitability over the property cycle.

4.72 A number of academic studies using US data have found that the price stickiness combined with the low barriers to entry does not lead to excessive profits. Rather it leads to excess entry, as higher prices and

more transactions attract more estate agents into the market. In relation to estate agency, while it is to be expected that a booming sector should attract new entrants, where estate agents do not compete on price and commission rates remain at the same level, this can lead to entry that is over and above that which is needed to service the extra demand and productivity falls as a result.

- 4.73 Hsieh and Moretti (2003),¹⁴⁵ used census data for several hundred US cities, where the number of real estate brokers could be tracked over time and analysed alongside data on the housing and labour markets for those cities. They concluded that sticky commission rates combined with low entry barriers seems to induce socially inefficient entry, with rising property prices increasing the fraction of real estate brokers in a city's labour force and reducing broker productivity, while leaving the typical broker's real wage unchanged.
- 4.74 We examined this issue in relation to the UK using a rough measure of productivity over the property cycle derived by combining ONS data on estate agents from the Annual Business Inquiry¹⁴⁶ with transactions data from CLG. While this very basic analysis has limitations, it does provide some indication that a similar issue arises in the UK with estate agents' productivity falling during property booms. Comparing these trends in sectoral productivity with changes in average house prices over the period suggests falling productivity as house prices and transaction numbers increase. Between 1998 and 2007, the number of transactions increased by 34 per cent, while the number of agencies grew by 90 per cent and the number of employees in the sector by 54 per cent. We can conclude that there is some evidence of declining productivity over the most recent property boom (ending in 2007), with the entry of offices

¹⁴⁵ Hsieh, C-T., and E. Moretti (2003) 'Can Free Entry Be Inefficient? Fixed Commissions and Social Waste in the Real Estate Industry'. *Journal of Political Economy*, Vol. 111(5).

¹⁴⁶ Office for National Statistics

and employees to the real estate sector (residential and commercial) outstripping the rise in transactions and sectoral productivity (or at least one measures of it) falling as a result.¹⁴⁷

Conclusions on price competition and price levels

- 4.75 Despite the fact, in general, estate agency markets are not highly concentrated due to low barriers to entry, it appears that price competition between estate agents is quite weak. There are a number of features of the market which can be used to explain this, predominantly consumer preferences and behaviour; the pricing structure that predominates in the market; and the lack of innovation by traditional estate agents, coupled with the lack of significant penetration by alternative business models.
- 4.76 Consumer preferences and consumer behaviour play an important role in driving price competition in any market. As discussed above, consumers are not primarily focused on the commission rate when they are choosing an estate agent. Their main focus, understandably, is on maximising the sale price they achieve and they factor in a number of aspects of the agent's offer, such as, reputation, local knowledge and the level of the valuation.
- 4.77 Many sellers who use an estate agent (one in three) do not shop around¹⁴⁸ and most (64 per cent) do not negotiate, so many pay the standard commission rate that the estate agent had quoted.¹⁴⁹ It is also worth considering that some sellers may fear that asking for lower fees may disincentivise their agent in a market where the estate agent is selling multiple properties at different commission rates.

¹⁴⁷ As we point out, this is a basic analysis and there are other explanations for what we observe, including the possibility that falling transaction numbers per estate agent may be related to improvements in the quality of service provided.

¹⁴⁸ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.8, page 29)

¹⁴⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.11, page 32)

- 4.78 The prevalent pricing structure involves quoting fees in percentage terms, which may lead to consumers not being as sensitive to how much they will pay in absolute terms as they might otherwise be. As noted above, the effect of this should be mitigated to an extent by the inclusion in the Property Ombudsman's Code for fees to be 'expressed as an actual amount' too. The widespread use of pricing points may well militate against small changes in commission rates.
- 4.79 As outlined below, while there has been some innovation in the market for estate agency services in recent years, most notably in relation to use of the internet for listing properties and for facilitating consumer research, there is still room for much more innovation in terms of contract types, menus of services provided and fees structures, as well as many areas where estate agents could facilitate innovation in dealing with process issues. This sluggishness in innovative effort, coupled with the, so far, limited penetration of alternative business models has meant that the traditional sector has to an extent been shielded from vigorous price competition.
- 4.80 Another possible explanation for weak price competition in a market which, in general, is not highly concentrated in most local markets is collusion. We have no reason to believe that explicit collusion takes place among estate agents. There are, however, a number of features of the market that may make tacit collusion, particular around price points, a possibility. As presented in Figure 4.10, the use of pricing points is widespread in this market. While there is some dispersion around the mean standard commission rate of 1.6 per cent, there is clearly a large proportion (over 30 per cent) of estate agents who charge 1.5 per cent.

Detriment due to lack of price competition

- 4.81 As discussed above, there are three areas where consumer detriment is likely to arise on a substantial scale in this market.
- potentially substantial detriment to sellers from estate agents not being sufficiently incentivised to achieve the highest possible sale price - collectively this could amount to more than £5 billion annually

although it is important to note that the net detriment across both buyers and sellers will be much less

- where sellers successfully negotiate lower fees they pay a commission rate of 0.4 percentage points less on average - this implies that the detriment to consumers from failing to shop around and negotiate could be in excess of £280 million, and
- sticky commission rates combined with low barriers to entry may lead to excess entry that is inefficient and so detrimental to productivity.

Entry and innovation

4.82 In this section we look at recent innovation in this sector, and what more we might expect, in terms of innovation in the traditional estate agency model, contracts and fee structures, and alternative business models. We then go on to discuss factors that might be inhibiting innovation in this sector.

Innovation in traditional estate agency

4.83 The most significant development in recent years has been the increased use of the internet for marketing properties, with portals and estate agents' own websites providing easier access to information for both buyers and sellers.

4.84 Ninety two per cent of estate agents use property portals 'very often'.¹⁵⁰ Over a third (37 per cent) of estate agents believed that more than half of their sales originated from property portals.¹⁵¹ Ninety-seven per cent of estate agents rated access to portals as an important factor in

¹⁵⁰ OFT Survey of Estate Agents, 2009 (Chart 3.16, page 27)

¹⁵¹ OFT Survey of Estate Agents, 2009 (Chart 3.17, page 28)

enabling them to attract sellers to their agency.¹⁵² Our 2004 study's business survey produced similar results, with 93 per cent of respondents claiming they used either a group website or an unrelated commercial site to advertise properties.¹⁵³

- 4.85 The internet acts as an enhanced shop window for estate agents, making it easier for sellers to find estate agents and for buyers to search for properties. This significantly reduces search costs for buyers, particularly those looking to move out of their local area. It also intensifies competition, because the local knowledge advantage of incumbent estate agents is reduced and because each estate agent is able to reach a wider range of sellers and buyers than was possible with a high street presence alone. The increased use of websites and property portals also had the effect of lowering barriers to entry. The incumbency advantages of well-established estate agents are reduced if an entrant can instantly reach a large number of buyers over the internet.
- 4.86 Another important positive effect is that the internet has made consumers better informed, especially about property prices. This is partly because of the increased ease of search and comparison of properties, but also because other sources of information about property prices (for example price information from Land Registry, price indices from lenders) are easily accessible online. Traditionally, valuation and advice on initial asking price, as well as changes to the asking price, have been important aspects of the service estate agents provide to sellers. Similarly, buyers have traditionally been somewhat reliant on the advice of the (seller's) estate agent when making offers. Both buyers and sellers now have much easier access to objective information on property prices, which should reduce their dependence on traditional estate agents.

¹⁵² OFT Survey of Estate Agents, 2009 (Chart 3.3, page 13)

¹⁵³ Annexe B of Estate Agency Market in England and Wales, OFT 2004 (Table 5.3, page 17)

- 4.87 However, internet-related innovation by traditional estate agents has been largely confined to assisting marketing of property and of the estate agent itself. Some estate agents use, or are developing, information technology for communications during transactions (for example, online access to transaction records). However, we have not yet seen widespread innovation of this kind.
- 4.88 We have also seen surprisingly little innovation in relation to the substantive model of selling property. The dominant model is still the traditional estate agent with a high street presence retained by the seller and paid a fee on completion based on a percentage of the achieved price. Given the reduced importance of the high street shop front, we might expect to see estate agents looking to cut costs by shifting their shop front off the high street and onto the internet. While some traditional estate agents have set up virtual offices, this is not yet common practice, though as discussed earlier, this may in part reflect the preferences some consumers express for personal, face-to-face contact with their estate agent.

Innovation in contracts and fees structures

- 4.89 Another striking feature of this market is the homogeneity of the service offering – most estate agents offer broadly the same package of services (valuation, production and distribution of marketing material, accompanied viewings, and negotiation) at broadly the same price (one to two per cent of the achieved sale price).
- 4.90 Given the heterogeneity of sellers, it is perhaps somewhat surprising that we do not see greater variety in terms of service offered, or greater use of 'menus' of services, with the buyer deciding which parts of a package to buy. Similarly, it is perhaps surprising that a single form of contract (flat percentage commission) dominates. We might expect sellers who urgently want to sell to use a flat no sale-no fee contract, while those who are in no hurry but want to realise the maximum possible sale price might opt for a stepped commission rate.

- 4.91 Traditional estate agents are often not disposed towards providing menu pricing. In principle, any consumer who wanted to change any elements of the bundle could incorporate this in the bilateral agreement they enter into with their agent. In practice, however, we would generally expect a competitive market to offer options to consumers, rather than rely on consumers to amend standard contracts themselves.
- 4.92 We have seen evidence of some innovation in fee structures, primarily among online estate agents. For example, of those we looked at most offered a range of packages varying on price and level of service, or offered a standard deal with the possibility of paying extra for additional services. It is also common for online estate agents to provide a range of different fee structures for the same service, allowing the consumer to choose how much to pay as a fixed up-front charge and how much to pay as a flat percentage fee upon completion. Nonetheless, online estate agents are still very much at the margins of the industry, so these pricing options have yet to enter the mainstream.
- 4.93 There are some indications that innovation has proceeded faster in other countries. In the US, agents increasingly provide a menu of services, with fees varying in line with the level of service provided. This gives consumers more control over pricing and enables them to manage their costs, which in turn is encouraging competition in the market and driving changes in the fees charged.¹⁵⁴ In the Netherlands, buyer agents, who use menus of services more often than seller agents, are reducing their fees and becoming more flexible.¹⁵⁵

Alternative business models

- 4.94 Another striking feature of this market is that the full-service, traditional estate agency model remains the single predominant sales channel.

¹⁵⁴ National Association of Realtors reports, 'The Future of Real Estate Brokerage' and 'Change is Relentless', both published 2003

¹⁵⁵ Estate Agency Market in England and Wales (2004), annexe C International Comparisons

Given the reduced importance of the high street shop front, and the fact that buyers and sellers are less reliant on agents as a source of pricing information, we might have expected to see a trend towards less use of and reliance on the services and advice of intermediaries like estate agents (or 'disintermediation') in this market.

- 4.95 Some new business models have emerged, such as online estate agents and private seller websites, but, to date, uptake has been limited. In the US, by contrast, it has been asserted that alternative brokerage models have grown from representing approximately two per cent of transactions in 2003 to approximately 15 per cent in 2005.¹⁵⁶
- 4.96 There will inevitably be resistance from consumers to trying new ways of buying and selling homes – it is a very large and infrequent purchase and many people will be unwilling to take a risk on an untested approach. Our consumer research explored attitudes to alternative business models and found that over a quarter of sellers (27 per cent) who used a traditional estate agent had considered using an alternative selling method, and slightly more than half of these specifically considered an online estate agent.¹⁵⁷ While this is still a minority of sellers, the online estate agents and other alternative models are generally quite small scale and relatively new, so even this level of awareness and interest is significant and represents an important change since our 2004 study.
- 4.97 Our view is that there is likely to be significant value for consumers in alternatives to traditional estate agency – both cost advantages and, potentially, more secure sales methods. Other markets, have demonstrated that, presented with a compelling alternative, consumers are confident enough to forego face to face contact and buy online. We believe that this can be the case even for relatively high value and

¹⁵⁶ FTC, Opinion of the Commission in the matter of Realcomp II Ltd., 30 October 2009, Docket Number 9320, Page 12

¹⁵⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.2, page 21)

emotionally significant purchases, with travel agency providing an example of a sector where alternative models have flourished, though this is a far from perfect comparator.

- 4.98 Needless to say, these models will not suit all sellers, and for a significant number the traditional estate agent may remain their first choice, but it seems likely that the wider use of these models will make sense for a significant number of consumers and their greater presence in the market would impose a competitive constraint on the pricing and quality of service of traditional estate agents.

Why so little innovation?

- 4.99 It is impossible to make an objective assessment of whether there is 'enough' innovation in a market. However, given the emergence of factors which we might expect to trigger changes (for example greatly improved access to local pricing information) and, given evidence of faster innovation in home buying and selling markets overseas, it is surprising that even straightforward innovation appears muted.

Consumers' reluctance to use alternative models

- 4.100 Our consumer surveys gave us some useful insights into sellers' and buyers' attitudes towards business models that offered an alternative to traditional estate agents. Our survey of sellers revealed a number of reasons why some consumers were reluctant to use alternatives to traditional high street estate agents. When sellers who had used traditional estate agents were asked why they had not used or had not considered using an online estate agent, the main reasons given were worries about communication (14 per cent), preference for personal/face-to-face contact (11 per cent), a lack of trust in online estate agents (11 per cent), and the desire for local agents with local knowledge (10 per cent).¹⁵⁸

¹⁵⁸ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.3, page 23)

- 4.101 Of those buyers who had bought through a traditional estate agent, 42 per cent responded that they would not have been at all concerned if the sale had not been handled by a traditional estate agent, while 35 per cent stated that would have been a little concerned, with the remaining two per cent having been either fairly concerned or very concerned.¹⁵⁹
- 4.102 While some of the respondents to our survey of sellers did give dissatisfaction with traditional estate agents as being a reason for using alternative methods, this did not appear to be the main motivation for most such sellers. Of the 34 respondents who had used alternatives, 13 did so because they had a buyer already, while 10 did so due to the cost saving, with the remainder citing reasons, such as greater ease, speed or control, or previous bad experiences of traditional estate agents.¹⁶⁰ Of those who did choose a traditional estate agent, 73 per cent had not considered using an alternative, a similar proportion to the 2004 survey. One in six had considered using an online estate agent, while a further one in six had considered selling privately, with just three per cent considering using an auction.¹⁶¹
- 4.103 Although the main driving force of consumer choice in this market comes from sellers, as they decide how to sell their home, the preferences of buyers are also an important determinant of how the market works. We found that, once they had been introduced to a seller, two thirds of buyers preferred to buy through an estate agent, rather than directly from the vendor.¹⁶² Asking buyers who had used a traditional estate agent whether they would have been concerned if their sale had not been handled by a traditional estate agent, we found that 42 per cent would not have been concerned at all, 35 per cent were a

¹⁵⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.60, page 81)

¹⁶⁰ OFT Quantitative Consumer Survey Report, GfK 2009 (Paragraph 5.4, page 20)

¹⁶¹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.2, page 21)

¹⁶² OFT Quantitative Consumer Survey Report, GfK 2009 (Paragraph 6.2, page 77)

little concerned, 14 per cent fairly concerned and eight per cent very concerned.¹⁶³ Among those who would have been concerned if a traditional estate agent had not been used, the main reason was that they feared that it 'might be less secure' (mentioned by 39 per cent, a similar proportion to our 2004 survey), while other less common reasons were that it might be harder to communicate, they did not trust the details supplied or had little experience of buying.

4.104 Interestingly, nine per cent expressed the sentiment that using an estate agent was the usual way to buy a house, while seven per cent felt that they needed the guidance and expertise of an estate agent.¹⁶⁴ Among the main benefits that buyers who used a traditional estate agent considered traditional estate agents to have included being able to arrange viewings (mentioned by 82 per cent), it made it easier to discuss issues when making offers and negotiating (76 per cent), easier access in the event of problems (73 per cent) and that it was less stressful (66 per cent).¹⁶⁵

4.105 It is difficult to quantify the detriment to consumers from lack of innovation, but we might expect innovation to have some impact in terms of reducing at least two types of detriment identified elsewhere in this report, in particular, as discussed above, developments such as the emergence of low cost models could sharpen price competition in this market.¹⁶⁶ Furthermore, the emergence of unbundled or low cost

¹⁶³ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.60, page 81)

¹⁶⁴ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.61, page 82)

¹⁶⁵ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.63, page 85)

¹⁶⁶ Government Accountability Office, 'Real Estate Brokerage: Factors that may affect price competition', August 2005, page 12. This report found some evidence of a decline in commission rates potentially attributable to this effect in the US. A similar effect appears to be emerging in the Netherlands: OECD, Policy Roundtables. Improving Competition in Real Estate Transactions, 2007, pages 125-126.

services should reduce the extent to which consumers pay for a 'gold-plated' service that goes beyond their needs.

Barriers to alternative models

- 4.106 Alongside consumer attitudes, we have identified two further factors that are potentially inhibiting innovation in this market. The first is that the legislation governing estate agency, which dates from 1979, is defined in terms of the traditional estate agency model. The second is that the major property portals to which consumers predominantly turn when looking for a new home to buy are dominated by traditional estate agencies.
- 4.107 The OFT has undertaken a review to identify the main types of business models currently operating on the internet in the home buying and selling sector and the application of two key pieces of legislation to these models, the Estate Agents Act 1979 (EAA) and the Property Misdescriptions Act 1991 (PMA).¹⁶⁷ This is set out in Table 4.13 below.

Table 4.13 Summary of regulation applying to internet selling models

| Category | Typical activities undertaken | Applicable regulations |
|---------------------------------|--|--|
| Estate agent only portal | The portal lists properties offered for sale by estate agents to which consumers are directed. | Estate agents to which the buyer is directed are subject to the EAA and PMA. |

¹⁶⁷ Other consumer protection laws and regulations may, of course, apply, such as the Consumer Protection from Unfair Trading Regulations 2008, Sale of Goods and Services Act 1982, etc.

| | | |
|----------------------------------|---|--|
| Estate agent website | Estate agent uses its website to market its properties for sale, and to offer other services. | Estate agent is subject to EAA and PMA. |
| Online estate agent | Online estate agents offer traditional estate agent services ¹⁶⁸ to consumers but operate on the internet only (with no high street premises). | The online estate agent is subject to EAA and PMA. |
| Private seller website | <p>Private sellers place property adverts on website which acts as a forum. The buyer contacts the seller directly.</p> <p>The website serves to introduce buyers and sellers only. It does not offer traditional EA services.¹⁶⁹ The seller sets the price, describes the property, arranges viewings and negotiates the sale.</p> <p>The website operator may offer additional services, such as a 'for sale' board, legal or other advice, email notifications or messaging facilities for example a voicebox number or secure web space.</p> | <p>A private seller is not subject to the EAA or PMA.¹⁷⁰</p> <p>If the website provides advertising space only, the EAA and PMA do not apply to the site operator who is a mere publisher of advertisements.</p> <p>However, if the website operator does anything beyond publishing advertisements or disseminating information, the EAA and PMA apply even though it is not offering services traditionally associated with an estate agent.</p> |
| Classified advert website | Private sellers and/or estate agents place property ads on website which acts as a forum. The buyer contacts the seller or estate agent directly. | <p>If the listing is provided by an estate agent, the estate agent is subject to the EEA and PMA.</p> <p>A private seller is not subject to the EAA or PMA.</p> <p>The position of the website is as described above.</p> |

¹⁶⁸ Services may include market appraisals, responsibility for obtaining HIPs, property descriptions, 'for sale' boards, accompanied viewings, and negotiating the sale.

¹⁶⁹ See above footnote.

¹⁷⁰ The regulations regarding Home Information Packs are likely to apply, however. See chapter 3.

4.108 As a general rule, businesses running classified advertisement sites and private seller websites work to a different business model to that provided by the traditional estate agent. In particular, these sites do not purport to act as legal agent for the seller in the sale of the property in the manner of a traditional estate agent. The central function of the website operator on these business models is as a forum to bring buyers and sellers together.

Appropriateness of the EAA to new business models

4.109 There is an issue whether the definition of the activities which are subject to regulation as defined by the Act remain relevant today or may even serve as a barrier to innovation. The EAA refers to the expression 'estate agency work'. This is defined broadly to cover the activities of businesses which act on instructions either to introduce sellers to buyers of UK property (or vice versa) or to secure a sale (or purchase) after such an introduction has been effected.¹⁷¹

4.110 The definition of 'estate agency work' is, accordingly, very widely drawn. The Act does not require an agency relationship to be in existence in order to apply, merely that a business acts 'pursuant to instructions'. The Act does not require the business in question to be predominantly or even significantly involved in what is traditionally understood to be an estate agency business, or have any connection to what is conventionally understood to be the role of the traditional estate agent.¹⁷²

¹⁷¹ Under section 1(1) the Act applies, subject to exceptions, to 'things done' by any person in the course of a business (including a business in which he is employed) pursuant to instructions received from another person ('the client') who wishes to dispose of or acquire an interest in land (a) for the purpose of, or with a view to, effecting the introduction to the client of a third person who wishes to acquire or, as the case may be, dispose of such an interest; and (b) after such an introduction has been effected in the course of that business, for the purpose of securing the disposal or, as the case may be, the acquisition of that interest. The expression 'estate agency work' refers to things done as mentioned above to which the Act applies.

¹⁷² See Murdoch, Law of Estate Agency, Fourth Edition, page 266-7.

4.111 The scope of the Act may have been appropriate at the time the Act came into force (in 1982)¹⁷³ when the predominant form of selling homes was through an estate agent with a physical presence in a particular locality, acting as legal agent for the principal, his client. However, it appears doubtful that the scope of the Act remains appropriate in the light of new technologies which were not in contemplation when the Act came into force. This may apply, in particular to the narrow exclusion for the publication of advertisements and dissemination of information.

Publication of advertisements or dissemination of information

4.112 The Act also does not apply to the publication of advertisements or dissemination of information when no other estate agency work is involved.¹⁷⁴ The intention of the Act was to exclude from regulation, for example, a newspaper which merely publishing classified advertisements. However, if a business – even one which does not call itself an estate agent or undertake the traditional activities of an estate agent – undertakes activities which fall within the broad definition of estate agency work but outside one of the narrow exclusions, it will be subject to the Act.

4.113 This may be particularly relevant to new business models, particularly those operating only on the internet which do more than publish advertisements or disseminate information while providing services which fall short of traditional estate agents. Typical services which could cause an internet property retailer to fall within the scope of the EAA may include sending out property particulars (even if prepared by the

¹⁷³ The Estate Agents Act 1979 (Commencement No.1) Order 1981, SI 1981, No. 1517, although some sections have still not come into operation, for example section 22 on standards of competence.

¹⁷⁴ Section 1(4): 'This Act does not apply to the publication of advertisements or the dissemination of information by a person who does no other acts which fall within subsection (1) above'

seller) and fielding queries from potential sellers or buyers (for example by providing a secure online message board).¹⁷⁵

- 4.114 The OFT takes the view that the legislation governing estate agents should focus on those activities that pose real risks to consumers. While the legislation addresses the important risks, it applies so widely that it may catch business models that do not in fact pose those risks to consumers. In the view of the OFT, it is not necessarily appropriate that the obligations contained in the EAA and PMA apply to business models which, essentially, do no more than act as passive intermediaries on behalf of buyers and sellers. On the contrary, the application of the legislation to these models may be impeding innovation in this sector.
- 4.115 The Department for Business, Innovation and Skills (BIS) will shortly be undertaking a project to look at the future of estate agency legislation, including the scope for simplification and/or consolidation and whether regulation needs to be adapted to meet the future needs of the market. They are expected to report in 2011.¹⁷⁶ We recommend that BIS consult on modernizing and simplifying the EAA to make it clear that it is targeted appropriately at businesses which undertake the activities which present risks to consumers which the original legislation was intended to mitigate.
- 4.116 The key risks to consumers in this market arise from agents negotiating on behalf of sellers. The seller cannot fully observe the actions of the estate agent so there is a risk that the estate agent will not always act in the best interests of the seller. The law affords protection in this area, for example, in the form of a requirement that the estate agent passes on all offers and declares any conflicts of interest.

¹⁷⁵ The OFT has produced advice for internet property retailers on its website. See www.oft.gov.uk/advice_and_resources/resource_base/legal/estate-agents-act/retailers

¹⁷⁶ A Better Deal for Consumers, Delivering Real Help Now and Change for the Future, July 2009. This followed a White Paper commitment to simplify and modernize UK legislation to coincide with the implementation of the new Consumer Rights Directive.

- 4.117 One approach to modernising the regulation would be to define the activities that pose risks to consumers, and link the prohibitions and requirements in the law to those activities. Another would be to frame the law in terms of the agency relationship between the seller and the intermediary – if the intermediary is 'standing in the shoes' of the seller (in both marketing the property on their behalf, and negotiating) then they should be subject to regulation, whereas if the intermediary is a neutral trading platform that facilitates direct contact between individuals, then they should not. At the same time, it is, of course, important that buyers and sellers know what type of intermediary they are dealing with - whether they are dealing with a professional agent or whether they are essentially dealing directly with a private buyer/seller facilitated through an intermediary.
- 4.118 The case of Tesco Property Market (TPM) illustrates the potential problems new entrants may face on the regulatory front. In 2007 Tesco launched a residential property search and listings website. This allowed private sellers to post details and photos of their property on its website, as well as receiving a 'for sale' sign, for £199.¹⁷⁷ Moreover, TPM offered an online chat room for buyers and sellers to ask questions.
- 4.119 Since TPM went beyond being a pure classified advertising space, the OFT found, after careful consideration of the relevant regulations, that this meant that TPM fell outside the exclusion applying to publication of advertisements and dissemination of information. To comply with the PMA, Tesco needed to have people on the ground checking property descriptions, and TPM subsequently withdrew from the market.
- 4.120 The case of TPM also points to another potentially important issue. This is the potential value that the involvement of a big, household brand name may have in encouraging consumer trust in online estate agents or other alternative models whose services do not cover the full range of services offered by traditional estate agents, including those providing

¹⁷⁷ *Tesco drops estate agency plans*, Financial Times, 1 May 2008.

services to private sellers. A recognised and trusted brand could give consumers, both buyers and sellers, some comfort that the internet-based providers in the sector were reputable. Once consumers become used to purchasing services from one online provider this would then facilitate entry by others, thereby greatly enhancing competition among internet-based models and between these and traditional estate agents.

Property portals

4.121 Our consumer survey reports that six per cent of sellers who used a traditional estate agent didn't consider selling privately because they wouldn't have access to portals.¹⁷⁸ Additionally, 20 per cent cited marketing ability, of which property portals are a major component, as a reason they decided to use a traditional estate agent.¹⁷⁹

4.122 Some of the submissions we received from new entrants into online estate agency suggested that, while they had experienced problems in the early stages, they had now been granted access to the major portals. For example, one online estate agent told us that it had been 'kicked off' two of the portals in response to pressure from traditional estate agents, though they are now re-established on them, while their membership fee for another website had increased 400 per cent because of their model. They also told us that local press refused to carry their advertisements at first, and that when they were allowed to place ads, they were not allowed to advertise their price. This was allegedly because the newspapers feared that traditional estate agents would stop advertising with them in protest.¹⁸⁰

4.123 Other jurisdictions have taken steps to require property portals to offer access to new business models. In the US, the Government

¹⁷⁸ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.4, page 24)

¹⁷⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.6, page 26)

¹⁸⁰ Submission to this study, April 2009.

Accountability Office (GAO) report¹⁸¹ noted that traditional agents were limiting their cooperation with non-traditional agents who were moving away from the accepted standard fees rates. This was achieved, for instance, by refusing to show homes listed by non-traditional agents to prospective buyers or by giving a reduced share of commission to such agents. An investigation carried out by the FTC¹⁸² on a particular multiple listing service in South East Michigan noted restrictions placed on non-traditional estate agents, including 'refus[ing] to transmit discount real estate listings to its own and other publicly available Web sites and exclud[ing] such listings from the default searches within its own database', whilst traditional agents were able to do so for free. The FTC's final order required that the company cease this practice completely and provide non-discriminatory access to its services to non-traditional estate agents

4.124 We undertook a short website survey to ascertain the extent to which alternative business models are currently represented on the major portals. We found that, of 11 online estate agents' websites reviewed, all listed property on all the major portals, with the exception of one agent who did not list on Rightmove. This does not, on the face of it, suggest that there is a need to intervene to ensure that online estate agents are able to access the major portals.

4.125 We did find that many private seller websites and classified advertising websites are not able to access the major portals. For example, one of the longest established sites, told us that since 2004 the property portals refused to list its properties, which had led to a reduction in business. The company claims that these practices still continue and have restricted their growth: '[f]rom newspaper advertising to web

¹⁸¹ Government Accountability Office, 'Real Estate Brokerage: Factors that may effect price competition', August 2005

¹⁸² FTC, Opinion of the Commission in the Matter of Realcomp II Ltd., 30 October 2009, Docket Number 9320.

design, the company is refused marketing opportunities or use of services owing to its private sales model.¹⁸³

- 4.126 An argument was put to us that the exclusion of private sellers from the major portals is justified, on the grounds that there is potential for consumer confusion and reputational damage to the portal from mixing private and agency sales. We see some merit in these arguments in terms of direct access for individual sellers, as buyers may not be aware that they are buying from a private seller and/or they may not be aware that dealing with a private seller does not carry the same protections as dealing with an estate agent, for example, private sellers are not subject to the PMA, Consumer Protection from Unfair Trading Regulations (CPRs) or the redress schemes.
- 4.127 We also see merit in the argument that for portals to allow direct access to private sellers would impose administrative costs on the portals that their current business models are not designed to bear.
- 4.128 We less see merit in these arguments where the listing is via a platform hosting private seller, for example there is effectively a business relationship with the portals, and this business ensures that listings are clearly flagged as being made by a private buyer.
- 4.129 While we do not believe that selling privately and removing estate agents from the process is necessarily advisable for all sellers, it is suitable for some and the availability of this route could be important in providing choice to consumers and imposing competitive constraints to and spurring innovation among the established industry.
- 4.130 In order to require existing portals to provide access to private seller platforms under the Competition Act 1998,¹⁸⁴ the OFT would need to

¹⁸³ Submission to this market study, April 2009.

¹⁸⁴ An alternative route would involve a market investigation reference of the market to the Competition Commission under the Enterprise Act 2002. This feature of the market would then be assessed to establish if it was a feature that 'prevents, restricts or distorts competition' and, if so, the Competition Commission could take actions to remedy this, including mandating access.

establish that the portal in question was dominant either individually or collectively in the market for property portal services and that the portal refusal of access amounted to an abuse of a dominant position. It would not be straightforward to define the relevant economic market and dominance could be difficult to establish in an area of rapid technological change.

- 4.131 The response of the established property portals to press reports about the potential entry of Google into the market for property listings illustrates this point.¹⁸⁵ In December 2009, a number of press reports (Google declined to comment) suggested that Google were planning to launch a property portal in the UK in early 2010. Shares in the leading property portal, Rightmove, fell by 10 per cent on the FTSE on the day the news broke. In July 2009, Google launched a property portal in Australia, google.com.au, where estate agents and other property portals can list properties for free.
- 4.132 In addition, if some of the regulatory barriers discussed earlier were removed, it seems clear that there is scope for a new player to enter this market and provide a platform with the necessary scale to overcome the issue of network effects in this market and the brand to overcome the issues of trust which currently persist in on-line markets. The decline in the private sales in recent years (the Price Commission in 1979 found that 25 per cent of sellers sold privately,¹⁸⁶ while our consumer survey found that just 11 per cent of sellers do this now)¹⁸⁷ could in part be attributed to the fact that listing on one or more of the major property portals is now seen as essential when selling a property.¹⁸⁸ This decline

¹⁸⁵ See, for example, *Google set to enter UK property market*, Financial Times, 2 December 2009.

¹⁸⁶ Price Commission (1979), 'Charges, Costs and Margins of Estate Agents', paragraph 2.24. Of the 25 per cent who sold privately, 14 per cent by personal contacts, nine per cent through private newspaper ads and two per cent using private 'for sale' boards or posters.

¹⁸⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.1, page 19)

¹⁸⁸ This could also be in part due to the significant increase in house prices in the intervening period.

in private sales has also been observed in the US, where the FTC and DOJ note that the proportion of homes sold privately dropped from 19 per cent in 1991 to 12 per cent in 2006.¹⁸⁹

Conclusion

- 4.133 It has been put to us that the unusual current market conditions must be kept in mind when analyzing the current market and designing remedies. As is clear in the report and in the consumer research that we have conducted, we have looked at evidence relating to a number of years and have not simply focused on the most recent period of falling house prices. Indeed, many of the issues that we focus on in this study are long-standing features of the estate agency market rather than being a function of conditions at any particular point in the property cycle.
- 4.134 It is possible that competition between traditional estate agents does not deliver the best outcomes, in terms of the prices charged to consumers and in terms of the productivity of the market for estate agency services. We have found that commission rates are sticky both across the property cycle and across properties of different values. There is also evidence that high profits during property booms leads to socially inefficient excess entry. Incentives for agents to compete strongly on price seem weak, particularly as consumers may focus on the estate agent's perceived ability to achieve a higher price, rather than on the commission rate that they are being charged. Sellers' propensity to shop around and to negotiate on fees has changed little since our 2004 study.
- 4.135 Flat rate percentage commissions are not optimal in incentivising agents to sell at the highest achievable price. This is clear from economic theory and has been observed by two US academic empirical studies, which were discussed earlier. Traditional estate agents rarely offer flat fee contracts or unbundled pricing, but a number of online estate agents do offer low cost no-frills services, flat fees and unbundled pricing.

¹⁸⁹ Report by the FTC and the DOJ, 'Competition in Real Estate Brokerage Industry', April 2007, p.21.

- 4.136 The internet now provides some of the roles formerly carried out by traditional estate agents. First, estate agents' websites and, especially, the major property portals have reduced the significance of the high street shop window as a source of buyers, with about 40 per cent of estate agents' sales now originating from portals. The availability of price information online means that the extent to which estate agents are better informed than consumers has decreased. We might expect these changes to lead to some disintermediation, with the market providing a range of business models, from full-service traditional estate agents to low cost, no-frills models to private seller platforms. Such innovations have been slow to emerge on a large scale for reasons including regulatory barriers and consumer preferences.
- 4.137 We have considered the case for mandating access for private platforms to the major property portals, but it seems clear that, if regulatory barriers were removed, there would be scope for a successful platform to become established and allow private sellers to list on a sufficient scale to make an impact in the market.

5 REGULATION, THE POSITIVE LICENSING DEBATE, AND ENFORCEMENT

Summary

Consumer satisfaction with traditional estate agents has improved. Consumers do not often blame traditional estate agents for problems which may arise when buying or selling a home. For many consumers, traditional estate agents provide a good service.

The most serious risks facing the consumer stem from the principal-agent problem:



Seller faces 'principal-agent' problem – cannot monitor agent's effort level, and there is a risk of conflicts of interest

Activity which poses a risk: negotiating on behalf of the seller

Protections: requirement to pass on all offers, declare conflicts of interest

Buyer faces 'adverse selection' problem – less informed about attributes of property than agent or seller

Activity which poses a risk: preparing marketing materials for the property including floorplans and descriptions

Protection: prohibition on misdescribing property

We believe that serious misconduct by estate agents is best dealt with by efficient enforcement and penalties which are high enough to deter. The current regime has a range of sanctions that can be imposed. New sanctions currently due to be piloted will add to these powers.

The OFT could make enforcement of existing legislation better. We have set out a programme of work to use OFT resources more effectively working with our enforcement partners, industry and the redress scheme operators.

Despite the raft of legislation and rules already in place, some stakeholders have argued that a licensing regime for estate agents should be introduced. We have considered these arguments carefully. Our view is that there is not a strong case for introducing more regulatory structures and rules in this sector.

5.1 addresses key risks to consumers in this sector, and consider whether there is a case for introducing an 'active regulation' or 'positive licensing' regime. We also discuss the role of self regulation.

Level of satisfaction with estate agents

5.2 The consumer survey commissioned for this study¹⁹⁰ found that 12 per cent of sellers were dissatisfied with the service provided by their estate agent. The findings for buyers were very similar - again 12 per cent expressed dissatisfaction with the estate agent that they bought the home through.

5.3 This is an improvement compared to our last survey in 2004, which found dissatisfaction among sellers and buyers of 26 and 28 per cent respectively, and surveys from other sources which suggest a history of dissatisfaction with estate agents.¹⁹¹

5.4 There are a number of possible reasons for this increase in satisfaction ratings, in addition to any underlying improvement in service quality:

- lower numbers of buyers and sellers in 2008-9 could mean estate agents were trying harder to win and keep customers in the period covered by this survey
- the introduction of a statutory redress scheme may have had a positive impact on service quality – poor service can have reputational as well as financial cost in the event of complaint.
- although there are no obvious differences in the phrasing of the questions or the demographics of the respondent base between the

¹⁹⁰ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.41, page 61 and Chart 6.98 page 121)

¹⁹¹ OFT Report 2004, Which? Move it, Briefing on Home Buying Reform December 2007, RICS Consumer Detriment in Domestic Property Transactions June 2008 (restricted to members)

2004 and 2009 surveys, both suffered from low response rates and may not be directly comparable.

5.5 While trends in consumer satisfaction are informative, it is difficult to say how high a measure of satisfaction 'should be' for any particular market or industry. Nonetheless, an 88 per cent satisfaction rating is by most measures good:

- The Institute of Customer Service¹⁹² reported that it regards 80 per cent as the benchmark for world class customer satisfaction.
- The Barker Review of Homebuilding¹⁹³ suggested that a service quality target of 85 per cent customer satisfaction with service quality would be appropriate for that sector.
- Our own research in the homebuilding sector¹⁹⁴ found quality of service satisfaction levels of 75 to 89 per cent.

5.6 There is, however, still room for improvement, especially given the importance of the transaction to consumers. In 2008 around 0.9 million houses were bought and sold.¹⁹⁵ At a 12 per cent dissatisfaction level, this implies some 108,000 consumers were dissatisfied with the estate agent that they dealt with.¹⁹⁶

5.7 We also note that our survey respondents were more satisfied with the other service providers involved in the home buying and selling process than they were with the estate agents. Dissatisfaction with mortgage

¹⁹² Institute of Customer Service UKSI July 2009

¹⁹³ Barker Review on housing supply, March 2004

¹⁹⁴ OFT Homebuilding in the UK, September 2008

¹⁹⁵ HM Revenue & Customs National Statistics Property Transactions in the UK over £40,000

¹⁹⁶ Calculation assumes that the level of dissatisfaction found in the OFT consumer survey is representative of all home buyers and sellers

lenders, insurance providers, solicitor/conveyancers, and surveyors ranged from four to 10 per cent.¹⁹⁷

5.8 Our survey questions asked why respondents were dissatisfied with the service received. For sellers, the top reasons were: keeping the seller informed of progress; chasing progress after exchange of contracts; and working in the seller's best interests.¹⁹⁸ For buyers, the top reasons were: keeping the buyer informed of progress; advice on what offers to make; being honest in their dealings with you; and accuracy/ completeness of information about properties and area. Previous research found broadly similar causes of dissatisfaction.¹⁹⁹

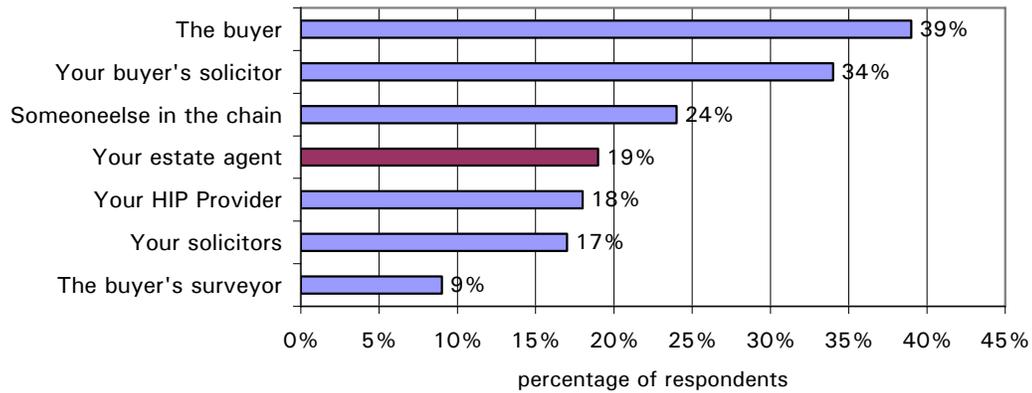
5.9 However, our survey found that estate agents were blamed less often than other individuals and their solicitors for serious problems encountered when buying or selling a home. Thirty five per cent of sellers reported that they had experienced a 'serious problem' while selling their home, and told us the problem was with:

¹⁹⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.45, page 65 and Chart 6.100 page 123)

¹⁹⁸ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.40, page 60 and Table 6.97, page 120)

¹⁹⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Table 6.97, page 120)

Chart 5.14: Who sellers had problems with (England and Wales)

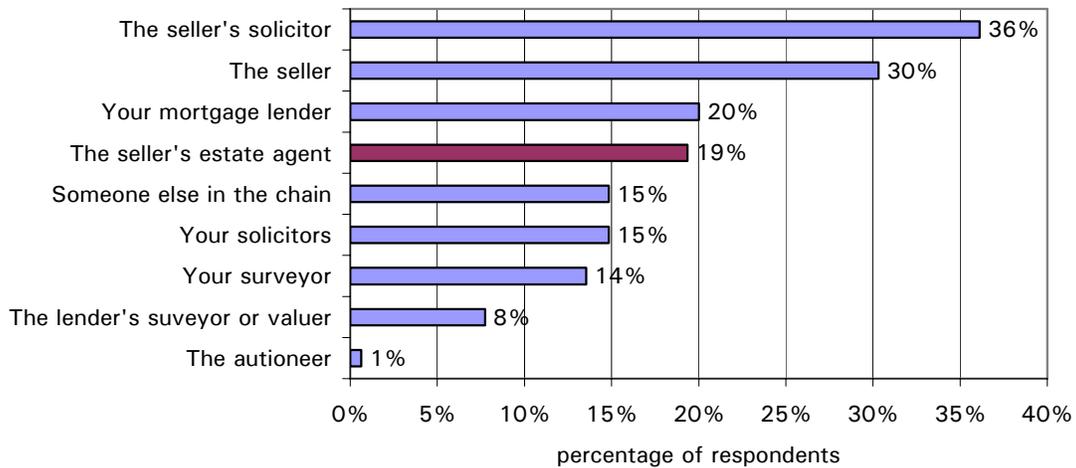


Base: all sellers who had any serious problems (88)

Source: OFT Consumer Survey, GfK 2009

5.10 For buyers, 36 per cent reported serious problems, and said the problem was with:

Chart 5.15: Who buyers had problems with (England and Wales)



Base: all buyers who had any serious problems (155)

Source: OFT Consumer Survey, GfK 2009

5.11 It is clear the majority of the serious issues complained about by both sellers and buyers are not blamed on the estate agent. Furthermore,

some of the blame that does attach to estate agents may be misplaced. We have been told by industry representatives that distrust of estate agents is in part due to a lack of understanding by consumers of the role of the estate agent in the process. Because the estate agent is the hub of the process and of communication between parties, buyers and sellers may have unrealistic expectations of what an agent can do on their behalf, particularly in dealing with delays and chasing up progress.

Risks facing the consumer

- 5.12 The UK has specific laws covering estate agency, over and above the general civil and criminal laws that apply to the home buying process (which give consumers grounds for pursuing breaches of contracts and act as punishment for the most serious crimes such as fraud).
- 5.13 The two main risks, and the existing consumer protection measures are summarised below in Figure 5.16:

Figure 5.16: Risk factors for buyers and sellers



- 5.14 The most serious risks facing the consumer stem from the principal-agent problem shown in Figure 5.16. Here, illegal or improper conduct may be difficult for consumers to detect. Deceptive practices, such as failure to declare a conflict of interest, will be hidden from consumers and may not be revealed even after the event.

- 5.15 We would not expect to detect significant incidence of deceptive practices in our surveys. Nonetheless, our survey did indicate that some buyers and sellers are concerned about such behaviour: two per cent of sellers and seven per cent of buyers said they were aware of offers that had not been passed on by estate agents to the seller. This may reflect a suspicion rather than certain knowledge of offers not being passed on.
- 5.16 Our Trading Standards survey points to a degree of non-compliance with the law, with a reported 24 per cent²⁰⁰ of estate agents not in full compliance with the law on the first visit.²⁰¹ However, some of these visits will have been in response to a complaint, so this should not be taken to imply that 24 per cent of all estate agents are non-compliant. In addition, non-compliance would include minor breaches where no more than guidance is required.
- 5.17 Our estate agent survey also indicates a degree of non-compliance with relevant legislation. Seventy six per cent of estate agents surveyed did not agree that all estate agents complied with the law.²⁰² Again, we recognise that not all breaches of the law represent serious irregularities.

The positive licensing debate

- 5.18 'Positive licensing' or 'active regulation' are terms used to cover a wide variety of potential models for regulation, the key ingredients of which, in the current debate, are an entry requirement, a code of best practice, and sanctions against failure to meet good standards of professional conduct.
- 5.19 In our 2004 report we concluded that the risks to consumers did not warrant the introduction of positive licensing in this sector. Since then,

²⁰⁰ OFT Survey of local authority Trading Standards Services, 2009 (Paragraph 3.6, page 9)

²⁰¹ Our survey did not identify what laws were not being complied with

²⁰² OFT Survey of local authority Trading Standards Services, 2009 (Paragraph 3.56, page 20)

and more recently, there have been further calls for strengthening regulation in this sector and introducing positive licensing.

- 5.20 There is widespread support for positive licensing from the industry. Our Trading Standards survey showed that most Trading Standards Services were also in favour of licensing. Licensing regimes are common elsewhere, including in 17 EU countries, the USA, Canada and Australia.
- 5.21 In 2007, three industry bodies – the Royal Institute of Chartered Surveyors (RICS), the National Association of Estate Agents (NAEA) and the Association of Residential Letting Agents (ARLA) - commissioned Sir Bryan Carsberg to review the residential property market (covering both sales and lettings). This review argued for the introduction of an 'active' regulation regime which would require membership of (or licensing by) an approved body which could establish admission requirements and would maintain a code of practice incorporating standards of behaviour.
- 5.22 A new initiative in the sector is the creation of the Property Standards Board (PSB). Publically launched on 16 September 2009 the PSB is an overarching industry body established by RICS, NAEA and ARLA. It includes representatives from TPO, ARMA, the Trading Standards Institute, the Solicitors Regulation Authority and has an independent Chair.
- 5.23 The PSB's intended role is to raise standards across the residential property industry, both sales and lettings, to embed consistent levels of service and competence across the sector. It proposes to do this partly by means of quality standards, whereby agencies which adopt and comply with them can use a 'PSB kitemark'.
- 5.24 In 2008, the Department for Business, Innovation and Skills (BIS) and the Department for Communities and Local Government (CLG) jointly commissioned Professor Colin Jones to review redress and regulation

arrangements in the UK housing market.²⁰³ This review also supported further regulation, with the main arguments being that:

- existing statutory regulation is a patchwork of laws that lacks a logical consistency and is arguably a weaker regulation approach compared with that of financial and legal services, and
- there are high levels of complaints about estate agents compared with other professional services required in a house sale.

Gap analysis

5.25 In this section, we attempt a systematic analysis of how further regulation, in the form of a licensing regime, would add value compared to existing requirements.

5.26 The following table demonstrates the main sector specific and general laws which public enforcers may use against serious irregularities.

Table 5.17: Current law applicable to serious irregularities

| Serious Irregularity | Sector Specific law | General law |
|---|-------------------------|---|
| Failure to disclose personal interest | Estate Agents Act (EAA) | Fraud Act 2006, Consumer Protection from Unfair Trading Regulations 2008 (CPRs) |
| Failure to pass on offers | EAA | CPRs (Reg 3 or Reg 6) |
| Failure to disclose to his client the fact that the buyer is offered additional services (for which the agent probably gets commissions or referral fees) | EAA | CPRs (Reg 3 or Reg 6) |
| Deception of buyer (for example, creating false offers) | EAA | Fraud Act, CPRs (Reg 5) |

²⁰³ Government review of regulation and redress in the UK housing market, January 2009

| | | |
|-----------------------------------|------------------------------------|--------------|
| Misleading information | Property Misdescriptions Act (PMA) | CPRs (Reg 5) |
| False Descriptions of key aspects | PMA | CPRs (Reg 5) |

5.27 Carsberg outlined a number of features that an active regulation might comprise; Professor Jones envisaged something similar.²⁰⁴ We have assessed these elements against the requirements in the existing statutory and self regulation regimes.

Table 5.18: Components of active regulation

| Possible ingredients of an active regulatory regime (Carsberg and Jones) | Current statutory regulation | Self Regulation (covers approx. 80 per cent of industry) |
|--|-------------------------------------|--|
| Entry requirement | No requirement at present | Trade bodies have membership requirements |
| Code of Best Practice | | In place under CCAS-approved TPO code |
| Complaints handling procedures | Required under CEARA ²⁰⁵ | In place under CCAS-approved TPO code |
| Professional indemnity insurance | Required under CEARA ²⁰⁶ | In place in some trade associations |
| Monitoring of compliance with the code | | In place under CCAS-approved TPO code |
| Powers to investigate complaints | OFT and LATSS can investigate | For breaches of code or trade |

²⁰⁴ Government Review of Regulation and Redress in the UK Housing Market January 2009

²⁰⁵ The requirement is not set out in the Act itself but is a criteria for OFT-approval to operate a redress scheme. OFT approval is required under CEARA.

²⁰⁶ As footnote above.

| | | |
|---|-----------------------|---|
| or compliance failures | breaches of the law | association rules |
| Legislative Enforcement Powers | OFT and LATSS powers | |
| Sanctions to prevent unsuitable practitioners from continuing | OFT can ban under EAA | Trade bodies can impose penalties and withdraw membership |
| Requirements to provide access to independent redress | Required under CEARA | In place under CCAS-approved TPO code |

5.28 This analysis shows that many of the components of active regulation already exist within the current statutory and self-regulatory regimes. While it is true that these requirements exist in a 'patchwork' of different laws and arrangements, it is not clear that there are significant gaps in the existing framework. It is the case that there are no entry requirements for estate agents. The OFT does have the power to ban estate agents for a range of offences and malpractice – this ability to exclude practitioners has led to the existing framework being described as one of 'negative' licensing.

5.29 During our discussions with stakeholders it was generally acknowledged that the existing framework covered the most serious risks to consumers, although questions were raised about the enforcement of the existing rules, to which we return later in this chapter. It was put to us that the rationale for introducing positive licensing was less about addressing serious risks or consumer harm than about raising standards, quality of service, and professionalism in the industry.

5.30 Quality of service and value for money are outcomes that we would normally expect a competitive market to deliver. However, we recognise that market discipline on quality is hampered when consumers cannot accurately judge in advance what quality of service they will receive. In this sector, and others, this is made worse by the fact that the scope for consumers to learn from their experience is limited by the infrequency of transactions.

- 5.31 However, in general, the OFT believes that the role of self-regulation is to overcome precisely this kind of difficulty in markets - to help suppliers signal their quality, and to help consumers identify high quality suppliers. In this industry specifically, self-regulation has made enormous progress in recent years.
- 5.32 The limitation of self-regulation in this market is that, since sellers choose the estate agent, the 'virtuous circle' of self-regulation will tend to operate in sellers' interest. Self-regulation will allow firms to credibly signal their quality to prospective sellers, and sellers will judge 'quality' according to their own needs, not the needs of prospective buyers.
- 5.33 However, it is important to recognise that in many respects buyers' and sellers' interests are aligned in this market – for example both parties want efficient management of the transaction from offer through to completion. The two areas in which buyers' and sellers' interests are directly opposed are the marketing of the property (where sellers will want the estate agent to play up the advantages and play down the drawbacks of their property) and the negotiations over the sale price.
- 5.34 Our view is that, if there is a credible argument for licensing of estate agents, it has to be that a licensing regime would afford buyers significantly more protection in these two areas than they enjoy at present. We do not believe that this case can be made. Buyers are already protected from misleading marketing by the CPRs (and the PMA until and unless it is removed), and can engage a surveyor to assess the quality of the property on their behalf. In negotiation, the agent is already prohibited by law from deception (for example, creating false offers) and beyond this has a legal duty to work in the best interests of the seller - it is not clear that licensing of estate agents could or should change this in any way.

Costs and benefits

- 5.35 It has been put to us that the incremental costs of introducing a licensing regime would be fairly low. Estate agents are already required to register with a redress scheme and with the OFT for anti-money

laundering purposes. The incremental administrative cost of a licensing regime might be lower than otherwise if it were possible to build on existing arrangements, although this is by no means certain.

- 5.36 However, the active regulation proposals would entail more than administrative costs. Licensing and active regulation schemes are typically operated on a self funding basis, with the fees financing both administrative and enforcement activities. If a regime is to be more than a piece of paper or simply a 'licence on demand', in which case the benefits seem hard to identify, it will need to be properly resourced and funded.
- 5.37 We do acknowledge the strong feeling in the industry that a basic entry requirement that all agents must be trained on key aspects of estate agency law would be beneficial and need not necessarily impose significant costs on new entrants. By the same token, however, it seems unlikely to us that it would help identify and exclude likely 'rogues'.
- 5.38 While entry requirements can have a significant impact in terms of introducing and sustaining professional ethics, we believe this is typically only the case where an entry barrier is created and the cost of being struck off is correspondingly high, as is the case, for example, for doctors. Clearly it would not be appropriate to introduce a very high entry barrier for estate agents, particularly in a sector where the key detriment in the sector appears to be generated not by lower than desirable quality measures, but by a lack of innovation and price competition.
- 5.39 We are also concerned that unnecessary active regulation risks protecting and further entrenching the traditional business model – no matter how well designed regulatory structures may be unintended costs often result. As we have argued, innovation represents a real and important prospect for improving not only value for money but also the wider consumer experience in this sector. Any regulation that acts as a further drag on innovation risks harming rather than benefitting consumers in the long term.

Application of the current enforcement regime

- 5.40 The agencies responsible for the enforcement of consumer protection regulation in this sector are the OFT, local authority Trading Standards Services (TSS) and the DETI in Northern Ireland.
- 5.41 These agencies are required to have regard to the principles of good regulation.²⁰⁷ This means that their activities should be carried out in a way that is transparent, accountable, proportionate, consistent and targeted only at cases where action is needed. Along with local enforcement agencies, we have published enforcement principles²⁰⁸ and policies.
- 5.42 The agencies have a range of formal and informal actions they can take in enforcing the relevant laws, both proactively and reactively. The principles of good regulation imply that only serious contravention of the laws should result in formal action being taken.
- 5.43 A primary role of enforcement agencies is to assist businesses in achieving compliance with their statutory duties. Proactively, the agencies provide information to businesses through web sites and leaflets. Trading Standard Services also offer business advice to those contacting them and will give advice during visits.²⁰⁹ The OFT provides a guide to the EAA on its web site.²¹⁰
- 5.44 TSS have a nationally agreed risk rating for all the types of business they oversee, and estate agents are classified as medium inspectional risk.²¹¹

²⁰⁷ Legislative and Regulatory Reform Act 2006

²⁰⁸ Statement of Consumer Protection Enforcement Principles OFT 964

²⁰⁹ OFT Survey of local authority Trading Standards Services, 2009 (Chart 3.8, page 16)

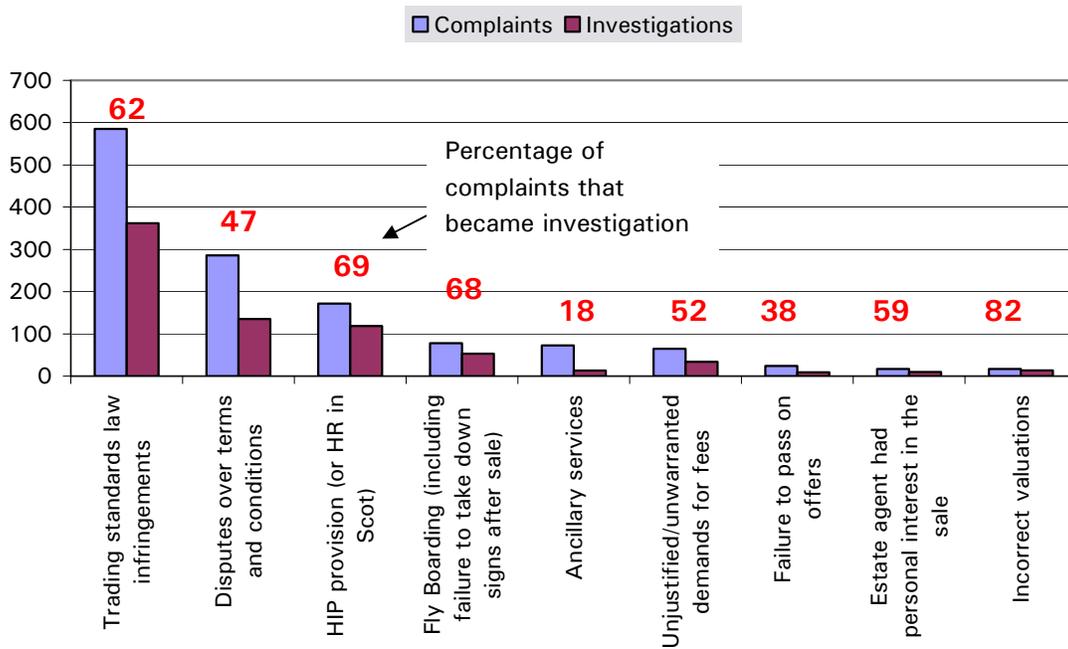
²¹⁰ Estate Agents Act – see www.offt.gov.uk/advice_and_resources/resource_base/legal/estate-agents-act/

²¹¹ LACORS risk assessment

It is up to the local authority to allocate its resources to address the inspectional risk of the businesses in its area. Typically an authority would plan to visit a medium risk every two years but this varies from authority to authority and is subject to resources and other priorities. Local authorities can upgrade the risk rating of specific businesses by taking into account local factors and the trader's history. Less than 0.01 per cent of estate agency businesses have been upgraded by their local authority to high risk.²¹²

5.45 Chart 5.19 provides an overview of the complaints made to TSS, and investigations started.

Chart 5.19: TSS complaints and investigations



Base: 44 TSS

Source: Survey of Trading Standards Services, 2009

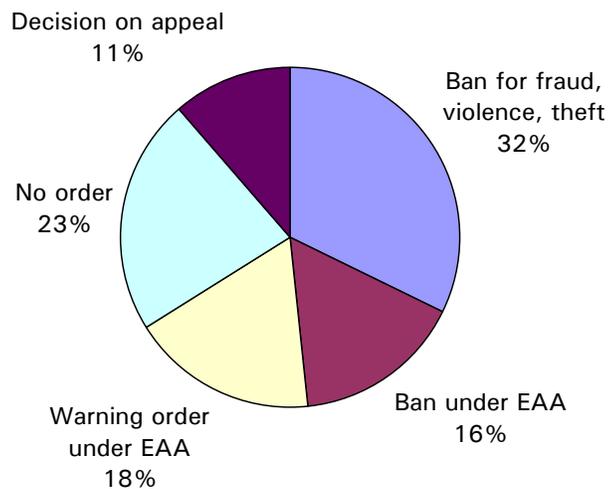
²¹² OFT Survey of local authority Trading Standards Services, 2009 (Paragraph 3.4, page 8)

5.46 Overall, 44 per cent of the complaints that were made to Trading Standards Services led to an investigation being commenced. Forty eight per cent of investigations resulted in no further action (over half of these were discontinued due to lack of evidence), while 42 per cent resulted in informal resolution and one per cent resulted in formal action.²¹³

5.47 Our role, as laid out in the EAA, is one of superintending the workings and enforcement of the Act and being the body which investigates and independently adjudicates on banning estate agents from practising.

5.48 In the last three years to December 2009, we have issued 62 decisions, which break down as shown in Chart 5.20:

Chart 5.20: Decisions issued by OFT concerning estate agent conduct



Source: OFT records

²¹³ OFT Survey of Local Authority Trading Standards Services, 2009 (Chart 3.7, page 15)

- 5.49 The OFT also provides guidance and runs training seminars for both estate agents and Trading Standards Services.

Effectiveness of enforcement

- 5.50 In his 2008 Review of Residential Property, Sir Bryan Carsberg noted that the lack of active enforcement was a weakness of the current regime.²¹⁴ His view was that Trading Standards Services were limited in what they could do by a shortage of resources and limitations on their powers. He noted that there was much room for improvement.
- 5.51 We have not found direct evidence of a major enforcement 'gap' – we have not found evidence of complaints not investigated, or investigations dropped for lack of resource. However, we found some indirect evidence to suggest that the enforcement regime does not provide a strong deterrent effect to misconduct in this sector: our Trading Standards Services survey found that 67 per cent of respondents did not consider the likelihood of detection was effective in ensuring compliance.²¹⁵ It is worth noting, however, that our survey of estate agents²¹⁶ found that 82 per cent did consider that possible visits by Trading Standards Services helped to ensure they complied with the law.
- 5.52 We have considered whether there are improvements that could be made to the enforcement of the current regime, to address some of the perceived weaknesses. We have looked at the possibility of giving TSS and OFT greater powers, or more resource, or putting in place tougher sanctions for breaches of estate agency law.

²¹⁴ Carsberg Review of Residential Property - June 2008

²¹⁵ OFT Survey of local authority Trading Standards Services, 2009 (Chart 3.11, page 20)

²¹⁶ OFT Survey of Estate Agents, 2009 (Paragraph 3.56, page 47)

Inspection powers

- 5.53 Under both general and sector-specific consumer protection laws, TSS and OFT have powers to enable them to exercise their functions. In order to require information under the EAA or PMA, an enforcement officer must first have reasonable grounds to suspect an offence under the relevant Act has been committed.
- 5.54 Since one of the difficulties in the sector is the detection of serious breaches, in other words consumers are likely to be unaware that an estate agent has committed a serious breach and so unlikely to raise a complaint, one way to make enforcement more effective may be to introduce a general power to inspect for compliance with all provisions of the EAA. An increase in inspections, or at least an increase in the possibility of inspections, may well create a deterrent effect, and ought to result in higher rates of detection of serious irregularities. In addition, it could be argued that a broader power of inspection would fit well with future record-keeping requirements,²¹⁷ such that estate agents' records could then be subject to spot inspections.
- 5.55 There are clear disadvantages to the suggestion that the threshold for exercising a power to inspect be lowered - the most obvious one being that 'reasonable suspicion' before a power to inspect is used guards against imposing unnecessary costs on businesses and the perception of unfair or random treatment.

²¹⁷ CEARA also introduced section 21A (not yet commenced) which requires that all those engaged in estate agency work in the UK to keep certain records for a period of at least six years. This section will come into force on 6 April 2011. The records include offers received (including details of offers not passed on to clients) and the contracts agreed with clients and variations of such contracts.

5.56 Despite the disadvantages, it seems to us that there is merit in exploring the costs and benefits of such a proposal in more detail - of course any change must be examined through a proper consultation process before it is made. Our recommendation is that the Government consider consulting with the industry and TSS on including a generic power to inspect premises for compliance with relevant legislation as part of its review of TSS powers. The introduction of a single set of powers for TSS is currently being considered by the Government in the context of its White Paper, *A Better Deal for Consumers* (July 2009).²¹⁸

The Property Misdescriptions Act (PMA)

5.57 Of the investigations undertaken by TSS, the Property Misdescriptions Act was the law most often used, and was seen as the most effective enforcement tool.²¹⁹ BIS indicated in the Consumer White Paper²²⁰ that it was considering whether to repeal the PMA on the basis that the CPRs achieve the same objectives, and we understand that BIS is planning to consult on this during 2010.

5.58 While there is likely to be significant overlap between the coverage of the PMA and the CPRs, TSS indicated to us that they were strongly opposed to repealing the PMA mainly because it is a tried and tested tool for protecting consumers, whereas by contrast it has not yet been demonstrated how CPRs would apply to property misdescriptions, and TSS have established experience of enforcing the PMA, whereas the CPRs are still relatively new on the enforcement landscape. In addition, there is concern over whether the CPRs provide sufficient clarity for traders about what is, and is not, permitted in property advertising.

²¹⁸ Chapter 4, *Modernising Consumer Law* paragraph 4.5 page 83-85

²¹⁹ OFT Survey of local authority Trading Standards Services, 2009 (Chart 3.9, page 17)

²²⁰ *A Better Deal for Consumers: Delivering Real Help Now and Change for the Future*, paragraph 4.4.

- 5.59 We intend to respond to the BIS consultation in due course. The OFT is in favour of simplifying the law, removing unnecessary duplication or conflicts of requirements. There are in our view advantages in principles based legislation applying to property descriptions, and we do not think it is by any means inevitable that such legislation results either in less protection for the consumer or greater uncertainty for traders. The CPRs aim to provide a high level of protection for consumers, and to remove legislative obstacles to cross border trade within the European Community. They are designed to lay down clear principles by which traders and enforcers can assess whether any given commercial practice is 'unfair', rather than to set out a closed list of things traders must or must not do. In this sense they ought to provide a sensible level of consumer protection, and not leave loopholes which can be exploited.
- 5.60 Further, the CPRs lay down a minimum standard which must be complied with already by all traders. Insofar as there is any uncertainty in their scope or application, this exists irrespective of repeal of the PMA, since investigations can be carried out either under the CPRs or PMA.
- 5.61 As part of its work with TSS, in the estate agency sector and more broadly, we will continue to work with TSS on enforcing the CPRs, for example through training and taking cases to clarify any areas of uncertainty. It is critical that TSS feel the CPRs are a useful and effective enforcement tool. We expect that, over time, the practical enforcement of the CPRs will be demonstrated in the estate agent sector and once they are established and shown to be effective, the OFT's view is that the PMA could be repealed.

Resources

- 5.62 We recognise the competing demands on limited resources for enforcement work, both inside and outside the OFT. We have not seen sufficient evidence of serious consumer harm in the course of this study to make a case for increasing enforcement resources for this sector, particularly in the current economic climate and the downward pressure on all public spending.

5.63 Furthermore we believe it is entirely appropriate that, in line with the current system of locally enforced fair trading legislation, the amount of enforcement resource spent on estate agency by TSS be determined against competing priorities at a local level – the markets for buying and selling houses are local, and local residents and prospective local residents will be the ones to feel the impact of local enforcement priorities.

5.64 Given the level of likely consumer harm, the current economic climate and the local nature of the markets, we believe the best response is to make sure that the resources currently available are used in the best way possible. We think that there is some potential to achieve more with current resources by:

- prioritising resources according to the seriousness of the allegation under investigation
- establishing protocols between enforcement and redress agencies to exchange information and intelligence, and co-operate with each other to maximise their impact and deterrent
- disseminating knowledge and guidance on best methods to achieve compliance, and
- encouraging the use of the full range of enforcement tools available to take the appropriate action to address the seriousness of the breach, in particular by considering whether the Enterprise Act or the CPRs could be used as a more effective tool than either the EAA or PMA in specific cases.

5.65 To that end we propose to offer resource to LACORS and TSS to explore how we can make enforcement more effective. Some of the areas which could be explored are:

- agreeing priorities for enforcement in this sector in terms of identifying the most serious offences

- agreeing the primary responsibilities of investigators, that is, what TSS are best placed to do, and what the OFT is best placed to do
- establishing protocols on investigations with the effective gathering and transfer of evidence between different agencies to achieve compliance and sanction irregularities, and
- whether the OFT should provide TSS with more OFT resource in terms of information and training.

5.66 In particular, we will look to leveraging our expertise to assist TSS – it is important to stress that we have no intention of reducing the amount of resource the OFT puts into this sector. It is the case, however, that even a small increase in TSS action could result in a multiplier effect for OFT resources. So whilst we are required to retain the function of adjudicating on fitness we will prioritise our resources for cases of misconduct in estate agency and serious irregularities we will seek to use the evidence of other agencies in compiling cases and direct matters to the body most appropriate to deal with the issue.

5.67 The redress scheme operators do obtain information that could be used as intelligence in effectively targeting the resources of the enforcement agencies. We are of the view that the passing of information between the redress scheme operators and enforcement agencies could be improved –clear protocols could cover when and how any information is exchanged, how such information should be used and the expectations for action on both sides.

5.68 There are protocols for exchange of information between the redress scheme operators and the OFT. We recognise that there are sensitivities that the scheme operators must observe with the information they are given and that their role is not that of an enforcement agency. Also they are not investigating complaints in order to establish breaches of the law, so the information has to be taken in context. It seems likely, given these sensitivities, that the industry representative bodies may be interested in being consulted on any change to the protocols.

Sanctions

- 5.69 Under the existing regulatory regime, prohibition is considered the main sanction available. The OFT may prohibit an individual from engaging in estate agency work if the OFT is satisfied that certain 'triggering' conditions have been met and that the individual is unfit to engage in estate agency work. These triggering conditions are set out in Annexe A.
- 5.70 Rather than viewing prohibition orders as the main sanction available, they might be more appropriately viewed as a tool to be used in those cases where an offence is so serious that prohibition should be considered in addition to other sanctions for that offence, or where there is evidence of a pattern of repeat behaviour.
- 5.71 The current regulatory regime has a range of sanctions that can be imposed. These range from Penalty Charge Notices for breaches of Home Information Pack (HIP) requirements, through civil injunctions under the Enterprise Act, fines under criminal action in the magistrates court, warning and prohibition orders under the EAA, and imprisonment for the most serious criminal offences. For example, where an estate agent has failed to declare a personal interest and purchased a property considerably under the market value the investigator could consider action under the Fraud Act as well as CPR offences and/or Prohibition.
- 5.72 Macrory powers,²²¹ when implemented under the Regulatory Enforcement and Sanctions Act, will give additional civil sanctions that can be imposed. These might include fixed monetary penalties, discretionary requirements, stop notices and enforcement undertakings.

²²¹ Regulatory Justice, Making Sanctions Effective Nov 2006 - new sanctions include: fixed and variable monetary penalties, compliance and stop notices, restoration notices, voluntary undertakings, enforcement undertakings.

- 5.73 Therefore there is now, and will continue to be, a wide range of sanctions available to TSS and OFT. It is also important to bear in mind whether the sanction will be effective. For example, Prohibition of an estate agent means that the agent cannot realistically practice openly as an estate agent (for example they cannot be a member of a redress scheme as required), and it also creates a significant amount of negative publicity for the individual concerned. However it is not in itself a punishment and the sanction for breach of a Prohibition Order is simply a fine. Further, insofar as the individual can continue in business, the Prohibition would not prevent future misconduct of the same kind in relation to non-estate agency work. Therefore it may be that in some cases the use of an Enforcement Order under the Enterprise Act is actually a more effective means of deterrence, given that this can be applied to a wide range of misconduct and the penalty for breach is a finding of contempt of court which may involve prison and an unlimited fine.
- 5.74 We would therefore recommend that Government consider revision of relevant legislation to increase the sanctions for breach of a Prohibition Order, and to integrate the Prohibition regime more closely into the other statutory sanctions available now and in the future.

Local investigation and enforcement

- 5.75 As mentioned above, in many cases local enforcement against local estate agents is an entirely appropriate use of resources, and in many cases local TSS are also in by far the best position to conduct an investigation into and gather evidence against local estate agents. This is so even where the sanction envisaged is Prohibition by the OFT. For example, TSS will often have had ongoing contact with the estate agent, as well as having interviewed the complainant(s). TSS have the local knowledge which the OFT does not necessarily have. Such local knowledge also in many cases puts TSS in the best position to assess which sanction of the suite available may be most appropriate (such as Enterprise Act, Fraud Act, Prohibition etc).

- 5.76 In many instances securing the evidence to prove an offence is difficult. A high proportion of cases investigated by both Trading Standards and the OFT are closed due to lack of evidence.²²² It is therefore vital that we do all we can to ensure that relevant evidence is captured as early as possible in an investigation by the investigator best placed to achieve this. In many cases this will be the TSS officer.
- 5.77 Therefore even where TSS decide that a case should be referred to the OFT to consider Prohibition, there is still scope for local services to take responsibility for preparing the evidence for cases for the OFT to adjudicate on prohibition. This is particularly the case where prohibition is complimentary to some other tool being used for serious breaches (such as a fraud or CPRs prosecution), since it makes sense for the OFT to receive the case 'worked up' into a set of reasons why the trader should be prohibited as well. However the principle also applies where prohibition is suggested as a single sanction, since the TSS are very often simply the best placed to collect evidence in the most resource efficient manner.

²²² 26 per cent of cases no further action was taken due to lack of evidence (see OFT Survey of local authority Trading Standards Services, 2009 (Chart 3.7, page 15)). An internal review of OFT cases found 27 per cent with no further action.

6 ANCILLARY SERVICES

Summary

Many consumers purchase ancillary services either from or through their estate agent. The majority of sellers purchase a Home Information Pack (HIP) from their estate agent rather than directly from the HIP provider. Buyers may also purchase services, such as mortgages or insurance, either from or through the seller's estate agent.

We are satisfied that the majority of consumers are aware that they could purchase ancillary services directly and do not have to do so through their estate agent. The fact that many consumers choose to purchase these services through their estate agent is not, of itself, a cause for concern.

Concerns were raised with us about the price estate agents charged sellers for HIPs. We would expect any gap between wholesale and retail prices to reduce over time, as consumers become more familiar with HIPs and as direct sales become more common. If retail prices remain high, HIPs providers will more actively market themselves directly to sellers which will put pressure on the margin estate agents can charge.

The prospect of additional income from buyers, however, may give the estate agent a financial incentive to prefer some buyers over others. For example, a fee paid to an estate agent for introducing a buyer could significantly alter the agent's incentives to recommend to a seller that they accept that particular offer

The income generated from ancillary services, either through direct sales or through income earned by referring or introducing sellers and buyers to third party suppliers, is important to the estate agency industry and any change must be proportionate.

We recommend that, as part of its work on the future of estate agency regulation, Government consider further whether the potential for conflicts of interest should be removed, including a ban on such payments.

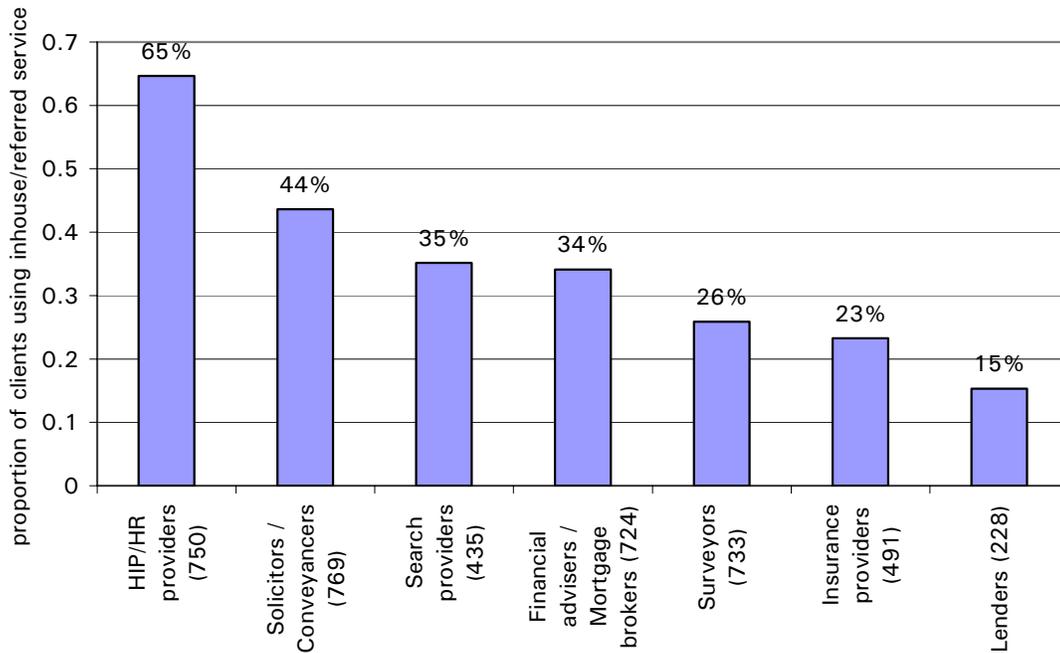
- 6.1 This chapter focuses on the relationship between estate agents and providers of other professional services involved in the home buying and selling transaction. We call these services 'ancillary services'.
- 6.2 During the course of a transaction an estate agent may recommend or sell a range of additional services to the seller and/or the buyer. For example, the seller may be introduced to a HIP provider, and a conveyancer or solicitor. The buyer might be introduced to a mortgage broker or to a lender, to a surveyor, conveyancer or solicitor.
- 6.3 In return for the introduction, the estate agent may receive a referral fee or commission. Not all ancillary service providers pay referral fees but the practice is common in the estate agency market.
- 6.4 In this chapter we address two broad questions. The first is the extent to which both buyers and sellers use these services, the benefits and drawbacks of estate agent referrals and the available choice and competition between ancillary service providers. The second question relates to a potential conflict of interest arising from the income that is earned from introducing buyers to other service providers. We are concerned that such buyer-side income might cause the estate agent to prefer a particular buyer, when the estate agent's primary duty is to act in the best interests of the seller.
- 6.5 It is not just estate agents who have a 'gatekeeper' role in terms of directing consumers to additional services. In particular, the use of panels of surveyors and solicitors by lenders (high street banks) was brought to our attention during the course of the study, and is discussed briefly at the end of this chapter.

Purchasing ancillary services

- 6.6 This section reviews the evidence on how often estate agents refer buyers and sellers to other service providers, and how often buyers and sellers take up those services.

6.7 We asked estate agents what proportion of clients used ancillary services sourced by the estate agent, either in-house or via referral – see Chart 6.21.

Chart 6.21: Proportion of clients using ancillary services provided in-house or via referral when offered



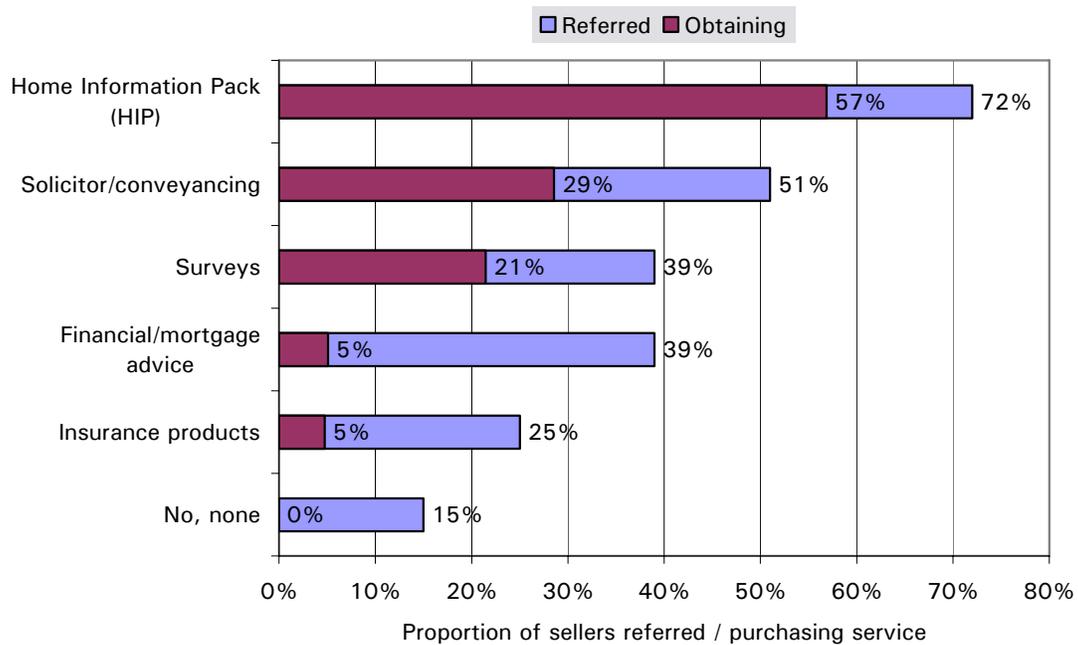
Base: as shown in brackets

Source: OFT Survey of Estate Agents, 2009

Seller purchases of ancillary services

6.8 Chart 6.22 shows which service providers sellers were referred to by their estate agent and which services they ultimately purchased by that route.

Chart 6.22: Proportion of sellers 1) referred to a third party provider and 2) purchasing the service/product as a result



Base: England and Wales sellers who used a traditional or online estate agent (Base: 227)

Source: OFT Consumer Survey, GfK 2009

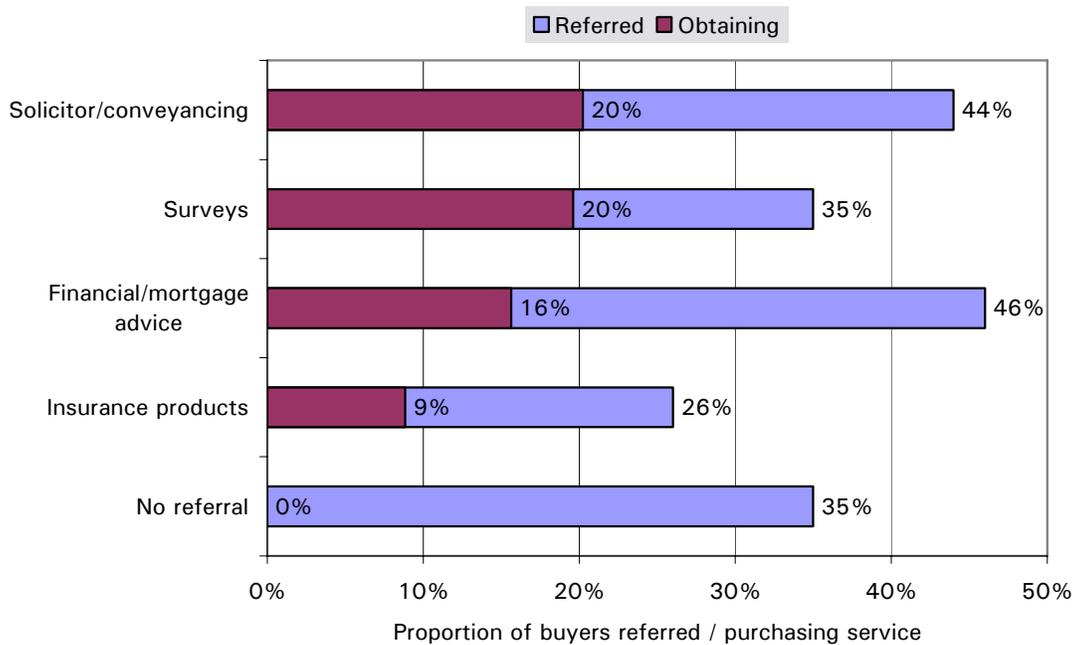
6.9 We note that over half of sellers purchased their HIP through a referral from their estate agent. Around a quarter chose a solicitor or surveyor through a referral from their estate agent.

6.10 The research suggests that, while a clear majority of HIP referrals resulted in a sale, just over half the referrals to solicitors and surveyors resulted in a sale, while the proportion of successful referrals for insurance or mortgage advice was much lower.

Buyer purchases of ancillary services

6.11 Chart 6.23 shows the comparable findings for the buyers surveyed in our consumer research.

Chart 6.23: Proportion of buyers 1) referred to a third party provider and 2) purchasing the service/product as a result



Base: England and Wales buyers who used a traditional or online estate agent (Base: 397)

Source: OFT Consumer Survey, GfK 2009

6.12 Again, for solicitors and survey work, approximately half of the referrals resulted in a sale. A much lower proportion (around one in three) of referrals for mortgage or financial advice resulted in a sale.

6.13 We found that first time buyers were more likely to be referred to ancillary service providers than were experienced buyers. Overall, 34 per cent of first time buyers stated that they received third party service provider recommendations, compared to 19 per cent of buyers that had already bought more than one property.

The importance of ancillary services to the estate agency industry

6.14 This section reviews the evidence on the size of referral fees and commissions that estate agents typically earn and the proportion of their overall income that this accounts for.

Typical referral fees earned by estate agents

6.15 We asked estate agents what referral fees they typically earn in relation to particular services on a typical transaction on a property worth £200,000. Table 6.24 shows our findings.

Table 6.24: Referral fees

| | Typical Referral Fee* | Service Provided to: | |
|--------------------------|-----------------------|----------------------|-------|
| | | Seller | Buyer |
| Lender | £300-350 | | ✓ |
| Financial adviser/broker | £50-150 | | ✓ |
| Solicitor/conveyancer | £250-300 | ✓ | ✓ |
| HIP provider | £50-100 | ✓ | |
| Surveyor | £0-100 | ✓ | ✓ |
| Search provider | £0-100 | | ✓ |
| Insurance provider | £0-50 | | ✓ |

* as reported by estate agent respondents

Source: OFT Survey of Estate Agents, 2009

Income from referral fees

6.16 We also asked estate agents what proportion of their profit came from referrals or in-house sales of ancillary services. Responses suggested

that profit from sales of ancillary services varied from nothing to 20 per cent of profits.²²³

- 6.17 Submissions made to the OFT by interested parties at the outset of the study suggested that ancillary services can contribute significantly to an estate agent's total income. Furthermore, a Key Note report²²⁴ published in 2008 estimated that the fees earned from mortgage and insurance sales were £1,500 million (approximately 20 per cent of an estate agents total revenue earned from residential sales - see Table 6.25). Note that this research pre-dated the introduction of both HIPs and the Home Report in Scotland.

²²³ OFT Survey of Estate Agents, 2009 (Table 3.28, page 41)

²²⁴ Key Note Market Report 2008: Estate Agents

Table 6.25: Estimated Breakdown of Total Estate Agency Revenue from Residential Sales in the UK (£m), 2007

| Description of fee | £million |
|--|----------|
| Fees from property sales* | 4,943 |
| Fees from mortgage and insurance sales | 1,500 |
| Lettings and property management including sundry auction sales** | 145 |
| Valuations and surveys | 120 |
| Total | 6,708 |
| <p>* - assumes an average commission of 1.4% on 1.8 million transactions, at an average house price of £196,478 (which was the average house price for the UK in 2007, according to Halifax plc)</p> <p>** - estimate for high street agencies only, excluding specialist surveyors, property management companies and the public sector</p> | |

Source: Key Note

- 6.18 We understand from stakeholders that fees for referrals for mortgage advice have come down considerably since 2007. It seems plausible that the total contribution to industry income from ancillary services is of the order of 10-20 percent, but at the low end of that range. Nonetheless, on a transaction where an estate agent does earn income from ancillary service referrals, this can be very significant relative to the estate agency fee itself.
- 6.19 The relationship between estate agents and ancillary service providers can take a variety of forms. For example, looking just at sales of mortgages, the estate agent may have an in-house specialist mortgage broker or could sell mortgages direct. Alternatively, it may have a pre-existing relationship with an independent mortgage broker or financial adviser.

Competition and choice

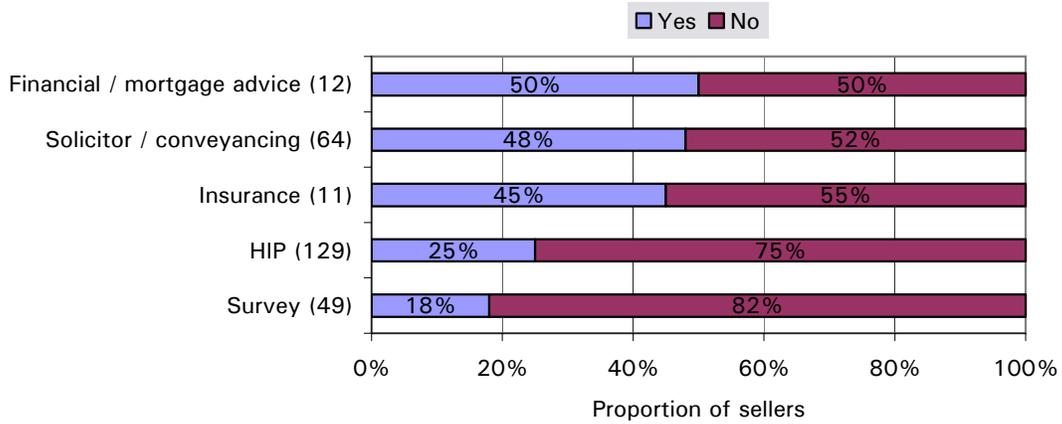
- 6.20 One of the obvious benefits of purchasing ancillary services through the estate agent is the convenience factor – organising all the services you need to complete a transaction through a 'one-stop shop'.
- 6.21 On the other hand, consumers purchasing services through their estate agent may select from a more limited set of providers than if they were purchasing independently on the open market. We return to the issue of preferred suppliers in the context of lenders' panels of surveyors later on in this chapter.
- 6.22 Furthermore, consumers may find it difficult to assess the quality of the ancillary services they are purchasing. This makes them vulnerable to purchasing services through their estate agent that represent poor value for money, particularly if the estate agent is referring consumers in part on the basis of the referral fees or commissions that they will receive, rather than solely on the basis of the quality or appropriateness of the service that will be provided to the consumer.
- 6.23 Worse, the prospect of earning referral fees might lead the estate agents to put undue pressure on the consumer to buy the services recommended. They may, for example, overstate how much better the chances of the transaction proceeding smoothly are if they work with professionals they know. We consider the prevalence of pressure selling later on in this section.
- 6.24 Another potential concern is where third party providers such as solicitors and conveyancers rely on an estate agency as a significant source of business. In such a situation, the provider may be reluctant to provide advice that might jeopardise future referrals.
- 6.25 We recognise, however, that estate agents have an incentive to recommend service providers who they know are of sufficient quality to progress the transaction to completion in a timely and efficient way.

Evidence on 'shopping around'

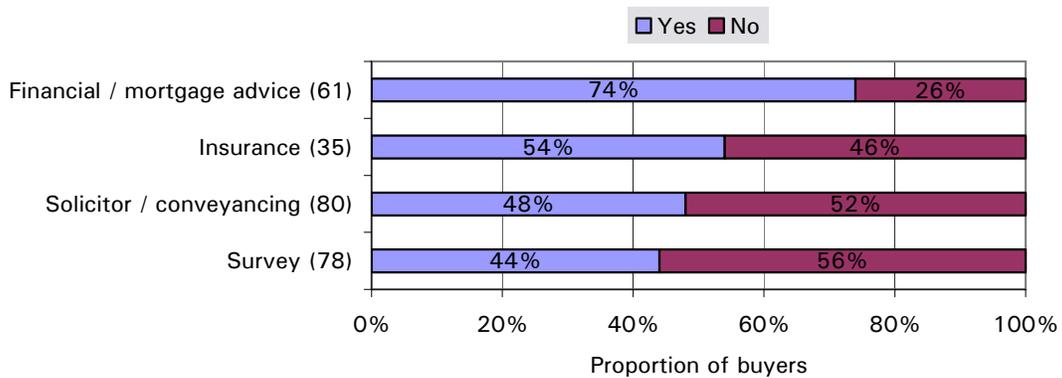
- 6.26 To recap the evidence presented earlier on purchasing behaviour of sellers and buyers, referred to above at Figures 6.2 and 6.3, respectively, we found that, in most cases, a significant proportion of consumers referred by their estate agent to solicitors and surveyors did make purchases from those providers. Around 80 per cent of HIP referrals were successful, while around one third of mortgage referrals to buyers were successful. The fees earned from introductions can be large, particularly for mortgages and conveyancing (see table 6.4 above)
- 6.27 We asked consumers whether they shopped around for ancillary services. Chart 6.26 shows how many buyers and sellers looked at other service providers before purchasing through their estate agent. Consistent with the above findings, buyers were more likely to shop around for mortgage advice than other services, while sellers were less likely to shop around for HIPs.

Chart 6.26: Whether investigated other service providers before deciding on third party services

Sellers



Buyers



Base: All who purchased each service (as shown in brackets on Chart)

Source: GfK Quantitative Consumer Survey

6.28 We also asked those who replied 'no' to the above question, why they did not investigate other providers. The most common responses were that: it was easier to accept the agent's recommendation, they did not think they would get a better deal, they did not know where to look for

other services.²²⁵ Others (just over one in six) said they did not investigate other providers because the estate agent suggested it would be cheaper or faster to use their recommendation. The Law Society, in relation to conveyancer services, submitted that:

'There is a substantial amount of anecdotal evidence that buyers are pressurized to use the conveyancer offered by the agent by being told it will be quicker and in many cases in a buoyant market being told that they have to use the agent's conveyancer if they want their offer accepted in the first place'.²²⁶

6.29 We found some evidence that consumers came under pressure from estate agents to accept ancillary service referrals. For example, a review of referral fees carried out by The Hampshire Incorporated Law Society in November 2006 found that some solicitors' clients had been told by their estate agent that they must use a particular solicitor and alleged that:

'Some of the national chains of estate agents have given instructions to their branches that they must refer clients to particular 'solicitor factories' due to the referral fee arrangement. This is despite the local estate agent not wishing to do so, because the quality of the service received from these firms is on the whole poor'.²²⁷

6.30 Our Qualitative consumer research also found that estate agents routinely attempted to cross-sell the services of the partner solicitors, surveyors, insurance companies and financial advisers. Some consumers complained that they were put under undue pressure to purchase

²²⁵ OFT Quantitative Consumer Survey Report, GfK 2009 (Table 5.23, page 43 and Table 6.70 page 92)

²²⁶ Letter dated 13 November 2009 from the Law Society to the OFT.

²²⁷ *Review of Referral Fees 2006* – see www.hampshirelawsociety.co.uk/application-forms-in-word/HILS%20Review%20of%20Referral%20Fees%20Nov%202006.doc

ancillary services from the estate agent's business partners.²²⁸ For example, some buyers found the estate agent pushed them into interviews or meetings with financial advisers based in their branch, even when they said they were not interested in purchasing financial services.

- 6.31 Most buyers said that the estate agent had described the options available for taking third party services, but did not push them. Thirty-one per cent of buyers that used the recommended service said their agent at least encouraged them to use the financial or mortgage advisors recommended to them. Similarly, 40 per cent of those who took the recommended insurance products felt some degree of pressure to take the recommendation, as did 28 per cent of those who used the recommended surveyors and 29 per cent of those who used the recommended solicitors or conveyancing services.²²⁹
- 6.32 Taking into account everything they had been told and offered when the seller's estate agent was recommending other service providers, the majority of buyers (82 per cent)²³⁰ did not feel that they had received a 'hard sell'.
- 6.33 We also note that while the Qualitative research found some evidence of 'shopping- around', the overall impression from the groups and depth interviews was that where consumers entered into contracts, they more typically did so without questioning the rates or scale of charges of the professionals.²³¹ For example, the research found some evidence to suggest that people who chose to use their own family solicitor or who went with a personal recommendation of a solicitor, were less likely to

²²⁸ OFT Qualitative Consumer Survey Report, GfK 2009 (Paragraph 7.3, page 11).

²²⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Paragraph 6.31 and 6.32, page 93 and Table 6.72 page 94)

²³⁰ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.73, page 95)

²³¹ OFT Qualitative Consumer Survey Report, GfK 2009 (Paragraph 7.5, page 11)

seek advance notice of their fees. It appeared that the outlining of the fees by solicitors in their confirmation of appointment letter was seen by the consumer as set in stone rather than as information they could then use to negotiate more favourable terms or a basis from which to start shopping around.²³²

- 6.34 Given this lack of price awareness or sensitivity, it is not surprising that in some cases estate agents may be able to earn extra income by adding their own mark-up to the price of ancillary products charged by the third party provider. Undisclosed mark-ups might be considered a 'secret profit'.²³³ This concern has been raised in relation to estate agent sales of HIPs in particular.

Home Information Packs

- 6.35 An estate agent who is marketing a residential property for a seller is responsible for obtaining a HIP before putting the property on the market.²³⁴ Where the HIP is purchased through the estate agent, the estate agent will typically charge a price for a HIP to the seller and then the HIP provider will separately invoice the estate agent for the cost of producing the HIP, once delivered. The seller may be charged a mark-up on the invoice price paid by the estate agent.²³⁵
- 6.36 A recent Which? Money report²³⁶ suggested that HIPs purchased from estate agents can cost over 50 per cent more than those bought direct

²³² OFT Qualitative Consumer Survey Report, GfK 2009 (Paragraph 7.6, page 11)

²³³ If the client has consented to the agent being remunerated at a higher rate than the services were obtained for then the mark-up would not be considered to be a 'secret profit'.

²³⁴ See chapter 7.

²³⁵ This arrangement may be separate from, or additional to, a referral fee arrangement.

²³⁶ *Be careful where you lay your hands on HIPs*, published 19 August 2009 – see www.which.co.uk/about-which/press/product-press-releases/which-money-magazine/2009/08/be-careful-where-you-lay-your-hands-on-hips.jsp

from a specialist HIP provider. The Which? Money research found that the price for a HIP purchased direct from an online HIP provider for a three bedroom freehold semi-detached property could be less than £200, whereas the price for a HIP purchased through an estate agent could be more than £400.

- 6.37 The estate agent may have to do some work on the HIP (for example advising the seller, or preparing information for the pack) and this may justify the addition of some additional cost. Furthermore, sellers may take the view that the price of the HIP is secondary to other considerations, such as the need to put their property on the market quickly. Sellers may also take the view that the cost of the HIP is only a small proportion of the total cost of selling a home.
- 6.38 We note that the Association of Home Information Packs Providers (AHIPP) in response to the Which? Money findings suggested that comparing the price of HIPs purchased through an estate agent and a HIP purchased online was misleading, commenting that an estate agent may need to carry out additional checks on a HIP purchased independently of the estate agent to ensure that the estate agent would not be in breach of its regulatory responsibilities and duties.²³⁷
- 6.39 We believe that the price differential identified in the Which? Money report may be a temporary phenomenon – the HIP market is relatively new. We understand that many HIP providers entered the market following the introduction and roll-out of the HIP requirements in the period between August and December 2007, but that the housing market started to fall shortly thereafter, which meant many suppliers were chasing a falling number of transactions. This resulted in a collapse in the wholesale price of HIPs.
- 6.40 We would expect the gap between wholesale and retail prices to reduce over time, as consumers become more familiar with HIPs and as direct

²³⁷ *Industry hits back over HIP costs* – see www.estateagencynews.co.uk/news/news-0909a.asp

sales become more common. Currently the market is quite fragmented and HIP providers rely on the larger estate agent chains to put custom their way. We would not expect excessive mark-ups to be sustainable over time – if retail prices remain high, HIPs providers will more actively market themselves directly to sellers which would put pressure on the margin estate agents can charge.

- 6.41 However, it is possible that some uncertainty around the future of HIPs²³⁸ could be delaying investment in direct channels of distribution. This could mean that HIP providers continue to be overly dependent on the large estate agent chains for distribution. The current economic climate may also be stalling such investment, meaning that the market is not maturing or developing as quickly as it might otherwise. Given such factors, the price differential observed in this market may persist until supplier confidence improves.
- 6.42 In conclusion, while most sellers may be paying more for HIPs than they would if they purchased them independently, this may in part be because sellers value the convenience of purchasing through the estate agent. It is also possible that sellers are simply unaware that the estate agent is obtaining a financial benefit from a particular recommendation and are, therefore, not 'shopping around' to get a better price. Furthermore, to the extent that estate agents' mark-ups may in some sense be 'excessive', we believe that excessive mark-ups are unlikely to be sustainable in the long-term (though they may persist in the short-term).
- 6.43 As well as the concern over the cost of HIPs, we have also found some anecdotal evidence to suggest that some 'free' HIPs may be invoiced to the seller if the seller decides to stop marketing the property or switch estate agents. Suppliers which engage in misleading practices risk enforcement action by Trading Standards and/or the OFT under the

²³⁸ *Conservative Home Information Pack policy to stall property market* – see www.hip-consultant.co.uk/blog/conservatives-home-information-pack-policy-to-stall-property-market-123/

Consumer Protection from Unfair Trading Regulations and other consumer protection legislation.

Overall conclusions on competition and choice

- 6.44 On balance we are satisfied that the majority of consumers are aware that they could purchase ancillary services directly and do not have to do so through their estate agent. The fact that many consumers choose to purchase these services through their estate agent is not, of itself, a cause for concern.
- 6.45 The fact that first time buyers are more likely than more experienced buyers to be offered ancillary services by their estate agent or act on their estate agent's recommendation suggests that there might be a role for consumer education. However, there is a lot of information already available on how the buying and selling process works (for example advice services such as Consumer Direct, consumer guides on buying and selling a home, and widespread media coverage of property issues). There seems little scope for a public information or education initiative to add significant further value here.

Distorted incentives and conflicts of interest

- 6.46 This section addresses the issue that income earned from introducing buyers to other service providers may create a conflict of interest in terms of the estate agent's duty to act in the best interests of the seller.
- 6.47 The example below shows a hypothetical scenario where two buyers make offers on a property. One buyer is also likely to obtain a mortgage through the estate agent, while the other is not. The purpose of the illustration is to show the potentially distortive influence of such fees being earned on the buyer side.

Table 6.27: Hypothetical illustration of the potential distortive impact of referral fees

| | Competing Buyers | |
|-------------------------------|------------------|----------|
| | Buyer 1 | Buyer 2 |
| Offer | £160,000 | £175,000 |
| Commission rate | 1.60% | 1.60% |
| Fee for Selling House | £2,560 | £2,800 |
| Fee for mortgage introduction | £350 | |
| Potential income | £2,910 | £2,800 |

Source: OFT

- 6.48 In this example, the estate agent would be better off if the seller accepted the offer from Buyer 1, even though Buyer 2 might be offering £15,000 more for the property. This could lead the estate agent to act against the interests of his client, by preferring the buyer who has made the lower offer.
- 6.49 If the estate agent either failed to pass on Buyer 2's offer or was able to persuade the seller that Buyer 1 was a more secure prospect than Buyer 2, this would be a serious breach of professional ethics and the law. More plausibly, perhaps, an estate agent who has received an offer from Buyer 1 might persuade the seller to accept that offer, rather than hold out for a better offer, even where there was a reasonable prospect of a better offer (in this case the Buyer 2 offer) materialising.
- 6.50 It is very difficult to establish the extent to which this sort of conflict of interest either arises or results in harm to sellers in practice. In most cases sellers simply will not know that a particular buyer has been preferred by the estate agent or that a better offer might have come along if they had been prepared to wait a little longer.
- 6.51 However, our Qualitative Consumer Survey did establish that some consumers believe that the estate agent may favour buyers from whom they stand to earn additional income. The evidence therefore suggests that there is more than a theoretical risk of a conflict arising and that the fees being earned by estate agents from referring buyers to other

services could be adversely impacting on the impartiality of the advice being provided to sellers.

6.52 In terms of potential remedies for this problem, we have considered the following:

- banning estate agents from earning income from ancillary services sold to Buyers
- preventing individual sales negotiators from benefitting directly from Buyer referrals, and
- strengthening disclosure requirements and/or improving the visibility of disclosure.

6.53 As discussed in Annexe C, estate agents in the US are banned from accepting referral fees in connection with either buyers or sellers. The US Congress considered that the payment of such fees was artificially driving up the cost of settlement because consumers were indirectly paying the fee. Consequently they sought to end the payment of referral fees, 'kickbacks' or other kinds of payments as a way of lowering settlement costs.

6.54 Banning estate agents from accepting fees for referring buyers would remove the potential conflict of interest as estate agents would not have any financial incentive to prefer one buyer over another. While banning estate agents from accepting fees for referring buyers might remove the potential for the conflict of interest to arise, it is not clear that it would necessarily be a proportionate response to the problem, nor that it would be in the overall interests of consumers.

6.55 As noted above, referral fees and commissions earned by estate agents could in total amount to between 10 or 20 per cent of their revenue, although we suspect that the industry average is towards the low end of that range. Banning fees on the buyer side alone might therefore reduce the income of estate agents with some firms being affected to a much greater extent than others. This reduction in income could result in some

firms going out of business, while others might reduce their workforce and/or charge higher fees to sellers.

- 6.56 Clearly the transition disruption to the industry would be costly. In particular, there could potentially be some serious cost and restructuring implications for those estate agents that currently employ their own in-house mortgage advisors.
- 6.57 An alternative approach would be to try to prevent the individual sales negotiator from benefiting directly from any referral fee earned in the wider business. However, it is unclear how far such a 'Chinese wall' approach is likely to be effective in removing the conflict of interest for the negotiator. It is also unclear how it could be implemented for sole-traders.
- 6.58 Estate agents are subject to disclosure obligations to their clients regarding referral income they may receive from ancillary service providers.²³⁹ Our Survey of Estate Agents found that over half (53 per cent) of estate agents that receive a referral fee from solicitors informed their customers²⁴⁰ of the size of the fee. A further 28 per cent informed their customers about the existence of the fee, but not the amount.²⁴¹
- 6.59 It is not clear how disclosure requirements could be made more effective in practice. Furthermore, disclosure of the fee alone, under many circumstances, will do nothing to alert the seller to the existence of the possibility of bias. An estate agent may successfully encourage a seller to accept a particular buyer's offer regardless of referral fee disclosure.

²³⁹ Annexe D

²⁴⁰ The question asked in the Estate Agents Survey did not distinguish between Sellers and Buyers.

²⁴¹ OFT Survey of Estate Agents, 2009 (Chart 3.27, page 40)

Overall conclusion on conflict of interest

- 6.60 Our research suggests that there is a clear in principle problem with estate agents earning income from ancillary services sold to buyers. We have also found evidence to suggest that this is more than a theoretical risk.
- 6.61 The most certain remedy would be to ban referral fees outright, at least on the buyer side. However, we recognise that this would represent a substantial cost to the industry. In the longer-term the market might adjust, with commission fees rising to compensate for loss of referral fee income, but transitional costs are likely to be substantial.
- 6.62 We do not at this stage have sufficient evidence to say which of the possible remedies would be proportionate. We are nonetheless sufficiently concerned to recommend that Government consider a statutory response to the issue, perhaps as part of its review of the future of estate agency regulation.
- 6.63 An assessment of the costs and benefits of a change to legislation would be a challenge to undertake, and would need to take into account any available evidence of the extent of the problem in practice. The OFT stands ready to assist in any such assessment. We note that the market for estate agency services is not the only market in which a 'double agency' problem may arise.

Lender panels

- 6.64 Our study has mainly focused on the role of the estate agent. However, other parties, such as solicitors and lenders, may also be referring clients to other service providers.
- 6.65 Lenders' use of panels of surveyors is a particular issue that has been brought to our attention. Unlike estate agents, who can only recommend a particular service provider to their clients, lenders can require buyers to use an approved surveyor, at least for the purpose of obtaining a

mortgage valuation. Where buyers are allowed to use a non-approved surveyor, the lender may impose an additional charge.

- 6.66 Lenders require the use of approved surveyors or some other form of quality control over the mortgage valuation because they need to be confident that a property provides sufficient security for the loan that they extend. Many buyers will use the surveyor engaged to do the mortgage valuation to do any additional survey work, for example a full structural survey.
- 6.67 We have found some anecdotal evidence to suggest that the cost of surveys purchased independently of the lender can in some cases be substantially lower than those purchased from the lender's own panel. There may also be a very limited choice of surveyors on the panel, with buyers in some cases able to find only one or two approved surveyors working in their area. Responses to the Carsberg Review of Residential Property²⁴² also noted a lack of transparency in how lenders appoint surveyors to their panels.
- 6.68 Whether the use of panels unduly restricts choice and causes significant consumer harm will largely depend on the make-up of the panel and the additional costs levied where services are obtained off-panel.
- 6.69 At this stage, we have not seen sufficient evidence of consumer harm to warrant recommending any action to address the concerns raised. However, in principle there appears to be greater cause for concern in terms of competition and choice in ancillary markets where customers are required to use an approved supplier than where they are simply referred. We believe the issue of panels of approved suppliers goes beyond the home buying and selling process into a wider range of inter-professional referrals, and this may be something the OFT chooses to revisit in future.

²⁴² Carsberg Summary of Residential Property: A summary of responses to the Carsberg review of residential property.

Summary of conclusions and recommendations

On competition and choice

- 6.70 On balance we are satisfied that the majority of consumers are aware that they can purchase ancillary services directly and not through their estate agent and the fact that many consumers choose to purchase services through their estate agent is not, of itself, a cause for concern.
- 6.71 On HIPs specifically, we conclude that while most sellers may be paying more for HIPs than they would if they purchased them independently, this may in part be because sellers value the convenience of purchasing through the estate agent. Furthermore, to the extent that price differentials are in some sense excessive, we believe that they are unlikely to be sustainable long-term (though they may persist short-term). For these reasons we do not recommend any intervention at this point.

On conflict of interest

- 6.72 We conclude that there is a clear in principle problem with estate agents earning income from ancillary services sold to buyers, and that the evidence suggests that this is more than a theoretical risk. However, we do not at this stage have sufficient evidence to say which of the possible remedies would be proportionate.
- 6.73 We recommend that Government consider a statutory response to the issue, perhaps as part of its review of the future of estate agency regulation, and taking into account any available evidence of the problem in practice.

7 THE HOME BUYING AND SELLING PROCESS

Summary

Strictly speaking, in England and Wales, there is no 'transaction' at all at offer acceptance. There is only the potential for a transaction at a verbally agreed price. Until exchange of contracts, either side can pull out without being liable to the other for losses incurred. About 20 per cent of transactions fail between offer and exchange.

Failures in chains of transactions involve wasted costs for buyers, sellers and service providers, and stress and wasted time for both buyers and sellers. Our consumer research suggests that 46 per cent of sellers believed that their most recent transaction was part of a chain.

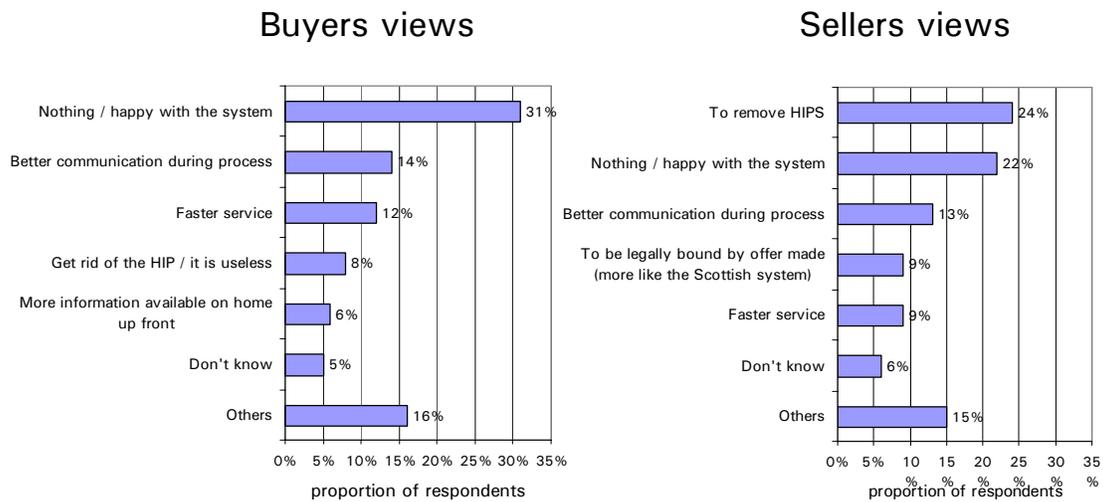
Some stakeholders told us that they believed the key to improving the process in England and Wales would be to introduce a point earlier in the process where parties make a binding commitment, for example, to mandate written offers and acceptances which are intended to be binding on the parties. The practical difficulties of bringing about such a change may be significant - success is likely to depend on the detail of any new process and the willingness of buyers and sellers in England and Wales, and their professional advisers, to accept the change.

It is not possible to quantify, with certainty, the costs and benefits of introducing a point of earlier commitment in the process for buying and selling a house in England and Wales, but it is clear that the potential benefits might be substantial.

We received mixed views about the necessity and value of compulsory Home Information Packs (HIPs). It is hard to see either a significant positive, or negative, impact of HIPs in their current form. Nevertheless, HIPs make information available to prospective buyers early in the process, and some buyers say they find the information useful and that it influenced their decisions, so could be argued that HIPs in their current form have a positive impact.

- 7.1 When asked what could be done to improve the process of buying or selling a home, 31 per cent of buyers and 22 per cent of sellers said 'nothing' or said that they were happy with the existing system.
- 7.2 Of those who were not satisfied with the existing process, and excluding sellers' concerns about HIPs, the top two areas for improvement mentioned by both buyers and sellers were the need for better communication and a wish for faster service.
- 7.3 This result is consistent with our qualitative research. A key finding of that research was that consumers felt more could be done to improve transparency and communication during what was often considered to be a time-consuming and unfamiliar process.²⁴³

Chart 7.28: Buyers and Sellers views on improving the process



Base: All buyers (435)

Base: All sellers (255)

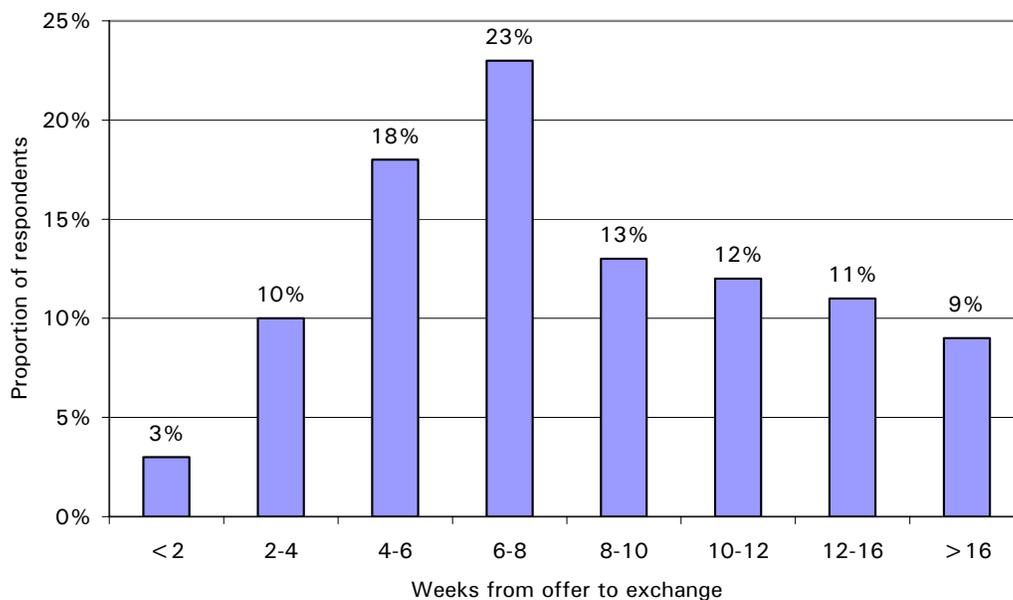
Source: OFT Consumer Survey, GfK 2009

²⁴³ OFT Qualitative Consumer Survey Report, GfK 2009 (Paragraph 7.6, page 2)

Time from offer to exchange

7.4 The period between offer acceptance and exchange takes on average nine weeks in England and Wales, according to both our consumer and estate agent surveys. There was considerable variation in the time taken to reach exchange, as shown in Chart 7.29 below. Around one-third (32 per cent) of transactions took 10 weeks or more although nearly 50 per cent took eight weeks or less.²⁴⁴

Chart 7.29 Average time from offer to exchange



Base: All buyers and sellers (690)

Source: OFT Consumer Survey, GfK 2009

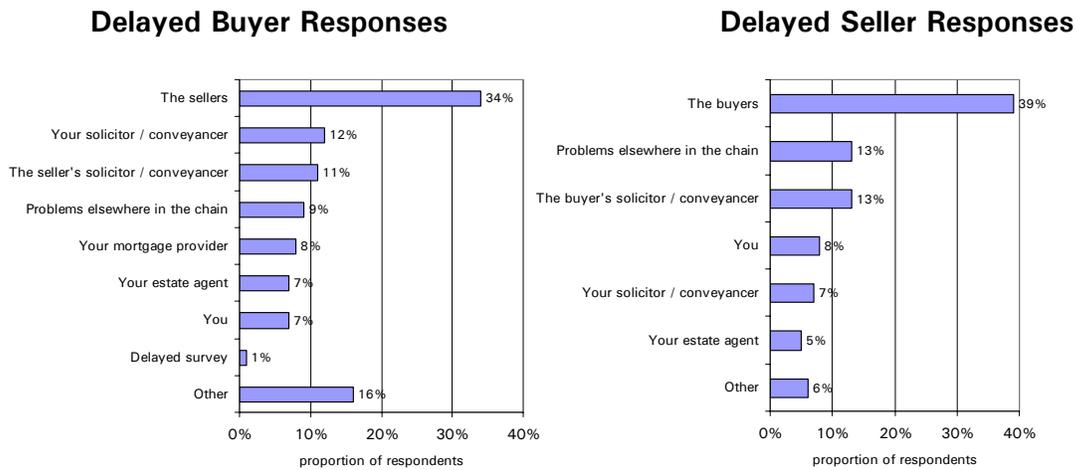
7.5 Home buyers and sellers in England and Wales anticipate quite a lengthy process. Nonetheless, for some the process took even longer than they had expected. Forty per cent of sellers and 38 per cent of buyers said

²⁴⁴ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.33, page 53)

that their transaction had been delayed.²⁴⁵ For 18 per cent of sellers and 17 per cent of buyers, the delay was more than four weeks.²⁴⁶

7.6 When asked who was responsible for the delay, the individual on the other side of the transaction was most likely to be blamed. Chart 7.30 below provides a break down of responses. Estate agents attracted a relatively small share of blame.

Chart 7.30: Who/what was responsible for delay



Base: All that experienced a delay (108 sellers, 166 buyers)

Source: OFT Consumer Survey, GfK 2009

7.7 Fifty-six per cent of sellers and 76 per cent of buyers in our survey with delayed transactions said that they had experienced 'general

²⁴⁵ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.35, page 54 and Chart 6.85, page 107)

²⁴⁶ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.38, page 57 and Chart 6.88 page 110)

stress/worry' as a result. A lack of control over what other people need to do contributes to the stress.²⁴⁷

7.8 Delays can also result in additional financial expense, in particular for buyers. Thirty-eight per cent of buyers experiencing delays to their transaction had incurred additional costs as a result, ranging from under £100 to £1,500 or more.²⁴⁸ The two main additional costs were renting accommodation and renting storage space because the move had been delayed.

Failure of transactions

7.9 Overall, our consumer survey results suggest that a little over 20 per cent of transactions fail between agreed offer and exchange of contracts.²⁴⁹ Our estate agent survey respondents also reported an average transaction failure rate of 20 per cent.

7.10 This is consistent with other research. CLG in its 2006 survey²⁵⁰ found a transaction failure rate of 21 per cent as reported by estate agent respondents, and 23 per cent in terms of buyers who had previously experienced a failed transaction.

7.11 From the perspective of our consumer survey respondents, decisions made by individual buyers and sellers were the main reasons for transaction failure. For example, sellers reported buyers withdrawing their offer, or lacking the funds. Buyers reported being gazumped. Chart 7.31 below provides a break down of the responses.

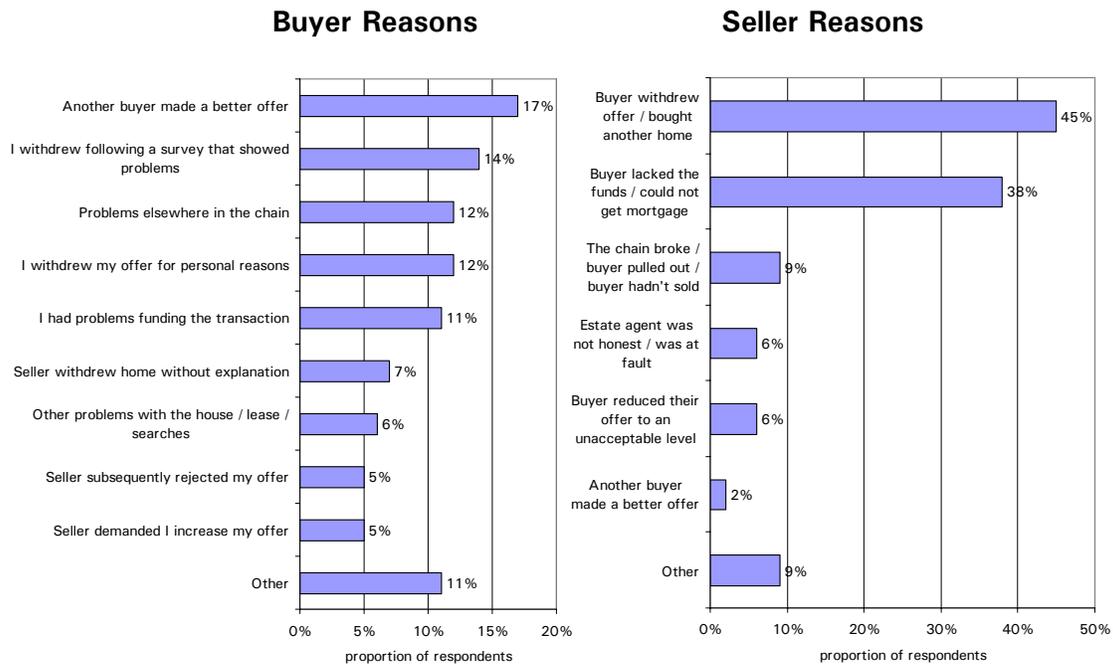
²⁴⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.39, page 58 and Chart 6.89 page 111)

²⁴⁸ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.90, page 112)

²⁴⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.46, page 66 and Chart 6.93 page 115)

²⁵⁰ HIP Baseline Research: Main Report, January 2007

Chart 7.31: Buyer and seller reasons for transaction failure



Base: all buyers / sellers that experienced a sale falling through (81 buyers, 64 sellers)

Source: OFT Consumer Survey, GfK 2009

7.12 The cost to consumers depends to a large extent on how far advanced the transaction was at failure. A change of mind shortly after offer acceptance may result in little or no cost at all. On the other hand, a buyer withdrawing after a lender's valuation report implies at least the cost of the report to the buyer.

7.13 Buyers are more likely than sellers to lose money as a result of a failed transaction. Around two-thirds (67 per cent) of buyers in our survey with failed transactions had incurred costs, such as survey fees, solicitor fees, and mortgage arrangement fees.²⁵¹ On average, these costs amounted to around £400. Some had incurred costs of over £1,500. By

²⁵¹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.95, page 117)

comparison, a little over one-third (37 per cent) of sellers had incurred costs,²⁵² primarily solicitor fees.

- 7.14 Only 11 per cent of buyers say the transaction failed because they had problems with finance. Thirty-eight per cent of sellers, however, say that the buyer lacked the funds to complete the transaction. This disconnect in the perception between buyers and sellers about why a transaction failed is not entirely surprising. For example, in the cases where 17 per cent of buyers say the transaction failed because another buyer made a better offer, we can assume a seller was happy to proceed with a different buyer, and a higher offer, and may not associate the change with 'transaction failure' at all.
- 7.15 The TPO Code obliges an estate agent to take reasonable steps to find out from a prospective buyer their source and availability of the funds for buying the property, and to pass this information on to the seller for their consideration.²⁵³ Some buyers may take the initiative in providing evidence of finance to the estate agent, and may have obtained pre-approval for a mortgage.
- 7.16 Even those buyers with a mortgage agreement 'in-principle' may find themselves unable to proceed if the lender decides not to fulfil an earlier offer of finance. Finance may be withdrawn or reduced if a lender has concerns about the value of the property, or about the buyer's ability to make payments on the mortgage.

Chains

- 7.17 Most home owners can only afford to move home if they sell their existing property. Chains of transactions may form, with a cash or first time buyer at one end of the chain, and a seller not looking to buy at the other.

²⁵² OFT Quantitative Consumer Survey Report, GfK 2009 (Table 5.48, page 68)

²⁵³ TPO Code, Paragraph 7 Financial Evaluation

- 7.18 Forty-six per cent of sellers in our survey said that they were in a chain,²⁵⁴ with an average chain length of between three and four transactions.²⁵⁵
- 7.19 'Problems elsewhere in the chain' were the main reason for transaction failure, according to our survey of estate agents.²⁵⁶ With transactions dependent upon one another, the failure of any one can cause the knock-on collapse of the chain.
- 7.20 Our consumer survey results on this point, however, were much lower. According to buyers, only 12 per cent of transaction failures were reportedly due to problems elsewhere in the chain.²⁵⁷ This may be because some respondents did not realise the chain-related nature of the problem.
- 7.21 Some of the buyers and sellers who participated in our qualitative research had experienced more than one chain-related transaction failure, with associated costs. Others expressed concern about the ease with which any one chain participant could change their mind and thereby jeopardise the whole chain.

'It was really upsetting (having the chain collapse twice)... Too easy for people to drop out... you pay for a survey and lose it (the property) because someone's dropped out. It's an expense... you shouldn't be able to just drop out...it can affect a lot of people...There were about nine people in the chain. Everyone (was) left in the lurch.'

²⁵⁴ Our survey results on chains were skewed towards sellers, because sellers who were also buyers (hence in a chain) were mostly classified as sellers, and asked to respond as such

²⁵⁵ The average number of other buyers and sellers was 2.6, in addition to the buyer or seller on the other side, which implies an average chain of between three and four transactions.

²⁵⁶ OFT Survey of Estate Agents, 2009 (Chart 3.22, page 33)

²⁵⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.94, page 116)

Point of commitment and options

- 7.22 Strictly speaking, in England and Wales there is no 'transaction' at all at offer acceptance. There is only the potential for a transaction at a verbally agreed price. Until exchange of contracts, either side can pull out without being liable to the other for losses incurred. A buyer is not committed to buy and a seller is not committed to sell until contracts are exchanged.
- 7.23 The non-binding nature of offer and acceptance means that there is less incentive for buyers to secure funding or find out more about the property in advance of making an offer, and for sellers to find out more about the buyer before accepting. Steps such as searches²⁵⁸ and surveys generally take place after an offer has been agreed.
- 7.24 A buyer may try 'gazundering' a seller by proposing a revised and reduced offer just before the transaction is due to become binding on both parties. A seller may 'gazump' a buyer by accepting a better offer, or decide at the last minute to raise the price they are willing to accept. From our online diary research:

'...he (estate agent) called me back and advised that his client now want the full asking price for the house for example, another £15,000 more than the price we had agreed on... I was distraught and said I could not believe that they would try and pull this one...'

Source: GfK Online Diary Management Summary

- 7.25 This is rational, self-interested behaviour on the part of consumers, given the lack of early commitment. It is also far from certain that individuals would want a different system, since from the perspective of any one

²⁵⁸ Searches are generally valid for three to six month, so where a property is on the market for longer than this, some searches that had been conducted for inclusion in the HIP may need to be repeated. In addition, some buyers choose to commission their own searches.

individual the option to change their mind has value. Of course, this value is likely to vary between sellers and buyers depending on the state of the housing market.

Home Information Packs

- 7.26 There have been mixed views about the necessity and value of compulsory HIPs. Criticism tends to focus on the cost imposed on sellers and the requirement to have a HIP in place before a home is marketed, which is said to create delay. Some have also said that the HIP contents are not helpful. On the positive side, there is some indication that HIPs help buyers make decisions about a property.
- 7.27 We asked sellers in our survey for their views on the contents of the HIP for the home they sold. Nineteen per cent said they had read the HIP for their property, understood it, and found the contents useful.²⁵⁹ This contrasts with 49 per cent of sellers not finding the contents useful. When asked what could be done to improve the process/make it easier, 24 per cent of sellers said that they thought HIPs should be removed.²⁶⁰ This compares to only eight per cent of buyers.²⁶¹
- 7.28 Participants in our qualitative survey were also asked about HIPs, Energy Performance Certificates and Home Reports, and the majority were indifferent or negative about HIPs.²⁶² Those who had reviewed a HIP for a property said it contained information they could have found out for

²⁵⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.19, page 39).

²⁶⁰ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.53, page 73)

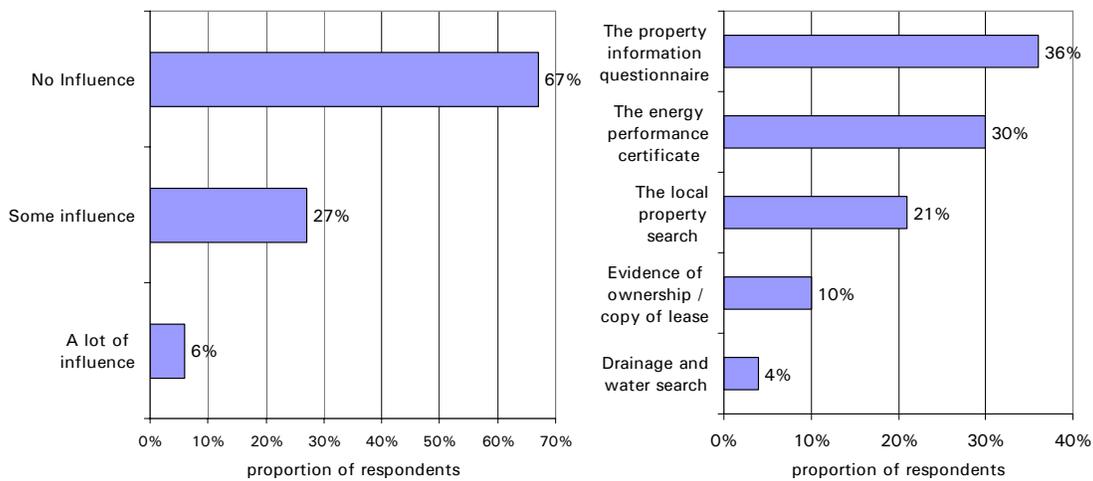
²⁶¹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.106, page 129)

²⁶² This may be a result of the timing of our survey and the participants that were targeted (participants had bought and/or sold a property between April 2007 and April 2009).

themselves. Opinion was more favourable towards the Scottish Home Report, because of the upfront survey contained within it.²⁶³

7.29 Buyers in our survey were more positive than sellers about the most recent HIP they had seen. Of those who had seen the HIP, 33 per cent reported it had had some influence, or a lot of influence on their decision to make an offer or on the amount to offer.²⁶⁴ Chart 7.32 below provides a break down of responses as well as showing which part of the HIP these buyers found most influential.

Chart 7.32: Level of influence the HIP had on buyer's decision to offer/amount to offer and part of the HIP that had most influence



Base: all buyers that saw a HIP (385)/all buyers that said the HIP had some influence (126)

Source: OFT Consumer Survey, GfK 2009

7.30 It is not a surprise that HIPs are more popular with buyers than with sellers as they shift an element of the cost of collecting information to the seller. Some buyers find the information helpful and to the extent

²⁶³ OFT Qualitative Consumer Survey Report, GfK 2009 (pages 12-13)

²⁶⁴ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.57, page 78)

that the buyer, rather than the seller, previously collected the same information, it can be argued that the overall direct financial cost of HIPs across both buyers and sellers should be broadly neutral. The direct financial benefits may outweigh the costs in those cases where HIPs are reused, and costs avoided, when transactions fail.

7.31 The possible impact of HIPs on the market, and particularly on prices and listings, rather than the home buying and selling process, has previously been considered in some detail by Europe Economics.²⁶⁵ This report concluded that fundamental drivers of supply and demand in the housing market are likely to far outweigh the impact of HIPs – this conclusion seems extremely plausible.

7.32 CLG modelled the financial case for HIPs²⁶⁶ in 2007 prior to their introduction. CLG found that:

'The pure financial savings from HIPs are expected to be relatively marginal... there is no commonly accepted methodology that allows the benefits in terms of increased speed and certainty or reduced stress to be quantified or monetised. Therefore the cost model that has been developed focuses narrowly on the financial costs and thus systematically underestimates the wider benefits of HIPs'.

7.33 In our survey of estate agents, participants were asked for any additional free-text comments. HIPs were the most talked about subject, mentioned by 10 per cent of all responding estate agents. The general attitude towards HIPs was negative, with criticism focusing on the cost and time taken to prepare HIPs, and the perceived lack of benefit.²⁶⁷

7.34 Overall, considering all the representations made to us, the original impact assessments, the work from Europe Economics and the

²⁶⁵ Home Information Pack, Housing Market Analysis, DCLG, November 2007.

²⁶⁶ Explanatory memorandum to the home information pack (no. 2) regulations 2007 No.1667

²⁶⁷ OFT Survey of Estate Agents, 2009 (Paragraph 3.57, page 49)

information from our recent surveys, it is hard to see either a significant positive, or negative, impact of HIPs in their current form. Nevertheless, HIPs make information available to prospective buyers early in the process, and some buyers say they find the information useful and it influenced their decisions, so could be argued that HIPs in their current form have a positive impact.

- 7.35 We discuss the cost to consumers of HIPs bought through estate agents in Chapter 6.

Could there be benefits from changing the system?

- 7.36 In Chapter 8 we compare the system of buying and selling houses in Scotland to that in England and Wales. We conclude that there are reasons to think that consumers in Scotland may be more satisfied with the process and that it apparently has some benefits. Two of the key differences between England and Wales and Scotland are: an earlier commitment by the parties in the process; and the Home Report, which includes a survey.

Earlier point of commitment

- 7.37 Some stakeholders told us that they believed the key to improving the process in England and Wales would be to introduce a point earlier in the process where parties make a binding commitment, for example, to mandate written offers which are intended to be binding on the parties. We note that there is nothing currently preventing individual buyers and sellers from adopting such a model today, however, as discussed earlier, it seems likely that at least one of the individuals in any transaction would value the option to change his mind, and the benefits of earlier commitments are likely to be to the overall system, including the current costs of failure of chains.
- 7.38 When asked what they thought might improve the process, only nine per cent of sellers thought that legally binding offers would be a good idea. There is no doubt that the transition costs, and practical difficulties, of introducing measures to bring about a change may be significant.

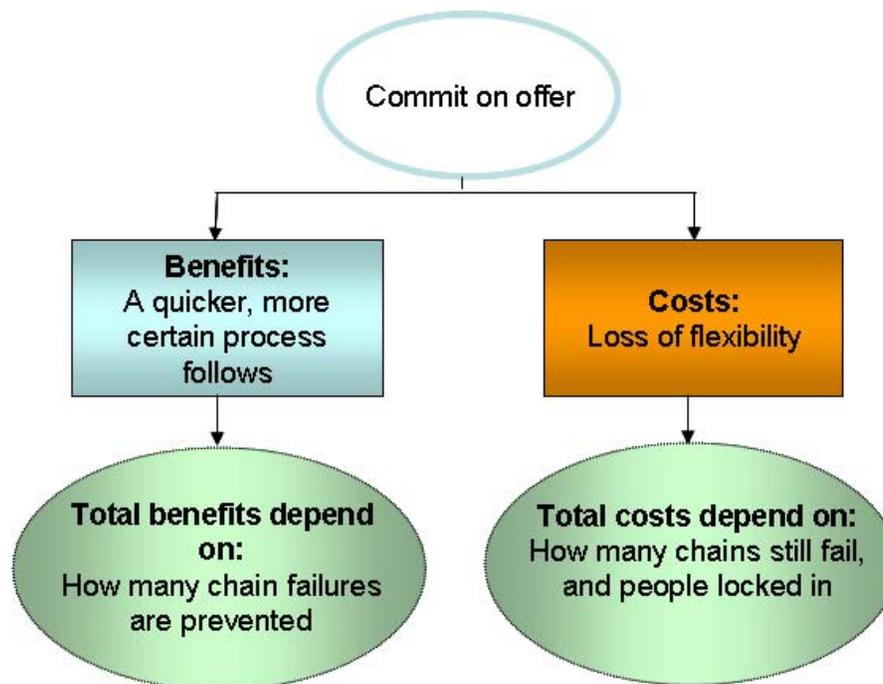
Although it seems feasible to introduce a change in law specifying, for example, that offers and acceptances should be in writing and contracts should be binding at the point of acceptance, it will be more difficult to secure a consistent approach to the terms agreed in the contract, or to restrict the potential to use 'get out' clauses that would allow one or other party not to proceed to completion.

- 7.39 It is likely that the current convention of, and familiarity with, a process where individuals do not make an early binding commitment would be difficult to overcome, unless common acceptance of revised standard contractual terms could be achieved. This does suggest that the effectiveness of efforts to change the process may be highly dependent on the willingness of buyers and sellers, and their professional advisors, to accept such a change.

Benefits of a quicker, more certain process

- 7.40 The current flexible system in England and Wales has some benefits. When individuals decide that a transaction is no longer in their best interests, even taking into account the costs they have already committed and may incur again in a replacement transaction, they have the choice to walk away. This flexibility does, of course, impose costs where the other party wishes the transaction to proceed, and has invested time and money. It may also have costs to the extent that parties enter into transactions without sufficient advance preparation and the transaction fails with regret, and costs, to both parties.
- 7.41 Regardless, however, of the costs and benefits to single transactions, failures impose costs on others in any chain of transactions that has formed on either side. It is not realistic to expect that forcing an earlier point of commitment would prevent all chains from failing and so some additional costs, in the form of parties more firmly locked into chains which still fail, should be considered.

Figure 7.33: Costs and benefits of an earlier point of commitment



Benefits of an earlier point of commitment

- 7.42 To the extent that failures in chains of transactions are reduced this would have benefits including a reduction in wasted costs of failed transactions (for buyers, sellers and service providers) and less stress and wasted time for both buyers and sellers.
- 7.43 The scale of the benefits would depend on the prevalence and extent of chains and the scale of the costs that are currently wasted. Our consumer research suggests that 46 per cent of sellers believed that their most recent transaction was part of a chain and 66 per cent thought that there two or three others in their chain.²⁶⁸

²⁶⁸ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.31, page 51 and Chart 5.32, page 52).

- 7.44 The scale of the benefits to fewer failures also depend on the costs of the failures that are prevented. More than one in three (37 per cent) of sellers who had experienced a failure had incurred some costs as a result, while 58 per cent of buyers who had experienced a failed transaction had paid for surveys²⁶⁹ (we note that the costs of surveys will still be incurred earlier in the process).
- 7.45 The reasons given by consumers and estate agents for chain failures are set out earlier. It seems likely that introducing an earlier point of commitment would help prevent chain failures due to: a failure to secure finance in advance of an offer, gazumping, gazundering, and individuals simply changing their mind.
- 7.46 Our consumer research found that 14 per cent of buyers who had experienced a failure had pulled out due to an adverse survey.²⁷⁰ Research by CLG found that 20 per cent of failures were due to adverse surveys.²⁷¹ In a system where consumers make a firm commitment on making an offer, those consumers who feel the need to commission a survey are likely do so before they make that offer, so chains are less likely to form which are dependent on parties who, potentially, are yet to find out about an adverse survey.
- 7.47 An important source of costs in failed transactions is the time and effort and marketing costs incurred by estate agents. Transactions that fail to complete impose costs on all other sellers, as estate agents must spread these costs over their other clients. Over and above the direct costs of failed transactions to buyers, sellers and estate agents, there is the opportunity cost that each have to bear. This relates to the transactions

²⁶⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Table 5.48, page 68 and Chart 6.95, page 117)

²⁷⁰ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.94, page 116)

²⁷¹ Communities and Local Government HIP Baseline Research, published January 2007

that they have missed in the course of spending time, effort and money pursuing a transaction that ultimately fails.

- 7.48 Overall, it seems likely that the benefits of an earlier point of commitment leading to a quicker, more certain process, which reduced the failure of chains of transactions, would be significant.

Costs of an earlier point of commitment

- 7.49 For every individual disappointed and frustrated because an offer or a selling price changes late in the process, there is another who believes they would benefit, or does benefit, from the change. While one side of a transaction may experience stress and costs from the other side backing out, it is likely that there is a benefit to the party who did exercise his option to walk away. In addition, more likely than not, there will be a replacement transaction which may involved a better fit between buyer and seller.
- 7.50 Earlier commitment in the process will not prevent all chains from failing. There will still be failure when the causes are outside the control of the parties involved. The costs imposed in this situation would depend on how many chains still fail and how easy it would be for consumers to extract themselves from stalled transaction chains or the costs incurred while waiting for a replacement 'link' in a chain to form.

Conclusion on earlier point of commitment

- 7.51 The actual costs and benefits of a change depend on a complicated combination of factors, some of which will vary over time and between different geographic regions, for example, the prevalence of chains of transactions. The practical difficulties of bringing about such a change may be significant - success is likely to depend on the detail of any new process and the willingness of buyers and sellers in England and Wales, and their professional advisers, to accept the change. Nevertheless, while it must be acknowledged that it is not possible to quantify with certainty the costs and benefits of introducing earlier commitment, it is clear that the potential benefits might be substantial.

Seller provided surveys

- 7.52 Our study provides evidence on the proportion of transactions that fail because negative information about the property surfaces after an offer has been accepted. In our survey of buyers and sellers, 14 per cent of buyers who had experienced a transaction failure said they withdrew their offer after the survey (which may in reality have been a valuation report) showed problems with the property.²⁷² Another six per cent reported a failed transaction as a result of problems with the house, lease, or legal searches.
- 7.53 It has been put to us that a lack of survey information early in the process results in a poor matching of buyers with sellers. Potentially deal-breaking information provided upfront by the seller would ensure that offers are made in the full knowledge of any problems, with buyers able to budget for the cost of repairs. In addition, sellers would have more incentive to address problems before putting their property on the market.
- 7.54 It has also been suggested by some stakeholders that a seller-commissioned survey may help avoid multiple buyers commissioning separate surveys on the same property (and, if there is a problem, then withdrawing when the same problem is revealed). One of the reasons given for the introduction of a mandatory seller commissioned report in Scotland was that the commonly used sealed bid process increased the number of buyers commissioning survey and valuation reports. It is likely that the cost benefit calculation for seller commissioned surveys may depend on trends in the way houses are sold and on the state of the housing market.
- 7.55 Our survey found that a large majority (78 per cent) of buyers felt that a survey at the outset would be helpful or very helpful.²⁷³ However, a

²⁷² OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.94, page 116)

²⁷³ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.107, page 130)

seller provided survey would only reduce costs in the process to the extent that buyers (and indeed mortgage lenders) are happy to rely on a survey commissioned by the seller. If not, then there will still be the cost of duplicative surveys in the process. When asked if they would trust a seller's survey, 16 per cent of buyers responded that they would not, 55 per cent would to an extent, while 29 per cent responded that they would rely on it.²⁷⁴

- 7.56 There is no requirement that the HIP include a valuation or seller-commissioned survey. While sellers may elect to include a home condition report in their HIP, the very large majority choose not to. There doesn't appear to be a large incentive for the seller to provide a survey voluntarily. With buyers and lenders unwilling to rely on a seller-commissioned survey, the additional expense for the seller may not seem worthwhile. Furthermore the absence of an upfront property condition report does not signal to buyers that there may be a problem with the property, since by convention sellers do not provide one anyway. On the introduction of the Home Report the law in Scotland was changed such that surveyors providing Home Reports are liable to buyers and lenders relying on the reports, as well as to their seller clients.
- 7.57 Making the process of listing a property for sale more expensive (in that the seller must provide a survey) may have a benefit in deterring speculative listings. This would represent a benefit to the extent that such 'market testing' is wasteful of buyer and estate agent time and marketing costs. Speculative listings do not just represent a cost, however, there is benefit to the consumer who is able to 'market test' cheaply and some listings which began as speculative will turn into sales.

Conclusion on seller provided surveys

- 7.58 The case for a mandatory seller-commissioned HCR in England and Wales is not clear cut. The majority of buyers do not at present

²⁷⁴ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.108, page 131)

commission a survey in addition to the lender's valuation report. Some sellers would be commissioning surveys that would not otherwise have been done. While for some properties that may be a good thing, for others a survey that goes beyond the lender's valuation report may not have been needed. On the other hand, a large number of buyers say that they would find a survey early in the process helpful.

- 7.59 Observing the practical benefits of the Scottish Home Report should be instructive - although we note that the sealed bid system in Scotland means the cost benefit analysis may be different than for England and Wales. The Scottish Government has set out plans for an interim review²⁷⁵.

Industry initiatives

- 7.60 We welcome the Law Society's initiatives to develop completion-ready packs, and work on standardising documentation for conveyancing. These initiatives should go some way to streamline and speed up the conveyancing process.
- 7.61 A working group of industry and consumer representatives, established by CLG, has been looking at identifying options for ensuring consumers have appropriate information about a property's condition, building on the Home Condition Report to develop market-led condition information.
- 7.62 The E-Home Buying Forum was established to work in collaboration with government and industry groups to discuss problems with process, and ideas for increasing commitment and bringing about 'faster certainty' for home buyers and sellers. Faster certainty means that the time taken for the consumer and property professional to feel confident that their transaction is going to be successful is reduced. The forum has made a number of recommendations to achieve this, set out in *A Blueprint for the Future of Homebuying*.

²⁷⁵ www.scotland.gov.uk/Topics/Research/new-research-projects/social-research/Interim-Review-Home

Market innovations

7.63 We have met with one firm developing a commercial product to achieve 'first day commitment' for agreed sales. The exchange of a pre-purchased insurance-backed bond will permit buyers and sellers to signal to each other their willingness to enter into commitment at the time of offer acceptance. The purpose of this product is to bring about greater peace of mind for buyers and sellers, and to ensure that any victim to a failed transaction is compensated if the other party breaks the terms of the agreement. The firm considers that this product could eliminate gazumping and gazundering and increase the certainty of exchanging contracts.

7.64 We are aware of other firms encouraging the use of 'goodwill', 'exclusivity', or 'lock out' agreements between buyers and sellers to help avoid gazumping and gazundering, and to stop vendors and purchasers from entering into sales they have no intention of honouring. Such agreements can differ in nature, but two possible agreements are:

- vendor agrees not to sell to anyone else as long as contracts are exchanged within a set period of time. This may be in exchange for a sum of money which is taken off the purchase price if the sale goes through, and
- each side pays a deposit that will be lost if they pull out without a good reason. The deposit could be a percentage of the agreed purchase price.

7.65 We note that some of the major property portals have recently introduced clearer sign posting to properties which are labelled, for example, 'chain free' and set out the benefits of these properties to buyers. Since legislation does not prevent a shift in the conventions of the home buying and selling market, any moves which may encourage individuals to prefer elements of a more well-functioning system seem positive.

Improving coordination and communication

- 7.66 Of those consumer survey respondents not satisfied with the existing process, and excluding sellers' concerns about HIPs, 'better communication during the process' came top of the list of suggestions from both buyers and sellers for how the process could be improved.²⁷⁶
- 7.67 The estate agent is generally at the centre of the transaction, coordinating the different parties involved and encouraging progress towards completion. With chains this can be a particular challenge. Furthermore, while an estate agent may find the cause of a delay, moving the transaction forward often depends on the action of an individual or their solicitor/conveyancer.
- 7.68 The internet offers a clear opportunity to improve coordination of transactions, particularly where there is a chain, through the better sharing of information between all parties. The Land Registry provisionally considered an e-conveyancing system, a prototype of which was launched in 2007. Called Chain Matrix, it allowed buyers, sellers and the professionals involved to keep track of the progress of their chain on the internet.
- 7.69 In Scotland, a new system to enable registration of title of land and property over the internet was introduced in 2007 by the Registers of Scotland. The seller's agent, buyer's agent and lender have access to information on their transaction. We have been told that there may be opportunities to extend this upstream to the exchange of Missives.
- 7.70 The difficulty for e-conveyancing systems is that they rely on all parties to the transaction submitting information to be truly useful. To the extent that some do not, the system is of little value. We have no doubt, however, that in the longer-term much more of the conveyancing process will be conducted online.

²⁷⁶ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.53, page 73 and Chart 6.106, page 129)

Improving general information and advice to consumers

- 7.71 In the course of our study we found that consumers are often ill-informed about the process of buying or selling a home and about the roles of the professionals involved. For example:
- in some of the online diaries we noticed that the term 'survey' was used to refer to the lender's valuation. A few buyers recorded that the report did not tell them very much – hardly surprising given that they had misunderstood the nature of it
 - buyers and sellers appear similarly confused by the terms 'exchange' and 'completion', sometimes using these terms interchangeably, and
 - over half of buyers (53 per cent) in our survey thought that the estate agent was representing their interests as much as the seller's, and a further six per cent thought that the estate agent was working mostly on their behalf.²⁷⁷

7.72 We think that there a number of important messages for consumers before they embark on the process of buying or selling a home. While some may seem obvious to the professionals involved, they may not be to someone new to the process. These messages are as follows:

For both buyer and seller

- take responsibility for informing yourself about what the home buying / selling process involves
- shop around to find advice and services that meet your needs
- keep yourself informed through the process. If you wish, you can ask the agent for direct contact with the individual on the other side of the transaction, and

²⁷⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 6.74, page 96)

- know your rights – there are redress schemes, covering most of the professionals you will deal with, and you can complain if you have a problem.

For the seller

- there are alternative ways of selling a house. You may find that using an online estate agent, selling at auction, or selling privately better meets your needs
- don't be shy to negotiate on fees and service levels
- providing information about the condition of your property might be a good way to signal that your house is in good condition or that you are being honest about any problems
- consider asking potential buyers to provide evidence of finance before accepting any offer, and
- you can help speed up the conveyancing process by getting information together early.

For the buyer

- the estate agent acts for the seller, and not for you – remember this during any negotiations
- get your finances in order before making offers. You can strengthen your hand in negotiations if you can provide evidence of your ability to finance the purchase, and
- the mortgage valuation is for the lender's benefit and is not a full survey of property condition. Consider paying for your own survey.

8 HOME BUYING AND SELLING IN SCOTLAND

Summary

There are some significant differences between the home buying and selling process in Scotland and the process in England and Wales. The Scottish process generally seems to provide greater certainty but less flexibility. Scottish buyers and sellers generally seem more satisfied with their experience than their counterparts in England and Wales.

There are also a number of recent initiatives in Scotland, in particular, the introduction of the Home Report, which should further accelerate and streamline the process.

Many features of the Scottish system have evolved from the practice of selling homes through sealed bids and early involvement of solicitors in the transaction. For example, checks and mortgage arrangements are carried out before an offer is made and there is, in general, greater commitment on the part of the buyer.

Convention and strong social pressures discourage sellers from reneging on verbal acceptance of an offer.

The statutory requirement for an offer to be made in writing fosters greater commitment on the part of the buyer. It also reduces the scope for an estate agent to fail to pass on an offer from a buyer who has not bought ancillary services through that estate agent.

We do not have any specific recommendations for Scotland, although notwithstanding the many positive innovations and aspects of the process in Scotland, we consider that there is still scope to extend choice and improve the experience for Scottish consumers. Therefore, we consider that all the recommendations made elsewhere in this report apply to Scotland.

- 8.1 This chapter considers home buying and selling in Scotland, first to ask whether the market is working well for Scottish consumers, and second as a basis for comparison with England and Wales.
- 8.2 We consider whether the recommendations made earlier in this report apply to Scotland and whether we should make any additional recommendations specific to Scotland.

The Scottish housing market

- 8.3 In 2008 Scotland had 2.3 million households,²⁷⁸ representing nine per cent of the UK. Of these, 29 per cent were located in the four cities of Glasgow, Edinburgh, Aberdeen and Dundee.
- 8.4 Approximately 65 per cent of homes in Scotland were owner occupied, compared with 73 per cent in England and Wales. The level of home ownership has increased substantially since 1994, when 57 per cent were owner occupied relative to 68 per cent in England and Wales.
- 8.5 In 2008 there were 99,000 residential property transactions in Scotland²⁷⁹ with a total value of £16.8 billion. According to provisional estimates, the volume of transactions fell in 2009 to 74,000.²⁸⁰
- 8.6 The volume of transactions peaked in 2007 at 148,000 transactions with a value of £24.5 billion.²⁸¹ Transactions fell by 33 per cent from 2007 to 2008, and value fell by 31 per cent.
- 8.7 Traditionally, home sales were mediated by solicitor estate agents, who both marketed the home and handled the conveyancing. Home sales

²⁷⁸ General Register Office for Scotland

²⁷⁹ HMRC data, figure shown reflects transactions of properties priced above £40,000

²⁸⁰ Monthly Property Transactions in the United Kingdom 2006 – 2009 – see www.hmrc.gov.uk/stats/survey_of_prop/val-40000-or-above.pdf

²⁸¹ Property transaction completions priced at £40,000 or above, June 2009 - see www.hmrc.gov.uk/stats/survey_of_prop/table16-2.pdf

today are split between solicitor estate agents and non-solicitor estate agents.

Key differences between the process in Scotland and the process in England and Wales

8.8 The home buying and selling process in Scotland is often cited as superior to the process in England and Wales. There are certainly important differences between the two processes, as detailed below:

- Offers are made in writing and then the buyer's solicitor and the seller's solicitor exchange letters, known as 'missives', clarifying details and agreeing conditions.
- Once agreement has been reached (at 'conclusion' of the missives) both parties are legally bound to proceed with the transaction.
- Solicitors are generally much more involved in the process, and from an earlier stage. Many solicitors also act as estate agents.
- Much of the preparatory work, such as arranging pre-approval for a mortgage, usually takes place before the bid is submitted.
- Where there are competing buyers, offers are submitted as sealed bids by a nominated closing date.
- There is virtually no leasehold, removing a layer of potential complexity.
- With the introduction of Home Reports, a condition survey and valuation, energy report and property questionnaire must be made available by the seller before the property is put on the market.

Early involvement of solicitors

8.9 Scottish sellers can opt for a solicitor estate agent or a non-solicitor estate agent (the equivalent to an estate agent in England and Wales.) A

solicitor estate agent will in most cases both market the property and provide all necessary legal and conveyancing services.

- 8.10 Scottish buyers engage a solicitor at a very early stage. Offers must be submitted in writing,²⁸² which in practice means that offers are submitted by a solicitor.
- 8.11 The buyer's solicitor is generally much more involved in the process than in England and Wales. With an expectation of greater commitment on the part of the buyer, checks and enquiries are usually made in advance of the bid.
- 8.12 The buyer's solicitor may also help with the arrangement of a mortgage. Funding is generally secured in principle in advance of making an offer. To the extent that an offer is submitted without conditions, and is accepted without conditions imposed by the seller, there will be a legally binding contract between buyer and seller.
- 8.13 The buyer's solicitor is not legally obliged to check whether their client has a mortgage in principle. However, at the very least they will explain that the buyer can, and in all likelihood will, be sued if they enter into a binding contract but fail to complete the transaction.

Sealed bids and offers over

- 8.14 While fixed price marketing is an option, many properties in Scotland are sold through sealed bids in which offers must be submitted by a seller-nominated closing date. The seller asks for 'offers over' or 'offers around' a chosen level, which is the minimum price that the seller is willing to accept.
- 8.15 Joint agency arrangements are rare in Scotland, in part because of the popularity of sealed bids. The sealed bids system is akin to a silent auction, with a single estate agent conducting the sale proceedings.

Buying and selling a home in Scotland: the key steps

Once a buyer has found a property of potential interest, they may request and expect to receive a copy of the Home Report. If the buyer then wants to notify the seller of their interest, their solicitor will need to submit a 'note of interest' to the seller's solicitor or estate agent.

To proceed with the transaction, the buyer's solicitor must make a formal written offer for the property on behalf of the buyer. The offer to buy and the seller's acceptance must be made through their respective solicitors. This takes the form of an exchange of letters known as 'Missives.'

If a number of buyers express interest in the same property, the sale is generally conducted through a sealed bid process. The seller's agent will set a time and date (the 'closing date') for offers to be made. This allows potential buyers to arrange finance for the transaction.

Details such as the price and date of entry will be included in the offer. The offer may also include various conditions such as requiring that there be no terms in the title deed affecting the property, as well as details of items which the buyer wants to be included in the transaction.

Once these conditions and any qualifications have been agreed between the solicitors, a formal letter of acceptance is sent and the Missives are 'concluded'. At this point there is a binding contract between buyer and seller.

The buyer's solicitor then proceeds with the conveyancing, which is the legal process for investigating and transferring legal title from the seller to the buyer. The buyer's solicitor also drafts the 'disposition,' which is the legal document actually effecting the transfer. This must be agreed with the seller's solicitor. The buyer usually obtains possession of the property when 'settlement' takes place. The buyer's solicitor certifies to the lender that the title to the property is valid, obtains the loan cheque from the lender and deducts his or her fees. The buyer's solicitor receives the disposition, other title documents and keys.

Finally, the buyer's solicitor registers title with the Land Register of Scotland.

The introduction of the Home Report

- 8.16 In December 2008 a major change was introduced, with sellers legally required to commission a 'Home Report' before they put their property on the market. A Home Report includes a structural survey (similar to a Scheme II survey), a valuation, an energy report (which includes an energy performance certificate) and a detailed property questionnaire.
- 8.17 Home Reports were introduced for a number of reasons, in particular:
- to address the condition of Scotland's housing stock, by providing better information on the condition of properties to buyers and sellers in advance of making an offer. The expectation is that this will act as an incentive for sellers to make repairs in advance of putting their home on the market, and for buyers to budget for repairs when making an offer
 - to provide more information upfront to buyers before they enter what is likely to be their largest financial commitment
 - to eliminate the potential for multiple surveys on the same property made by competing buyers under the sealed bids system, or by successive buyers should a transaction fail, and
 - to discourage artificially low asking prices in the 'offers over' approach, which could be unfair and misleading to buyers. With the introduction of the Home Report, the level set by the seller is often the valuation given in the Home Report.

The Home Report has three parts:

- a single survey and valuation
- a property questionnaire
- an energy report (including an energy performance certificate – EPC).

The single survey and valuation

The single survey report tells potential buyers about the type, accommodation, neighbourhood, age and construction of the property. A condition category will be given for each of 24 separate elements of the property surveyed, for example, the windows, external doors and roofing.

Category 1- no immediate action or repair is needed.

Category 2- repairs or replacement requiring future attention, but potential purchasers are advised to get estimates.

Category 3- urgent repairs or replacements are needed now. Failure to deal with them may cause problems to other parts of the property or cause a safety hazard. Estimates for repairs or replacements are needed now.

The property questionnaire

The property questionnaire contains information for purchasers much of which will also be useful for solicitors and surveyors. It includes: how long the seller has owned it; the council tax band; parking arrangements; issues that have affected the property such as a fire or storm; boundaries; any notices that affect the property.

The energy report

As in the rest of the UK, this provides an energy efficiency rating for the property and includes an Energy Performance Certificate.

- 8.18 The Home Report is expected to reduce the likelihood of material problems with the property emerging after the bid has been made, which can result in renegotiation and delay, or the sale falling through entirely.
- 8.19 In addition, the Home Report can help potential buyers decide whether to make an offer for a property, and if so how much to offer. Sellers must²⁸³ provide potential buyers with a copy of a Home Report within nine calendar days of request.
- 8.20 New legislation in Scotland means that while the seller is responsible for commissioning the survey in the Home Report, both buyer and seller can sue the surveyor for negligence. This allows multiple potential buyers to rely on the same seller's survey, avoiding unnecessary duplication of surveys and the associated costs.
- 8.21 The seller usually pays the cost of the Home Report upfront. The following table shows typical costs:²⁸⁴

Table 8.34: Typical Home Report Costs

| Property Value | Cost |
|-------------------------|------|
| up to £100k | £380 |
| between £100k and £200k | £500 |
| between £200k and £300k | £620 |
| between £300k and £400k | £750 |
| between £400k and £500k | £870 |
| between £500k and £600k | £990 |

Source: Warners Solicitors and Estate Agents

²⁸⁴ Warners Solicitors and Estate Agents

Transactions in Scotland

- 8.22 There is a common perception that transactions in Scotland fail less frequently, and are concluded more quickly, than in England and Wales. Our surveys provide some indication that this perception may be correct, but that the contrast is not as dramatic as expected. This may be because our surveys were conducted at a time of extreme market uncertainty, with falling sales volumes and prices. Transaction failure was, anecdotally, at a record high and the Home Report had not yet bedded in.
- 8.23 Furthermore, the results from our quantitative research need to be treated with caution, since only 52 sellers and 38 buyers responded to our survey in Scotland. The break down of responses to many of the more detailed questions lack statistical significance and we do not rely on those in this report.
- 8.24 All sellers in our quantitative survey were asked whether they had experienced a sale falling through after they had accepted an offer on their home. Nineteen per cent of Scottish sellers had experienced this,²⁸⁵ a somewhat smaller proportion than the 25 per cent of sellers in England and Wales.²⁸⁶ However, due to the small sample of consumers in Scotland, this difference is not statistically significant.
- 8.25 The average period between accepting a bid and concluding missives was around seven weeks in Scotland,²⁸⁷ relative to an average period of nine weeks between offer acceptance and exchange of contracts in England and Wales.²⁸⁸

²⁸⁵ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 7.138, page 161)

²⁸⁶ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.46, page 66)

²⁸⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 7.129, page 152)

²⁸⁸ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.33, page 53)

8.26 Around one-fifth (21 per cent) of sellers in Scotland said that they were in a chain.²⁸⁹ While the sample is small, this is significantly fewer than in England and Wales, where almost half (46 per cent) of sellers said they were in a chain.²⁹⁰

Choice and competition

8.27 This section considers the state of competition in the provision of estate agency services in Scotland. We provide some background on the structure of the market, and revisit the findings of the last competition investigation²⁹¹ in this area.

8.28 We then consider the significance of portals in Scotland, and discuss fees in Scotland. Finally, we consider the potential impact in Scotland of modernizing the Estate Agency Act 1979.

The structure of the market

8.29 One of the key differences between the market in Scotland and the rest of the UK is that there are two types of estate agent: Solicitor estate agents and non-solicitor estate agents. While we do not have a break down of market shares, we understand from industry sources that the market for estate agency services is today roughly evenly split between solicitor estate agents and non-solicitor estate agents although historically, solicitor estate agents had a much greater share of the market.

8.30 Solicitor estate agents co-operate by marketing properties for sale from jointly-owned Solicitors' Property Centres (SPCs). There are 12 SPCs in

²⁸⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 7.128, page 151)

²⁹⁰ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.31, page 51)

²⁹¹ 'Solicitors' Estate Agency Services in Scotland: A Report on the Supply of Residential Estate Agency Services in Scotland' published 1997 by the Monopolies and Mergers Commission.

Scotland providing multiple listing services, located in the major urban areas.

- 8.31 The continued resilience of solicitor estate agents has been to a large extent a consequence of the success of SPCs. By combining the homes offered for sale by individual solicitor practices, SPCs in general advertise far large numbers of homes than non solicitor estate agent competitors.

The investigation of the Monopolies and Mergers Commission

- 8.32 The structure of the market for estate agency services has in the past raised questions as to whether the market was sufficiently competitive. In 1997 the Monopolies and Mergers Commission ((MMC), which has since been replaced by the Competition Commission) conducted research into the supply of agency services for home buying and selling in Scotland.
- 8.33 This study was initiated following a reference from the OFT which suggested that solicitors in Scotland may have had a monopoly on the market for estate agency services in certain areas of the country.
- 8.34 The Commission found that:
- despite the more prominent role of solicitors in Scotland, non-solicitor estate agents still accounted for a considerable proportion of estate agency services. Indeed, solicitor estate agents and non-solicitor estate agents had almost equal shares of the overall Scottish market for residential estate agency services
 - patterns of competition varied considerably between regions. For example, non-solicitor estate agents were more dominant than solicitor estate agents in Glasgow and west central Scotland, whilst the opposite was true in Edinburgh, Aberdeen and Tayside.
- 8.35 Given these findings, the Commission concluded that consumers buying or selling a home in Scotland were not suffering detriment in relation to a lack of competition or choice in the provision of agency services, or from

there being barriers to entry in the market for new models of service provision.

- 8.36 The MMC also considered the rule whereby non-solicitor Estate Agents are not permitted to advertise properties through the SPCs. However, the MMC concluded
- that there were no physical or economic barriers which would prevent non solicitor estate agents from establishing facilities similar to SPCs
 - existing local and national newspapers provided non solicitor estate agents with a cost-effective alternative to the SPCs.
- 8.37 During the course of our market study, we briefly revisited this issue and were told that the barriers to joining an SPC are not as considerable as they might seem. For example, membership criteria may include an annual subscription fee; having a solicitor as one of the partners of the firm; and having indemnity insurance.
- 8.38 Although this would still preclude many small non-solicitor estate agents, it was pointed out to us that some of the large non-solicitor estate agents may meet the criteria for membership of some SPCs. However, they may prefer to advertise in newspapers to promote their estate agency businesses and to advertise the more valuable properties on their books. Property details provided by SPCs tend to be brief in comparison.

The significance of portals in Scotland

- 8.39 The SPCs all have websites very much like property portals, in that they enable potential buyers to view all the properties marketed by all the local solicitor estate agents in a particular region. In addition, property portals such as Rightmove and Globrix have grown to provide a substantial share of leads, and are used by both solicitor and non solicitor estate agents.
- 8.40 The increasing importance of property portals other than the SPC websites suggests that any exclusion of non-solicitor estate agents from

SPC websites has now become even less cause for concern. Buyers are able to find the majority of properties on sale in any local area on sites other than SPC websites.

Fees

- 8.41 Our consumer survey evidence indicates that the fees of non-solicitor estate agents and solicitor estate agents are broadly equivalent, with both charging an average fee of 1.1 per cent in the first half of 2009. Responses from our survey of estate agents also indicate an average fee in the region of 1.1 per cent²⁹² of the purchase price of the property.
- 8.42 This compares with the average fee of 1.6 per cent that we found in England and Wales.²⁹³ Moreover, house prices are generally lower in Scotland than in England so this further reduces the average Scottish estate agency commission compared to England and Wales.
- 8.43 However, the commission fee in Scotland is not directly comparable with the fee in England and Wales because marketing and advertising costs are typically charged separately. These together could easily represent 0.5 per cent or more of the purchase price, but are charged upfront or as incurred. We have been given the following break down as an example of upfront marketing costs charged to a typical seller by a solicitor estate agent:²⁹⁴

For Sale board - £30 inclusive of VAT

brochures - £181 inclusive of VAT

SPC insertion fee £300 inclusive of VAT

²⁹² OFT Survey of Estate Agents, 2009 (Chart 3.8, page 19)

²⁹³ The percentages shown represent the first six months of 2009.

²⁹⁴ Warners Solicitors and Estate Agents

any newspaper advertising – at cost depending upon advert size, and

If applicable, a viewing float to cover the estate agent's viewing costs (sellers in Scotland typically carry out their own viewings).

Modernising legislation

- 8.44 As discussed in Chapter 4, we take the view that the legal obligations set out in the Estate Agents Act 1979, (EAA), should fall to service providers only to the extent that they engage in the risky activities that those obligations were intended to address. We consider that it is not appropriate that such obligations apply to business models which do no more than act as passive intermediaries. On the contrary, the application of the legislation to these models may be impeding innovation in this sector.
- 8.45 Accordingly, we recommend in Chapter 4 that BIS consult on modernising and simplifying the EAA to ensure that it is targeted appropriately at businesses which undertake the activities which present risks to consumers which the original legislation was intended to mitigate. These changes to the EAA would have effect in Scotland as in the rest of the United Kingdom.

Overall conclusions on competition and choice

- 8.46 Our research did not present us with any serious concerns about competition and choice for consumers as regards traditional estate agency services in Scotland.
- 8.47 Anecdotally, we understand that non-solicitor estate agents are gaining market share. The growth of portals such as Rightmove and Globrix provide an alternative to the SPC websites and coverage for properties which are not marketed by solicitor estate agents.
- 8.48 As with the property portals, SPCs provide considerable efficiency gains for both buyers and sellers. Buyers find it helpful to have one prime location where they can find details of local properties for sale. Sellers

use SPCs because they represent an efficient way of reaching large numbers of buyers.

Consumer protection and enforcement

8.49 This section considers the consumer experience of estate agency and associated legal services in Scotland and the regulation of estate agency in Scotland to the extent that it differs from England and Wales.

Consumer satisfaction with estate agency services

8.50 According to our quantitative consumer survey, overall satisfaction amongst those who had used an estate agent to sell their home was high, with 92 per cent of sellers saying that they were satisfied with the agent who sold their home and 68 per cent 'very satisfied'.²⁹⁵

8.51 This result is marginally higher than the finding in England and Wales where 88 per cent of sellers were satisfied with the agent that sold their home.²⁹⁶ However, the difference in satisfaction levels between England and Wales and Scotland is not statistically significant.

8.52 The majority (59 per cent) of Scottish buyers who had bought a home through an estate agent were satisfied with their estate agent dealings, of whom 42 per cent were very satisfied. On the other hand, 11 per cent of respondents said that they were dissatisfied with the estate agent.

8.53 Buyers in Scotland were most likely (56 per cent) to feel that the estate agent was working mostly on the seller's behalf, with 22 per cent feeling there had been an equal representation of both the seller's and their own interests.²⁹⁷

²⁹⁵ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 7.133, page 156)

²⁹⁶ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.41, page 61)

²⁹⁷ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 8.144, page 169)

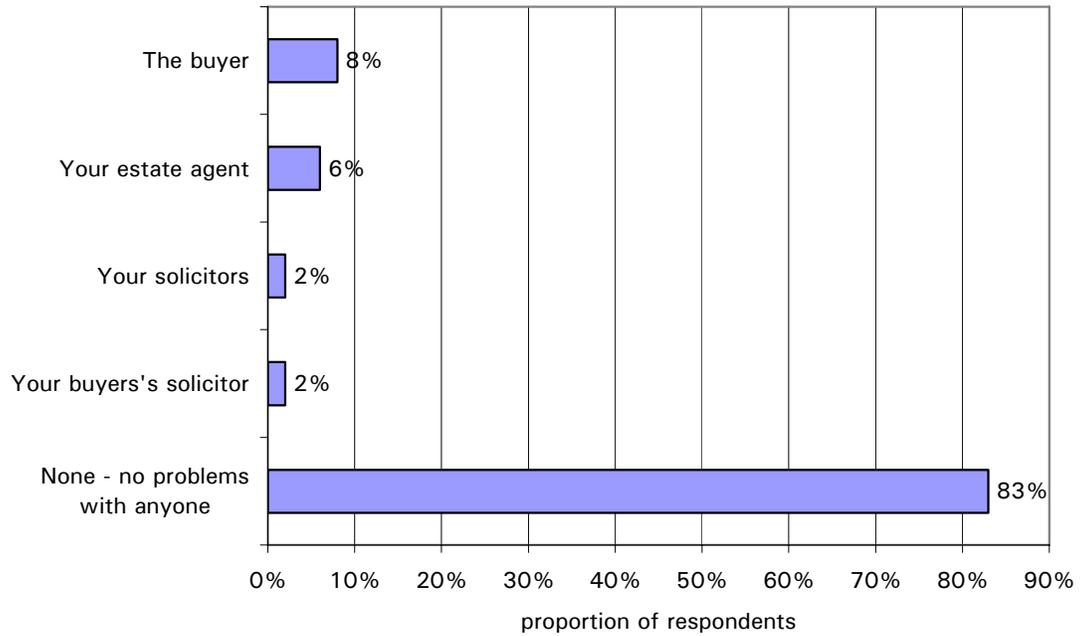
- 8.54 Our survey also sought information about consumers' satisfaction with a number of aspects of the service which sellers received from their estate agent. Satisfaction was very high in relation to 'accessibility/ability to contact' (94 per cent), 'quality of advertising' (92 per cent), 'support/advice during negotiations (92 per cent) and 'advice on the likely selling price' (90 per cent).²⁹⁸
- 8.55 As in England and Wales, we found that dissatisfaction amongst sellers was highest in connection with the following aspects of an estate agent's service: keeping the parties informed of progress, chasing progress after acceptance of written offer; and working in their client's best interests.
- 8.56 For buyers it was: advice on what offers to make; and accuracy/ completeness of information (as in England and Wales) and also ability to contact.

Complaints

- 8.57 Most people said that they had not had any problems with anyone. Estate agents were blamed less often than other individuals, and slightly more than solicitors, for serious problems encountered when selling a home.

²⁹⁸ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 7.132, page 155)

Chart 8.35: Whether had any serious problems / who problems were with



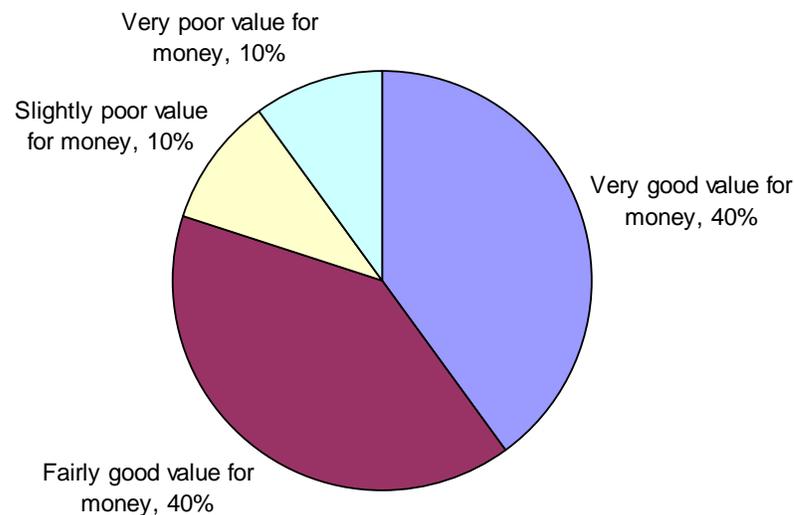
Base: all who sold a home in Scotland (52)

Source: OFT Consumer Survey, GfK 2009

Value for money of estate agency services

8.58 In our survey, 20 per cent of sellers felt that their estate agent had represented poor value for money.

Chart 8.36: Whether fees paid to estate agent represented value for money (Scotland)



Base: all who used a traditional estate agent in Scotland (50)

Source: OFT Consumer Survey, GfK 2009

8.59 The 10 sellers in our survey who felt that the fees that they had paid their estate agent had represented poor value for money were asked why they felt that the estate agent fees had represented poor value for money. Due to the small base size on this question, the responses below are qualitative rather than representative of Scottish sellers in general:

- 'they gave poor service' (four respondents)
- 'they did not earn it' (three respondents)
- 'poor communication/no feedback' (three respondents)
- 'they made little effort to advertise' (two respondents)
- 'I had to do most of the work myself' (two respondents).

8.60 We were unable to assess the proportion of serious problems directly attributable to poor service on the part of the solicitor estate agent or non-solicitor estate agent. Our research found that they were not

necessarily seen as a major cause of serious problems in the process. Moreover, as in England and Wales, it is also possible that some of the blame that attaches to solicitor and non-solicitor estate agents is misplaced due to a lack of understanding by consumers of their role.

Enforcement

- 8.61 As in the rest of the United Kingdom, Trading Standards Services in Scotland are responsible for the enforcement of the PMA and are also jointly responsible with the OFT for the enforcement of the EAA, the Consumer Protection from Unfair Trading Regulations 2008; and the Unfair Terms in Consumer Contracts Regulations 1999.
- 8.62 In addition, Trading Standards Services in Scotland are involved in ensuring compliance with Home Report requirements in the Housing (Scotland) Act 2006.
- 8.63 The average proportion of estate agents found to be non compliant was nine per cent in Scotland compared to 25 per cent in England and 23 per cent in Wales. The Trading Standards Services who responded to our survey in Scotland considered that compliance levels were generally high because most estate agents were also solicitors. As a result, only one respondent cited the need for regulatory change.

The regulatory framework governing estate agency

- 8.64 The key regulation which governs the regulation of estate agents in the United Kingdom is the EAA. However, the EAA does not apply to the activities of a practising solicitor or his employees.
- 8.65 This excludes solicitors operating as solicitor estate agents from the provisions of the EAA unless they are providing estate agency services through a business which is not owned by a solicitor. Solicitors are, however, bound by professional obligations.
- 8.66 Unlike the Law Society of England and Wales, the Law Society of Scotland does not have detailed rules which are specific to estate agency work and which mirror the provisions of the EAA. Nevertheless,

the Law Society of Scotland has told us that they consider that the Solicitors (Scotland) (Standards of Conduct) Practice Rules 2008 (which came into operation on 1 January 2009) provide at least the same stringent consumer protection as the provisions of the EAA.

Complaints and the role of redress

- 8.67 A new independent body, the Scottish Legal Complaints Commission was set up in October 2008 to deal with complaints from consumers about services provided by solicitors. All solicitors must make it clear on their terms of business that their clients can complain to the Scottish Legal Complaints Commission.
- 8.68 Consumers who use non-solicitor estate agents rather than solicitor estate agents are protected by the Consumers Estate Agents and Redress (CEAR) Act 2007. As detailed in Chapter 5, this provides that all non-solicitor estate agents must belong to an independent, approved ombudsman redress schemes.
- 8.69 We note that some stakeholders such as the Law Society of Scotland told us that consumers enjoy different levels of protection depending on which professional group they use to provide estate agency services. However, we remain unconvinced that this, in itself, causes any significant consumer detriment.

Overall conclusions on consumer protection and enforcement

- 8.70 According to our consumer surveys, consumer satisfaction with estate agency services in Scotland is relatively high and estate agents are blamed less often than other individuals (except solicitors) for any serious problems encountered. These results are similar to the results for England and Wales.
- 8.71 A significant number of Scottish buyers still think that the estate agent acts on their behalf. We would encourage estate agents to make it clear to the buyer that they are not acting for them.

Ancillary services

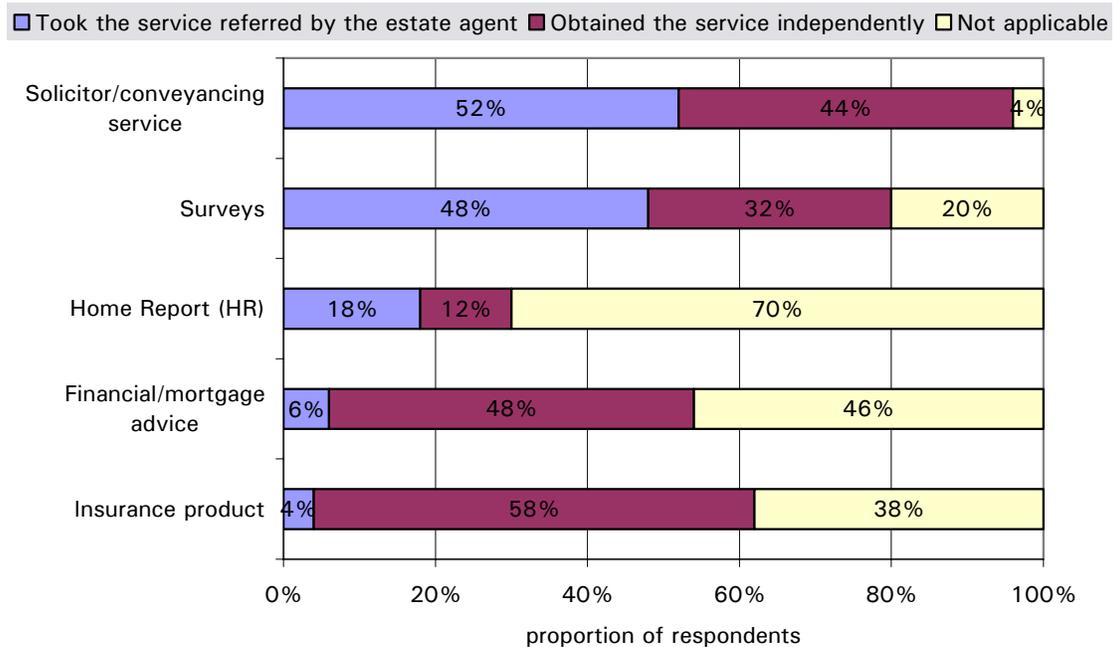
- 8.72 This section focuses on the relationship between Scottish estate agents and providers of other professional services involved in the transaction (which we refer to as ancillary services).
- 8.73 As in Chapter 6, we consider: the extent to which consumers in Scotland use ancillary service providers; the benefits and drawbacks of them; and the available choice and competition between ancillary service providers.

Purchasing ancillary services

- 8.74 As part of our quantitative survey, sellers who had used an estate agent were asked whether they had obtained ancillary services through providers recommended to them by their estate agent or had obtained them independently.
- 8.75 Our survey results need to be qualified because:
- the sample base is limited
 - many transactions are mediated by solicitor estate agents and therefore, the legal and conveyancing services will be provided by the solicitor estate agent so there will be no recommendation to a third party for these services, and
 - sellers rather than buyers will have been responsible for commissioning the survey for homes placed on the market after December 2008 since this is a component of the mandatory Home Report. However, some of the transactions will not have required a Home Report since the homes may have been marketed continuously since before December 2008.
- 8.76 As the chart below shows, sellers were most likely to obtain the service recommended by their estate agent for their solicitor or conveyancing services (52 per cent). With insurance products and financial or

mortgage advice, sellers were more likely to have obtained the service independently (58 per cent and 48 per cent respectively).

Chart 8.37: Whether obtained additional third party products or services independently



Base: All who used a traditional estate agent in Scotland (50)

Source: OFT Consumer Survey, GfK 2009

8.77 These responses are in line with those given in England and Wales, where sellers were most likely to have used the solicitor and conveyancing service referred by the estate agent (56 per cent), but most likely to have obtained financial and mortgage advice and/or insurance independently (72 per cent and independently 74 per cent respectively).²⁹⁹

8.78 We also asked buyers about their use of ancillary services recommended to them by the seller's estate agent. In each case, the majority of buyers

²⁹⁹ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 5.21, page 41)

reported that they had obtained the service independently rather than using the service provider recommended to them by the estate agent.³⁰⁰

Consumer protections

- 8.79 The legal and self regulatory protections for consumers, both buyers and sellers, who purchase ancillary services through estate agent referrals are outlined in Chapter 6 of this report.
- 8.80 The same protections apply to Scottish consumers. However, Scottish solicitors, including those acting as solicitor estate agents are covered by the Sharing Fees - Solicitors (Scotland) Practice Rules 1991.³⁰¹ These broadly provide equivalent safeguards and disclosure requirements to those contained in Rule 9 of the Solicitors Regulation Authority Code of Conduct which applies to solicitors in England and Wales.

Competition and choice

- 8.81 This section considers the extent to which Scottish consumers seem to be shopping around for ancillary services and the potential benefits and drawbacks of using preferred suppliers.
- 8.82 We highlight particular features of the home buying and selling process in Scotland which reduce the scope for consumer harm. We also refer to some of the concerns which have been raised with us about the use of panels.

Evidence of shopping around

- 8.83 While our sample for Scotland was small, the evidence suggests that Scottish consumers do shop around for ancillary services. With the

³⁰⁰ OFT Quantitative Consumer Survey Report, GfK 2009 (Table 8.142, page 167)

³⁰¹ Sharing Fees - Solicitors (Scotland) Practice Rules 1991. And Relative Guideline – see www.lawscot.org.uk/Members_Information/rules_and_guidance/guides/Rules/SharingFees/sharefees.aspx

exception of conveyancing and legal services, over half of our respondents bought ancillary services and products independently.

- 8.84 We asked the minority of buyers who had taken the service recommended to them by the estate agent whether they had investigated other service providers before deciding to use the recommended service provider. Most of these buyers had not investigated other service providers before deciding to use the estate agent's recommended providers.³⁰²
- 8.85 Those who had not investigated other service providers before deciding to take the provider recommended by the estate agent were asked why they had not carried out such investigations. The most frequent response was that it was easier or more convenient to follow the recommendation. A smaller number of respondents said that they did not know where to look for the service providers.³⁰³

Potential benefits

- 8.86 In chapter 6, we outlined some of the potential benefits to consumers of purchasing ancillary services through their estate agent. These potential benefits are applicable in Scotland as in the rest of the United Kingdom.

Potential drawbacks

- 8.87 Many of the potential drawbacks are applicable in Scotland as in the rest of the United Kingdom. However, we note some specific Scottish practices which may mitigate, or even eliminate, some of the potential problems experienced in England and Wales concerning distorted incentives, conflicts of interest and pressure selling which we set out in chapter 6. In particular:

³⁰² OFT Quantitative Consumer Survey Report, GfK 2009 (Table 8.143, page 168)

³⁰³ OFT Quantitative Consumer Survey Report, GfK 2009 (Paragraph 8.12, page 168)

- all offers in Scotland must be submitted in writing. This reduces the scope for an estate agent to fail to pass on an offer (which would be in breach of both professional ethics and the law) from a buyer who had not bought ancillary services through that estate agent
- where the sealed bid system is used, the seller will have an opportunity to assess all the offers at the same time. This reduces any opportunity for an estate agent to act against the client's best interests and steer the seller away from accepting the most favourable offer available.

Lender panels

- 8.88 Although the Home Report means that it is now the seller rather than the buyer who must commission a survey in Scotland, the survey and valuation are usually arranged by intermediaries such as the Solicitor estate agent or non-solicitor estate agent rather than independently by the seller. These intermediaries tend to recommend the same firm of surveyors to all their clients.
- 8.89 Furthermore, mortgage lenders use a panel system of approved surveyors and require the valuation (and sometimes, the survey as well) to be written by a surveyor who is on their panel. This was the situation before the introduction of Home Reports, and continues to be the case.
- 8.90 Given the relatively recent introduction of the Home Report, it is not possible for us yet to form any views as to the extent to which the Home Report has had any positive impact on competition between surveyors.
- 8.91 Whether the use of panels unduly restricts choice and causes significant consumer harm will largely depend on the make-up of the panel and the additional costs levied where services are obtained off-panel.
- 8.92 At this stage, we have not seen sufficient evidence of consumer harm to warrant recommending any action to address the concerns raised. However, in principle there appears to be greater cause for concern in terms of competition and choice in ancillary markets where customers

are required to use an approved supplier than where they are simply referred.

- 8.93 We believe the issue of panels of approved suppliers goes beyond the home buying and selling process into a wider range of inter-professional referrals, and this may be something the OFT chooses to revisit in future.

Overall conclusions on ancillary services

- 8.94 On balance, we are satisfied that the majority of consumers in Scotland are aware, as are their counterparts in England and Wales, that they can purchase ancillary services directly and not through their estate agent. The fact that many consumers choose to purchase these services through their estate agent is not, of itself, a cause for concern.
- 8.95 Although greater price awareness and shopping around for consumers should be encouraged, we do not see any need for regulatory intervention to address the issue of consumers getting value for money.
- 8.96 We consider that there is a clear 'in principle' problem with estate agents earning income from ancillary services sold to buyers. However, as in England and Wales, we do not at this stage have sufficient evidence to say which of the possible remedies would be proportionate.
- 8.97 The requirement for offers to be made in writing and the sealed bid system reduces the scope for conflicts of interest for estate agents in Scotland.

Improving the Process

- 8.98 In this section we discuss the home buying and selling process in Scotland. We look at the experience that Scottish consumers have of the existing process, why there seem to be fewer problems with the process in Scotland than in England and Wales and we highlight some initiatives and innovations in Scotland.

Buyers' and Sellers' experiences

8.99 Our qualitative research reveals that although a few Scottish buyers had some concerns over the Scottish sealed bid process, most of the participants in our focus groups and interviews maintained that the Scottish system was more effective than that used in other parts of the UK.³⁰⁴

8.100 The Scottish buyers and sellers whom we interviewed for our qualitative research expressed more confidence than buyers and sellers in England and Wales that their system was on the whole fair, transparent and timely.

8.101 This viewpoint arose from a greater certainty that an agreed sale would go through because of greater buyer commitment and the fact that legal penalties would be imposed on defaulters after conclusion of missives. One consumer commented

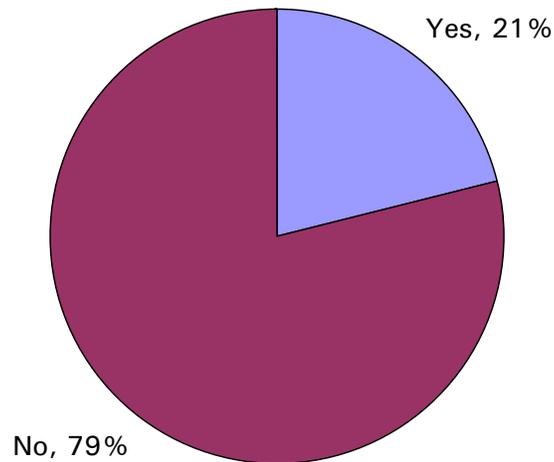
'If the buyer backs out and you then can't sell the house for the same amount, you know you can sue that person for the difference'

8.102 We asked a number of questions in our quantitative survey relating to: delays; how well informed the sellers felt about the progress of the sale; chains; and transaction failure. Although there is scope for improvement, in all areas the results for Scotland were better than the results for England and Wales.

8.103 We asked Scottish sellers whether their transaction was delayed and the majority (79 per cent) felt that it had not been delayed, while one in five (21 per cent) felt there had been a delay.

³⁰⁴ OFT Qualitative Consumer Survey Report, GfK 2009 (page 3)

Chart 8.38: Whether transaction was delayed



Base: All who sold a home in Scotland (52)

Source: OFT Consumer Survey, GfK 2009

8.104 The 11 Scottish sellers who felt that the transaction was delayed were asked about whom or what was to blame. Although we cannot analyse data with such a small base, the responses seem to suggest that sellers blame buyers rather than estate agents. Five of the sellers blamed the buyers themselves and four blamed the buyers' solicitors.

8.105 During the period between accepting the buyer's offer and concluding Missives, 87 per cent of sellers in Scotland said they felt well informed about the progress of the sale. In fact, around three quarters (73 per cent) said they were 'very well informed' about the progress of the sale.³⁰⁵

³⁰⁵ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 7.130, page 153)

8.106 Just over half (51 per cent) of respondents to our quantitative survey in Scotland said that nothing needed to be done to make improvements and that they were happy with the system of selling or buying a home. The most frequently mentioned improvement was better communication (nine per cent).³⁰⁶

8.107 We also described earlier how our quantitative survey results indicate that transaction failure in Scotland was higher than it had been historically because of the market conditions prevailing at the time of the survey. All sellers in our quantitative survey were asked whether they had experienced a sale falling through after they had accepted an offer on their home. In England and Wales, 25 per cent of sellers had experienced this compared to 19 per cent in Scotland. However, due to the small sample size achieved in our consumer survey in Scotland, this difference is not statistically significant.

Why there seem to be fewer problems with the process in Scotland

8.108 Two aspects of the Scottish system of home buying and selling are particularly significant as they mean that the process is often faster and more predictable than in England and Wales.

Gazumping and gazundering

8.109 In Scotland, buyers and sellers do not exercise their option to change their minds as frequently as they do in England and Wales. Gazumping (where a seller accepts a higher offer from another buyer), gazundering (where a buyer lowers the price offered at the last minute) and 'gazovering' (where a seller raises the price they are willing to accept at the last minute) tend to occur far less frequently. There are a number of reasons for this:

³⁰⁶ OFT Quantitative Consumer Survey Report, GfK 2009 (Chart 9.149, page 175)

- Firstly, Missives are generally concluded more quickly than the exchange of formal contracts elsewhere in England and Wales. The process of exchanging formal contracts is often lengthy. This, in itself, increases the scope for another buyer to 'gazump' the sale by making a higher offer for the property or for the buyer to gazunder by pressurising the seller to accept a lower offer.
- As in the rest of the United Kingdom, there is nothing legally to stop a seller accepting another bid until Missives are concluded which is the equivalent to the exchange of contracts in England and Wales. However, instead there seem to be strong social pressures not to renege on deals without good cause.
- Moreover, amongst solicitor estate agents gazumping, gazundering, and gazovering (to the extent that it occurs) are very much discouraged. In January 2005, the Law Society for Scotland published a guideline which states that a solicitor estate agent acting for a seller should not continue to provide the associated legal and conveyancing services if the seller decides to accept a gazumping or gazundering offer:

'Where a solicitor for a seller has intimated verbally or in writing to the solicitors for a prospective purchaser that their client's offer is acceptable – whether after a closing date or otherwise – the seller's solicitor should not accept subsequent instructions from the seller to accept an offer from another party unless and until negotiations with the original offeror have fallen through. The solicitor should advise the seller to instruct another solicitor if he wishes to accept the later offer'.³⁰⁷

³⁰⁷ Gazumping, Gazundering and Closing Dates –see www.lawscot.org.uk/Members_Information/rules_and_guidance/guides/Rules/ClosingDates/close_date.aspx

- 8.110 We have been told that non-solicitor estate agents also follow this practice of withdrawing from providing further services if the seller accepts a gazumping or gazundering offer.
- 8.111 While there are clear advantages to greater commitment, the loss of flexibility has its downsides. For example, a seller accepting a gazumping offer from another buyer gains by so doing. Furthermore, the buyer making that higher offer may value the property more than the original buyer, for a better matching between sellers and buyers.

Chains

- 8.112 Problems arising because of chains may also occur less frequently in Scotland. This seems to be because of a number of different factors.
- 8.113 Firstly, the period between submitting a bid and conclusion of Missives is generally shorter than the period between making an offer and exchanging contracts in England and Wales. We have been told that many non solicitor estate agents and solicitor estate agents will advise their clients to put their property back on the market if Missives have not been concluded within two to four weeks of acceptance of the bid.
- 8.114 As noted earlier, solicitors are more involved and from an earlier stage, such that more preparatory work is carried out before a bid has been accepted. This means that mortgage arrangements are at least set in motion before the buyer has submitted an offer.
- 8.115 Scottish stakeholders have told us that sellers may be more willing to complete the sale of their home before they have found a new home to buy. First, it may be more common for sellers to move into rental accommodation before completing on their purchase of a new home, with greater availability of rental accommodation in Scotland for this purpose. Second, bridging finance seems more commonly used to span the interval between completion of the sale and completion of the purchase.

Recent initiatives in Scotland

8.116 The major initiative in Scotland has been the introduction of Home Reports, as described above. We cover here the expected impact of Home Reports on process. In addition, we note the introduction of standard missives, and initiatives to improve transparency.

Standard Missives

8.117 The introduction of Standard Missives has gradually reduced the time taken to conclude Missives and enter a binding contract. On 1 October 2009, the combined Missive for Edinburgh and Glasgow was formally launched. Standard Missives cover a large part of Scotland and reflect geographical and other localised traditions.

Increased transparency

8.118 During the course of our market study, we were told by solicitor estate agents and non-solicitor estate agents about initiatives to give their clients access to their electronic records so that they could follow on line the progress of their transaction.

8.119 We welcome market led initiatives to improve transparency and introduce new ways in which consumers can inform themselves of the progress of their transactions.

The Home Report

8.120 The Home Report is expected to reduce the likelihood of material problems emerging after the bid has been made, which can result in renegotiation and delay, or the sale falling through entirely.

8.121 The structural survey, energy report and property questionnaire (which are mandatory components of the Home Report) should mean that there are less likely to be problems in connection with the property coming to light after a bid has been accepted. This, in turn, should reduce delays and the potential for chains to arise.

- 8.122 In addition, the Home Report can help potential buyers decide whether to make an offer for a property, and if so how much to offer. This is particularly significant as some buyers interviewed for our qualitative research indicated that they would have appreciated more guidance on what price to offer as they felt that the sealed bid process was frustrating as they felt that may be bidding blind.
- 8.123 One first time buyer, for example, complained that the first offers he made on properties were rejected because they were far below the seller's 'offers over' asking price. However, now that all properties must be marketed with a valuation from a surveyor as part of the Home Report, it seems that this concern has been significantly reduced.
- 8.124 It is too early for us to comment on how successful Home Reports have been in improving the home buying and selling process in Scotland. However, we have anecdotal evidence that to the extent that offers are being made 'subject to survey', this is only so that the buyer can quickly check that his or her lender is satisfied to rely on the valuation in the Home Report. We do not know how common it is for lenders to insist upon a separate valuation.

Improving the process: conclusions and recommendations

- 8.125 Our research indicates that both buyers and sellers in Scotland generally have a positive experience of the home buying and selling process. This is partly due to the conventions which have arisen from the importance of solicitors in the home buying and selling process and the sealed bid system.
- 8.126 The fact that more information is provided at an earlier stage also means that there is less risk of unforeseen problems arising after an offer has been made but before Missives have been concluded.
- 8.127 Home Reports should further accelerate the exchange and conclusion of Missives and also reduce if not eliminate the problem of multiple surveys by several potential buyers on the same property, or by a serially unsuccessful buyer on successive properties.

8.128 We recommend that BIS consider whether any lessons can be learned for the rest of the United Kingdom from the Scottish Government's interim review of the Home Report, due later this year, which will look at whether any amendments are required to smooth the implementation of the Home Report.

Overall conclusions and recommendations

8.129 There are some significant differences between the home buying and selling process in Scotland and the process in England and Wales. The Scottish process generally seems to provide greater certainty but less flexibility. Scottish buyers and sellers generally seem more satisfied with their experience than their counterparts in England and Wales.

8.130 There are also a number of recent initiatives in Scotland, in particular, the introduction of the Home Report, which should further accelerate and streamline the process.

8.131 Many features of the Scottish system have evolved from the practice of selling homes through sealed bids and early involvement of solicitors in the transaction. For example, checks and mortgage arrangements are carried out before an offer is made and there is, in general, greater commitment on the part of the buyer.

8.132 Convention and strong social pressures discourage sellers from reneging on verbal acceptance of an offer.

8.133 The statutory requirement for an offer to be made in writing fosters greater commitment on the part of the buyer. It also reduces the scope for an estate agent to fail to pass on an offer from a buyer who has not bought ancillary services through that estate agent.

8.134 We note that some stakeholders such as the Law Society of Scotland have told us that consumers enjoy different levels of protection depending on whether they use a solicitor estate agent or a non-solicitor estate agent. However, we remain unconvinced that this, in itself, causes any significant consumer detriment.

8.135 We do not have any specific recommendations for Scotland, although we have highlighted some considerations which we encourage the Scottish Government to take into account in its forthcoming evaluation of the Home Report.

8.136 Notwithstanding the many positive innovations and aspects of the process in Scotland, we consider that there is still scope to extend choice and improve the experience for Scottish consumers. Therefore, we consider that all the recommendations made elsewhere in this report apply to Scotland.

A SUMMARY OF APPLICABLE LAWS

Table 1: Sector Specific Laws

| Law | What does it provide for? |
|--------------------------------------|---|
| <p>Estate Agents Act 1979</p> | <p>The intention behind the Estate Agents Act 1979 (EAA) and its associated regulations is to ensure that both sellers and buyers are treated honestly and fairly by estate agents. It covers activities such as how offers should be handled, the information agents must provide to clients and the way in which certain key terms, such as 'sole agency' and 'sole selling rights' must be explained if used in estate agency contracts. It applies to England, Wales, Scotland and Northern Ireland.</p> <p>The legislation builds upon the obligations under the general law of agency.³⁰⁸ Estate agents are subject to additional specific requirements, for example to forward offers to their clients promptly and in writing, to inform their clients of certain services offered to prospective purchasers (such as financial assistance) and to disclose to potential buyers promptly and in writing a personal interest in the property being sold.</p> <p>From 1 October 2008, anyone who engages in estate agency work in relation to residential property in the UK is required to join an OFT-approved statutory redress scheme.</p> <p>The Act imposes a 'negative licensing' regime in that there is no requirement to demonstrate any particular qualification or competence in order to set up as an EA. Instead, an EA may continue to operate unless prohibited by the OFT. The OFT may only make a prohibition order if satisfied that particular 'triggering' conditions have been met and that the estate agent is unfit to engage in estate agency work.</p> <p>The triggering conditions which may lead to prohibition order are:</p> <p>Serious breach of the law relating to:</p> |

³⁰⁸ For example, the duty of loyalty. Under this duty, an agent must ensure that he does not allow personal interest (or the interest of others, such as relatives) to conflict with his obligations to his client and, where a potential conflict arises, the agent is under a strict duty to make full and frank disclosure of relevant facts to enable the client to decide whether to terminate the relationship See Murdoch, Law of Estate Agency, 5th Edition, pp. 62ff.

| | |
|--|---|
| | <ul style="list-style-type: none"> - failure to provide information on fees and charges - failure to explain statutory terms ('Sole agency' etc) - failure to disclose a personal interest - failure to inform clients of services offered to buyers - failure to pass on information about offers - misleading statements <ul style="list-style-type: none"> • Failure to comply with an undertaking under part 8 of the Enterprise Act or an Enforcement Order in relation to estate agency work. • Failure to respond to a letter sent by the OFT under Part 9 of the Estate Agents Act. • Failure to produce documents or files at the request of a trading standards officer. • Failure to join an OFT approved estate agents redress scheme. • Commission of a criminal offence involving fraud or other dishonesty or violence (and other specified offences). • Commission of racial or sexual (or other unlawful) discrimination during work as an estate agent. |
| <p>Property Misdescription Act 1991</p> | <p>This Act created the offence of making materially false or misleading statements about particular matters relating to land in the course of an estate agency business. Breach of the Act is a criminal offence punishable by a fine but does not provide direct rights of redress.</p> <p>A statement, whether made orally or in writing, is misleading even if (though not false) what a reasonable person may be expected to infer from it, or from any omission from it, is false. Misleading and false</p> |

| | |
|--|--|
| | <p>pictures are also caught as are 'any other method of signifying meaning'.</p> <p>The particular matters as to which statements must be false or misleading include, for example, the age, construction and condition of a property, its sizes, the length and terms of a lease, service charges, Council tax etc.³⁰⁹</p> |
| <p>Housing Act 2004</p> <p>(HIPs duties)</p> | <p>An estate agent³¹⁰ who is marketing a residential property for a seller is responsible for obtaining HIP documentation before putting the property on the market.³¹¹ Similar duties apply to private sellers, auctioneers and housing developers. The HIP documentation (which must contain specific documents)³¹² must be supplied on request to a potential buyer.</p> |
| <p>Money Laundering Regulations</p> | <p>Estate agents must put in place procedures to anticipate and prevent money laundering and to verify their client's identity before entering into a business relationship with them.³¹³ They must keep records for five</p> |

³⁰⁹ A complete list is set out in the Property Misdescriptions (Specified Matters) Order 1992 (SI 1982/2834)

³¹⁰ The definition of 'acting as an estate agent' is similar to the definition of 'estate agency work' under the EAA. Under the Housing Act 2004, a person acts as an estate agent for the seller of a residential property if he does anything, in the course of a business in England and Wales, in pursuance of 'marketing instructions from the seller'. 'Marketing instructions' means instructions to carry out any activities with a view to: (a) effecting the introduction to the seller of a person wishing to buy the property, or; (b) selling the property by auction or tender (section 150(2)).

³¹¹ The meaning of 'on the market' and related expressions is contained in section 149(2).

³¹² See section 155 and 163.

³¹³ This is likely normally to be the seller. Estate agents acting for buyers will, of course, also have to verify the buyer's identity.

³¹⁴ Fuller details of the obligations on businesses under the money laundering regulations (MLRs) are contained in the OFT published core guidance on the MLRs (OFT954). The application of the MLRs to estate agents is considered in section 10.

³¹⁵ The OFT is not required under the MLRs to keep a register of the businesses it supervises. Instead they provide that OFT may maintain a register of estate agents in order to fulfil their

| | |
|--|---|
| 2007 | years. ³¹⁴ In addition, they must register with the OFT. ³¹⁵ |
| Estate Agents (Record Keeping) Regulations (not yet in force) | <p>New regulations (not yet commenced but likely to be introduced in 2011) will require that all those engaged in estate agency work in the UK (including residential estate agents) keep certain records for a period of at least six years.</p> <p>In summary, this requirement will apply to information that estate agents are currently required to send to clients and third parties under the EAA and associated regulations (but are not currently required to keep a permanent record of). New regulations will extend the requirements to keep permanent records of offers received (including details of offers not passed on to clients) and to keep records of contracts agreed with clients and variations of such contracts.</p> |

duties as Supervising Authorities (Regulation 32(3)). The duties of supervisory authorities are set out in regulation 24.

B ESTATE AGENCY CHAINS AND AFFINITY GROUPS

Estate Agency Chains

Table B.1: The number of offices of residential estate agency groups (50 or more offices) from 2004 to Jan 2009, estimated market shares 2009

| Estate Agency Group | 2004 | 2005 | 2006 | 2007 | 2008 ⁺ | 2009* | Market Share** |
|----------------------------|------|-------|-------|-------|-------------------|-------|----------------|
| Countrywide Plc | 865 | 1,212 | 1,178 | 1,176 | 1,176 | 1104 | 7.6% |
| Connells | 487 | 488 | 485 | 496 | 499 | 470 | 3.2% |
| LSL Property Services plc | 291 | 267 | 401 | 420 | 460 | 378 | 2.6% |
| Halifax Estate Agency | 341 | 332 | 327 | 329 | 328 | 244 | 1.7% |
| Spicerhaart | 236 | 232 | 227 | 231 | 227 | 173 | 1.2% |
| Arun Estates | 120 | 121 | 122 | 123 | 123 | 113 | < 1% |
| Savills | 46 | 60 | 68 | 73 | 81 | 78 | < 1% |
| Hamptons International | 55 | 56 | 58 | 65 | 82 | 70 | < 1% |
| Kinleigh Folkard & Hayward | 66 | 66 | 67 | 67 | 67 | 59 | < 1% |
| Chesterton Humberts | 40 | 38 | 38 | 61 | 81 | 57 | < 1% |
| Andrews Estate Agents | 49 | 52 | 54 | 54 | 57 | 54 | < 1% |
| Knight Frank | 38 | 36 | 46 | 50 | 52 | 54 | < 1% |
| Strutt & Parker | 26 | 27 | 28 | 28 | 51 | 50 | < 1% |

⁺ Key Note Market Report 2008 using Estate Agency News February 2004 – 2008

* Estate Agency News League Table of Residential Estate Agency Offices

** Market share are estimated by OFT based on a total of 14,530 Estate Agency Offices

B.1 Countrywide Plc is by far the largest chain with 1,104 branches in 2009, up from 865 in 2004, partly as a result of their acquisition of Slater Hogg. The next largest, Connells, has 470 branches and LSL Property Services PLC, which includes Your Move and Reeds Rains, has 460 branches.³¹⁶

³¹⁶ Estate Agencies News, February 2004-2008

B.2 In total, the agencies listed above in Table 3.6 with more than 50 offices represent less than 25 per cent of the total number of offices, suggesting that the market is highly fragmented with many smaller companies. Overall, the number of estate agency enterprises with more than 50 offices has declined by four per cent and most of the growth in the sector since 2004 has been by smaller estate agent chains and independents.³¹⁷

Affinity groups

B.3 Many smaller agencies belong to affinity groups with other independent estate agents. This enables them to market their properties more widely through the group, and in some cases use the brand name of the group.

Table B.2: Market representation of affinity groups³¹⁸

| | Number of offices | Market representation |
|---|--------------------------|------------------------------|
| Movewithus | 1045 | 7.2% |
| Home Sale Network (Cartus) | 939 | 6.5% |
| NAEA HomeLink Network | 720 | 5.0% |
| The Guild of Professional Estate Agents | 530 | 3.6% |
| Mayfair Office | 318 | 2.2% |
| The TEAM Association | 312 | 2.1% |

³¹⁷ The 2004 study estimated there were 11,000 estate agency offices. However, this was for England and Wales and our number is for the UK as a whole so the numbers aren't directly comparable, however it is reasonable to assume number has increased since then.

³¹⁸ Estate Agency News League Table of Residential Estate Agency Offices

| | | |
|--------------------------------------|-----|------|
| Fine & Country | 286 | 2.0% |
| National Homes Network | 220 | 1.5% |
| The London Office | 176 | 1.2% |
| Independent Network of Estate Agents | 150 | 1.0% |

*Based on a total of 14,530 Estate Agency Offices

Market representation estimated by OFT

B.4 It is not uncommon for estate agents to participate in more than one affinity group. Despite membership of affinity groups declining by five per cent last year, the NAEA HomeLink Network grew by 25 per cent.³¹⁹

³¹⁹ Top 50 League Table of Residential Estate Agency Offices as January 2009 compared with January 2008 – see www.estateagencynews.co.uk/league.asp

C ANCILLARY SERVICE FEES IN THE USA

- C.1 The OFT has looked at the regulatory position with regard to ancillary services in other countries and, in particular, the USA.
- C.2 In the USA, the provision of ancillary services is governed by the Real Estate Settlement and Procedures Act (RESPA), which was introduced in 1974.³²⁰ Section 8 of RESPA prohibits anyone from giving or accepting a fee, kickback or any thing of value in exchange for referrals of settlement service business involving a federally related mortgage loan (which means a mortgage lender in the USA may not pay the real estate broker commission for referral to the lender).³²¹ In addition, RESPA prohibits fee splitting and receiving unearned fees for services not actually performed (a lender in the USA would not be able to add a further fee to a third party's fee and keep the difference).³²² Referral fees and commissions paid in the UK would constitute a criminal offence in the USA.
- C.3 RESPA also requires that certain information has to be disclosed to the consumer. Where the customer applies for a loan the lender must give the consumer a Good Faith Estimate of the likely costs that will be incurred during the purchase, this includes all the necessary cost of the ancillary services being purchased. A description of the business relationships between the ancillary service provider and the realtor also has to be provided to the customer.
- C.4 Many of the larger real estate broker firms in the USA do though have affiliated entities that supply ancillary services. Where an introduction is

³²⁰ US Department of Housing and Urban Development, www.hud.gov/offices/hsg/ramh/res/respa_hm.cfm

³²¹ RESPA Protection against illegal referral fees – see www.hud.gov/offices/hsg/ramh/res/sc2secti.cfm

³²² RESPA Protection against illegal referral fees – see www.hud.gov/offices/hsg/ramh/res/sc2secti.cfm

made to an affiliate entity, RESPA requires the referring party to give the consumer an Affiliated Business Arrangement Disclosure form. This form informs the buyer know that they are not required to use the affiliated business and are free to 'shop-around' and make purchases from other providers.

D CONSUMER PROTECTION, ANCILLARY SERVICES

- D.1 The level of consumer protection is different for sellers and buyers.³²³ Under the common (general) law applying to all agents an agent owes his client a duty of care and also a duty of loyalty.
- D.2 Under the duty of loyalty, an agent must not allow personal interest to conflict with his obligations to his client. Where a potential conflict arises, the agent is under a strict duty to make full and frank disclosure of relevant facts to enable the client to decide whether to terminate the relationship.³²⁴
- D.3 In particular, an estate agent is not permitted to make a 'secret profit', namely remuneration over and above that agreed with the client unless the client has consented to this.³²⁵ Where the client has consented, the estate agent should account to his client for such profit.
- D.4 Particular Codes of Conduct to which estate agents may subscribe may also prohibit the estate agent from receiving commissions that are not disclosed to the client, for example Rule 11 of the NAEA Rules of Conduct.
- D.5 The EAA and associated regulations also place certain disclosure obligations upon estate agents to their clients. There are no

³²³ Assuming the estate agent is acting for the Seller which is generally the case. An estate agent may also, but less frequently, act as a Buyer's agent.

³²⁴ See Murdoch, *Law of Estate Agency*, 5th edition, pages 62ff.

³²⁵ Murdoch page 70f., For example, *Hippesley v Knee Bros* [1905] 1 KB1. In that case the client of a firm of auctioneers agreed to pay all out of pocket expenses in addition to commission. The auctioneers obtained a trade discount. They were held not to be entitled to charge the full undiscounted rate to their client.

corresponding duties in relation to buyers. The main duties are set out in Table D.1 below.

Table D.1: referral fee disclosure obligations to Sellers

| Disclosure to seller | Disclosure to buyer |
|--|-----------------------|
| <p>Section 18 EAA: An estate agent must give written information before acting as to all the circumstances in which the client has to pay agency fees. This may include referral fee payments.³²⁶</p> | <p>Not applicable</p> |
| <p>Provision of Information Regulations:³²⁷ The estate agent must tell the client in writing, before agreeing to act, of those services (including insurance and financial assistance)³²⁸ which a third party may offer in cases where the estate agent would derive a financial benefit, including</p> | <p>Not applicable</p> |

³²⁶ Failure to disclose an advertising discount has been held by a Scottish court to be in breach of section 18 on the basis that the undisclosed discount amounted to remuneration for these purposes (*Solicitors Estate Agency (Glasgow) Ltd v MacIver*, 1993 SLT 23. In that case a client was charged advertising cost at the full rate whereas, unknown to him, the estate agent secured a discount. The discount was held to be a 'secret profit'.

³²⁷ The Estate Agents (Provision of Information) Regulations 1991, SI 1991 No. 859.

³²⁸ 'services' means any services to a prospective purchaser for consideration, being services which are such as would ordinarily be made available to a prospective purchaser in connection with his acquisition of an interest in land or his use or enjoyment of it (including the provision to that purchaser of banking and insurance services and financial assistance and securing the disposal for that purchaser of an interest in land if that disposal is one which has to be made in order for him to be able to make the acquisition he is proposing or is one which is a result of that acquisition).

| | |
|--|-----------------|
| commission or any performance related benefit. | |
| Undesirable Practices Order: ³²⁹ Where an estate agent has introduced a prospective purchaser to his client and that purchaser has made an offer, the agent must forward to his client promptly and in writing at all stages before exchange of contracts an accurate list of such services. | Not applicable. |

- D.6 In addition, in a measure which may protect both sellers and buyers, it is an undesirable practice (which may trigger prohibition - see chapter 3) to discriminate against a prospective purchaser on the grounds that a purchaser will not, or is unlikely to, accept particular services provided by an estate agent or by another person where the estate agent would derive a financial benefit (including commission and any performance related bonus) from the provision of the service.
- D.7 In addition to the above duties on estate agents, the ancillary service providers themselves may have disclosure obligations under professional rules. The obligations on solicitors, licensed conveyancers and surveyors are summarised in table D.2 below.

³²⁹ The Estate Agents (Undesirable Practices) (No. 2) Order 1991, SI 1991 No. 1032.

Table D.2: Disclosure obligations on ancillary service provider

| |
|--|
| <p>Solicitor: In England and Wales, financial arrangements between a solicitor and an introducer must be in writing and available for inspection by the Solicitors Regulation Authority.³³⁰ Under the agreement, before making a referral, the introducer must make a disclosure of the existence of the arrangement and the amount of any payment (Rule 9.02(e)). Before accepting instructions, the solicitor must make a similar disclosure to his client (Rule 9.02(g)).</p> |
| <p>Licensed Conveyancer (LC): An LC must disclose to a client in writing, as soon as they are known, the existence and amount of any sum payable by or to the LC arising, whether directly or indirectly, from the client's instructions.³³¹</p> |
| <p>RICS Surveyor: RICS Rules of Conduct establish a principles-based approach to self regulation. They provide a general duty on individual members and firms to act with integrity and to comply with ethical standards of openness and transparency. There are no specific disclosure duties regarding referral fees.³³²</p> |

D.8 A mortgage broker may also have an arrangement to pay a fee or commission to an estate agent for referrals. The referral may relate to a mortgage required by the seller, for example, for the property he is going

³³⁰ Rule 9 of the Solicitors Regulation Authority Code of Conduct. The guidance to Rule 9 was revised and in force from 13 November 2009. The full Rule and Guidance can be found at www.sra.org.uk/solicitors/change-tracker/code-of-conduct/rule9.page#r9n1. Other Rules also apply.

³³¹ Rule 5.2.8 of the Licensed Conveyancers' Conduct Rules 2009.

³³² RICS consulted on the issue of transparency in professional fees in October 2009 and has published a summary report on consultation responses. These may be found at www.rics.org/site/scripts/download_info.aspx?downloadID=3944&fileID=4618

to buy after the estate agent has sold his house or may relate to a mortgage required by the buyer to purchase the property the estate agent is selling (on behalf of the seller) to that buyer.

- D.9 In these circumstances, the estate agent is required to disclose to the person being referred the commission he receives from the mortgage broker if he wants to stay outside the parameters of FSA regulation.
- D.10 The reason for this is that the referral could be considered to be an activity ('arranging a mortgage') that is required to be regulated under FSA rules. To be excluded from FSA regulation, with the costs and obligations that that entails, the estate agent is required to disclose details of any payment received before making the introduction.³³³
- D.11 There is no obligation on the broker to disclose to the person who has been referred the commission paid to the estate agent.³³⁴

³³³ This is set out in Article 33A(2)(b) of the Regulated Activities Order (RAO): www.opsi.gov.uk/si/si2003/20031475.htm.

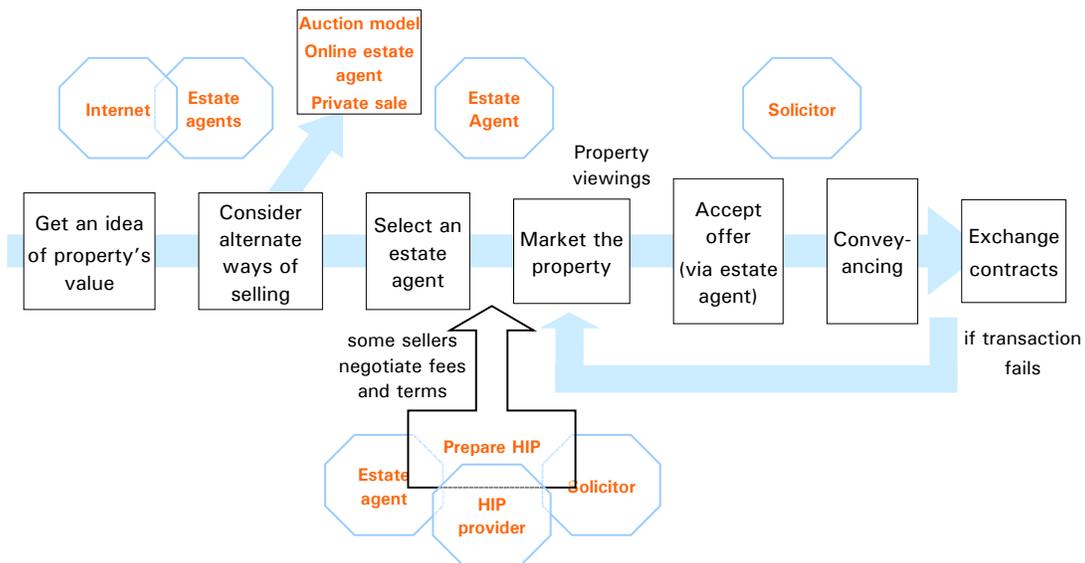
³³⁴ The position is to be distinguished from that of disclosure to the broker's client of commission received by the broker from the lender. Brokers are required to disclose to their client commission received from product providers (for example, lenders) in the Key Facts Illustrations (KFI). See MCOB 5.6.113 to 5.6.117: See <http://fsahandbook.info/FSA/html/handbook/MCOB/5/6>

E THE TRADITIONAL PROCESS FOR BUYERS AND SELLERS

The process for the seller

E.1 The diagram below sets out a typical seller's journey, from deciding to put their home on the market to exchange of contracts.

Figure A.1: The seller's Journey (England and Wales)



Source: OFT

E.2 The seller usually starts by getting an idea of how much their home is likely to sell for. If the seller is moving house, this will factor into how much they can afford to pay for their next property. Many sellers use property portals to research for sale prices of comparable properties in their area. Several websites also offer online property valuations. In addition, most estate agents will provide free valuations to prospective clients.

E.3 Next, the seller decides how to market the property. An increasing number of sellers (27 per cent in our survey) at least consider alternative

routes to market, such as selling privately, For Sale By Owner internet sites, online estate agencies, and selling at auction. However, the large majority of sellers (87 per cent) still choose to use a traditional estate agent, and we follow their journey here.

- E.4 Most traditional estate agent contracts are of fixed duration, with a fee payable on sale of the property. The fee is generally a fixed percentage of the sale price achieved. The estate agent's remuneration is contingent on the sale of the property – if the property does not sell, the would-be seller pays nothing. Contract lengths vary widely, from under eight weeks to more than six months.
- E.5 Once the contract has been signed, the seller will need a Home Information Pack (HIP). Most estate agents help the seller arrange this. Estate agent starts preparing a Home information pack (HIP). The purpose of the HIP is to provide prospective buyers with information about the property. The seller may at their option include a Home Condition Report within the HIP, but few choose to pay for this.
- E.6 With the HIP prepared, the estate agent begins marketing the property to prospective buyers. In England and Wales, the seller generally does not pay separately for marketing (in Scotland, sellers may be charged separately). The estate agent may list the property on their website, as well as on property portals such as Rightmove, Zoopla! and Primelocation. Many sellers agree to a For Sale board outside their home, and the estate agent may feature the property in local newspaper advertisements. In addition, most estate agents maintain lists of prospective buyers, and will contact those to whom the property may be of interest. If the property fails to attract offers, the estate agent is likely to suggest reducing the asking price.
- E.7 In addition to marketing the property, the estate agent provides a number of services for the seller. The estate agent generally arranges viewings, shows prospective buyers round the property, acts as an intermediary in negotiations, advises the seller during negotiations and co-ordinates the process through to completion.

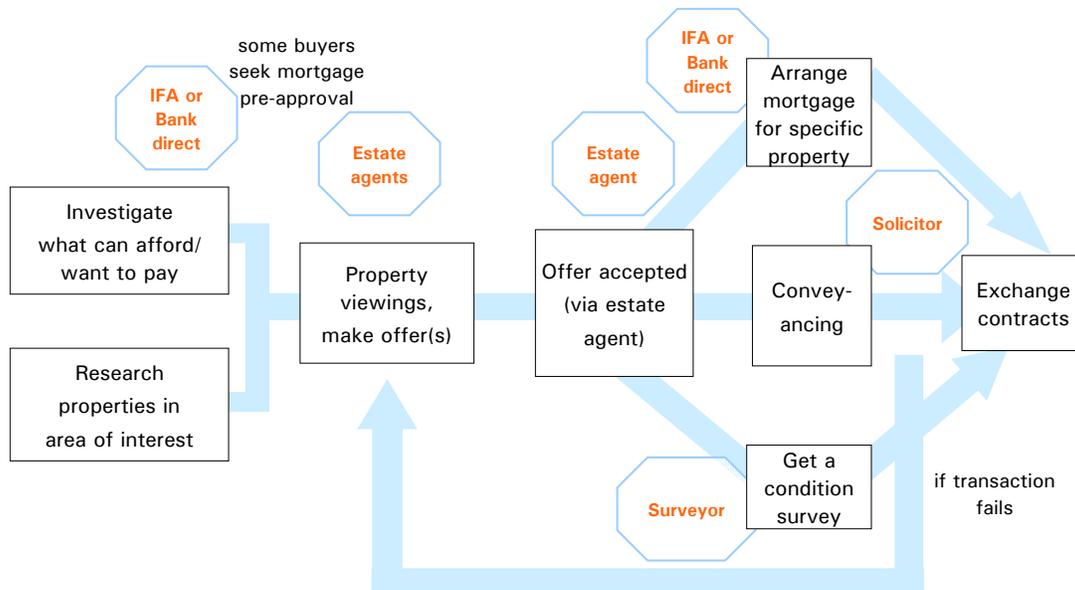
- E.8 The seller generally accepts an offer through their estate agent. At this point if not before, the seller will instruct a solicitor or licensed conveyancer³³⁵ to carry out the conveyancing work. The solicitor/conveyancer is responsible for the legal process that transfers ownership of the property to the buyer. The estate agent provides a memorandum of sale to both buyer and seller that includes contact details for the other side's solicitor/conveyancer.
- E.9 The period between offer acceptance and exchange of contracts can be subject to delays. Our survey results suggest an average of nine weeks waiting for the buyer to arrange finance, any survey to be carried out, and for the conveyancing work to complete, as well as for the successful progression of other transactions if there is a chain. This can be a tense time for both seller and buyer, since there is as yet no contract between them.
- E.10 Once the conveyancing is complete, buyer and seller sign and exchange copies of the contract through their respective solicitors. At the same time the buyer pays a deposit, usually 10 per cent of the purchase price. At exchange of contracts the transaction becomes legally binding. If the seller pulls out after this point, they must refund the deposit and will in addition be liable to the buyer for any losses incurred.
- E.11 At an agreed date generally shortly after exchange of contracts, ownership is formally passed from the seller to the buyer, and the buyer can move into their new home. This is known as completion. The seller receives the balance of the sales proceeds at this point, and the estate agent receives their commission from the seller.

The process for the buyer

- E.12 The diagram below sets out the process for a typical buyer, from searching for suitable properties to exchange of contracts.

³³⁵ A licensed conveyancer is a lawyer specifically trained in property law but not qualified as a solicitor or barrister.

Figure E.1: The buyer's Journey



Source: OFT

- E.13 A buyer usually starts by researching properties in and around the area they want to move to. At the same time, they start thinking about how much they can afford to pay for a property. Some may consult a financial adviser or contact a bank to get in-principle approval for a mortgage.
- E.14 Most buyers today use the internet to help them in their search for a new home. Property portals have developed into a highly valuable tool for buyers, providing a view across the large majority of properties being marketed in any given location. Buyers may also 'window shop' local estate agents for suitable properties, and enquire within the branch.
- E.15 Unlike sellers, buyers do not in general actively choose an estate agent. Instead they decide which properties they may be interested in viewing, and contact the estate agents marketing those properties. To the extent

that they are interested in a particular property, and decide to make an offer, the estate agent marketing that property is the estate agent that they will be dealing with through to completion.

- E.16 After one or more viewings, the buyer may decide to make an offer. Buyers may seek guidance from the estate agent as to whether the seller may be prepared to accept an offer lower than the asking price, and if so by how much. Conversely the estate agent will want to know more about the buyer, in particular about their ability to finance the purchase and whether they have a property of their own that they would need to sell in order to buy.
- E.17 On acceptance of an offer, the buyer will need to engage a solicitor or licensed conveyancer. The solicitor/ conveyancer will carry out searches and pre-contract enquiries to establish the seller's legal title to the property and any restrictions that the buyer should be aware of.
- E.18 Around three-quarters of buyers are not cash buyers, and will need to arrange a mortgage specific to the property they seek to purchase. Most lenders require a survey and valuation of the property to give them comfort that they are likely to get their money back should the buyer default on mortgage payments.
- E.19 The lender's survey, while paid for by the buyer, is for the lender's benefit. It is not designed to provide a comprehensive picture of any faults with the property that may need repair. Some buyers choose to commission a more extensive survey for their own benefit, such as a home buyer survey and valuation, or a full structural survey. The buyer may ask the lender's surveyor to carry out this additional work, rather than commissioning a separate survey.
- E.20 Before exchange of contracts, the buyer has no legal commitment to the seller. The buyer can lower the offer, perhaps on the basis of survey results, or can simply change their mind and walk away from the transaction entirely.
- E.21 Nonetheless, for around three-quarters of agreed offers, conveyancing proceeds to exchange of contracts and a legally binding agreement

between buyer and seller. The buyer pays a deposit at exchange of contracts, usually 10 per cent of the purchase price, and will lose the deposit should they pull out from the transaction from this point.

- E.22 The contracts will state an agreed completion date for transfer of funds to the seller and transfer of ownership to the buyer. The buyer can move into their new home.

F LIST OF CONSULTEES AND CONTRIBUTORS

Allsop Estate Agents

Aran Stanton Estate Agents

Ashtons Estate Agents

Association of Home Information Pack Providers

Association of Mortgage Intermediaries

Association of Property Advertisers

Association of Residential Managing Agents

Barnsley Metropolitan Borough Council

Be Housed

Bonetts Estate Agents

Bracknell Forest Trading Standards

BTW Cairns

Chartahouse Conveyancing Services

Citizens Advice England and Wales

Citizens Advice Scotland

Communities and Local Government

Consumer Focus

Consumer Focus Scotland

Consumer Focus Wales

Council for Licensed Conveyancers

Council of Mortgage Lenders

Council of Property Search Organisations

Countrywide Estate Agents

David Meddick & Co Limited

Davis & Latcham Estate Agents

Davies & Way Estate Agents & Chartered Surveyors

The Digital Property Group

Department for Business, Innovation and Skills

Department for Enterprise Trade and Investment Northern Ireland

Designs on Property

Easy House Exchange

Edinburgh Solicitors Centre

E-Homebuying Forum

Enable Conveyancing

Energy Efficiency Company

Energy Reports and Surveys Limited

EstateAgencyFeesDirect.com

European Consumer Centre Germany

European Consumer Centre Ireland

European Consumer Centre Malta

Federal Ministry of Labour, Social Affairs and Consumer Protection, Austria

Federal Trade Commission

Federation of Private Residents Associations Limited

Financial Services Authority

Google

GPM Estate Agents

Hampshire Law Society

Hamptons Estate Agents

Hanslips Property Search

Hatched Online Estate Agents

Home Search Consultancy

Homes Matter

Homewood Group

House Network Online Estate Agents

Houssimple Online Estate Agents

Independent Park Home Advisory Service

Independent Personal Search Agents

Independent Surveyors Association

Institute of Domestic Energy Assessors

Institute of Home Inspection

Institute of Legal Executives

International Consumer Protection and Enforcement Network

Irish Auctioneers and Valuers Institute

Keats Estate Agents

Land Registry

Landmark Information Group

Law Society

Law Society of Scotland

Law Society of Northern Ireland

Legal and General Assurance Society Limited

Legal Marketing Services

Legal Services Board

Local Authorities Coordinators of Regulatory Services

Local Government Association

LSL Property Services

Martin Coakley Solicitors

MDA Advantage

Miller & Son Estate Agents

My Home Move

National Association of Estate Agents

National Consumer Service, Chile

Neil Douglas Estate Agents

Norman Devlin Property Consultants and Surveyors

Northern Ireland Region, Irish Auctioneers and Valuers Institute

Notarial Council of Malta

Optima Legal Services

Ormerod Solicitors

OyezStraker Office Team

Pagan Osborne Solicitors

Profeco, Consumer Protection Agency Mexico

Professor Stewart Brymer

Property Codes Compliance Board

Property Finder

Property Magazine Company Limited

Property-match.co.uk

Property Ombudsman Service

Property Standards Board

Property Services Regulatory Authority, Ireland

Real Estate Institute of New Zealand

Really Moving

Rees Page Solicitors

Reference Line

REMAX Scotland

Rice-Jones & Smiths Solicitors

Rickerbys LLP

Rightmove

Ross Professionals

Royal Institution of Chartered Surveyors

Royal Institute of Chartered Surveyors Scotland

Scottish Government

Scottish Legal Complaints Commission

Slough Mortgage Centre

Smartlandlord

Society of Licensed Conveyancers

Spicerhaart

Stewart Title Limited

Surveyors Ombudsman Service

Swedish Board of Supervision of Estate Agents

T Hoskins Estate Agents

Thamesview Estate agents

Trading Standards Institute (and submissions from various local authority trading standards services)

Upad.co.uk

Verisona Solicitors

Vision Teknology

Warners Solicitors

Welsh Assembly Government

Which?