EXECUTIVE NOTE TO

THE HOUSING (SCOTLAND) ACT 2006 (PENALTY CHARGE) REGULATIONS 2007
SSI/2007/575

1. The above instrument is being made in exercise of powers conferred by Schedule 3, paragraph 2 to the Housing (Scotland) Act 2006 ("the 2006 Act").

Policy Objectives and background

2. The 2006 Act received Royal Assent in January 2006. Part 3 of the Act 'Provision of Information on Sale of House' introduces a new requirement for specified information to be provided in prescribed documents when a house is being marketed for sale in Scotland. Separate regulations are being made to prescribe the documents that will form a 'Home Report'. These are a survey report (the Single Survey and an Energy Report) and a Property Questionnaire.

3. The Single Survey is being introduced to address three main objectives identified by the Housing Improvement Task Force in its final report, 'Stewardship and Responsibility', published in 2003:
   - provide better information about the condition of properties to house sellers and buyers;
   - remove the need for multiple surveys and valuations; and
   - address the setting of artificially low asking prices.

4. Following a poor response to a market-led Single Survey pilot, there was a clear indication that the market could not deliver a voluntary introduction of the scheme where there was no incentive for the seller to participate. In March 2005, Ministers from the previous administration decided to conclude the pilot, with a view to introducing a compulsory system using the powers in the Housing Bill.

5. Proposals for the Housing (Scotland) Bill were outlined in the consultation paper 'Maintaining Houses, Preserving Homes' which was published in July 2004. Over 70 per cent of respondents to the consultation paper agreed that Ministers should have powers to introduce a Single Survey, with the vast majority of these respondents saying that there should be reserve powers, to be used only if the market did not adopt the survey voluntarily.

6. In February 2007, a consultation paper on draft regulations about the Single Survey, Energy Report and Property Questionnaire was published. A report on responses to the consultation was published by Communities Scotland in August 2007.

Purpose

7. The purpose of this instrument is to make provision for the amount of a penalty charge imposed by a penalty charge notice to be £500, which is the maximum allowable in terms of the powers in paragraph 2 of Schedule 3 to the 2006 Act.

8. A person who is responsible for marketing a house which is on the market must, under sections 98, 99(1), 101(2), or 103(2) of the 2006 Act, possess the prescribed documents in relation to the sale of a house and must provide an authentic copy to any potential purchaser on request. A person who breaches any of these duties may be given a penalty charge notice by an authorised officer of a local authority. Penalties will be enforced by Trading Standards officers from each of the 32 local authorities.

Consultation

9. A consultation paper "Better Information For House Sales: Consultation on Regulations" was published on 20th February 2007 and the consultation period ran for a period of 12 weeks, ending on 15th May. A report on the responses to the consultation titled "Consultation on regulations to give better information for house sales: A report on responses". The paper included the proposal that the penalty charge should be the £500, the maximum sum allowed by the 2006 Act. While many respondents to the consultation supported the specified charge, many others believed it should be either lower or raised although raising it would not be possible within the provisions of the Housing (Scotland) Act 2006, which prescribes that the penalty charge cannot exceed £500.

Financial Effects

Scottish Government

10. This instrument has no significant or ongoing financial effects on the Scottish Government.

Local Authorities

11. Local authority trading standards departments will face minor costs for investigating and enforcing the new requirements for provision of information to prospective house-buyers. The Society of Chief Officers of Trading Standards in Scotland (SCOTSS) has estimated these as £46,000 per year.

Buyers and Sellers

12. Sellers who do not possess the prescribed documents could face a penalty charge of £500. The instrument has no significant or ongoing financial effects on buyers.

Surveyors, Solicitors, and Estate Agents

13. This instrument has no significant on on-going financial effects on surveyors, solicitors, and estate agents.

REGULATORY IMPACT ASSESSMENT
BETTER INFORMATION FOR HOUSE SALES:
HOUSING (SCOTLAND) ACT 2006 (PRESCRIBED DOCUMENTS) REGULATIONS 2008
HOUSING (SCOTLAND) ACT 2006 (AMOUNT OF PENALTY CHARGE) REGULATIONS 2007

December 2007

SCOTTISH GOVERNMENT

NOVEMBER 2007

BETTER INFORMATION ON HOUSE SALES: CONSULTATION ON REGULATIONS

Regulatory Impact Assessment

Contents

1.	Title	3
2.	Purpose and intended effect	3
3.	Background	6
4.	Rationale for government intervention	8
5.	Consultation	10
6.	Options	12
7.	Cost Benefit Analysis	16
8.	Small Firms Impact Test	34
9.	Legal Aid Impact Test	37
10.	Test Run of Business Forms	38
11.	Competition Assessment	39
12.	Enforcement, Sanctions, and Monitoring	42
13.	Implementation and Delivery Plan	44
14.	Post Implementation Review	48
15.	Summary and Recommendation	49
16.	Declaration and Publication	51

1. Title

Housing (Scotland) Act 2006 (Prescribed Documents) Regulations 2008

Housing (Scotland) Act 2006 (Amount of Penalty Charge) Regulations 2007

2. Purpose and intended effect

Objectives

The regulations for Part 3 of the Housing (Scotland) Act 2006 ("the Act") achieve the following policy objectives:

1. to provide buyers and sellers with good information about the condition and value of the property before offers are submitted

2. to address the incidence of multiple surveys and valuations, this can result in abortive costs for house buyers;

3. to address the setting of upset prices at an artificially low level by sellers in order to stimulate interest in the property, which can result in prospective buyers spending money on an unnecessary survey or valuation report for a property outside of their price range.

The regulations introduce the package of proposals that were described in the consultation paper "Better Information on House Sales: Consultation on Regulations" which in summary are:

a) The prescribed documents that sellers (or their agents) must provide to prospective purchasers are:

- a Single Survey; and
- a property questionnaire (previously referred to as property sale questionnaire).

b) The Single Survey must:

- include a valuation;
- include an assessment of the condition of the property;
- include an accessibility assessment;
- include energy performance assessments to meet the requirements of EU Directive 2002/91/EU;

- be in the form provided in schedule 1 of the draft regulations, without advertising or marketing information; and
- be prepared by a person who is a chartered surveyor or who otherwise meets the requirements set out in regulation 5(1).

c) The Property Questionnaire must:
- be in the form provided in schedule 2 of the regulations; and
- be prepared by the seller or his or her agent.

d) On timing:
- the information in each document must be no more than 12 weeks out of date when the house is put on the market. A seller may also withdraw the property from the market and return it to the market within 28 days using the same prescribed documents.
- the documents must be provided to a potential buyer within 7 days of their being requested;
- Ministers are not proposing to use powers to prescribe that a document is no longer valid after a given period, i.e. there will be no prescribed 'shelf life' of the prescribed documents.

e) The requirement to provide prescribed documents applies to sellers of houses that are marketed. As houses purchased under the 'Right to Buy' legislation are not marketed, they are not included under these provisions of the Act. However, section 113 of the Act makes provision for information to be made available to prospective Right to Buy purchasers, and these provisions will be dealt with by separate regulations. The regulations provide that the requirement to provide prescribed documents will also not apply to the following:

- where the house is one of two or more houses being sold as a portfolio;
- seasonal and holiday houses;
- 'mixed sales' where the house is sold with one or more non-residential properties;
- dual use where the house is or forms part of a property most recently used for both residential and non-residential purposes;
- new build houses;
- converted houses;
- properties to be demolished; and
- unsafe houses.

The Housing (Scotland) Act 2006 (Amount of Penalty Charge) Regulations 2007.

The prescribed amount of penalty charge under Schedule 3, paragraph 2 to the Housing (Scotland) Act 2006 is £500.

3. Background

The Housing (Scotland) Act 2006[1] has established the policy and statutory framework for requiring prescribed information to be provided to potential buyers of houses in Scotland. The Bill that preceded the Act was substantially based on the work of the Housing Improvement Task Force established by Ministers in 2001.[2] A pilot of the Single Survey took place during 2004/05. A copy of the evaluation of the Single Survey Pilot can be found at:
http://www.scotland.gov.uk/Publications/2005/09/02142657/26576

A pilot of the Property Questionnaire took place during 2006/07. A copy of the evaluation of the Property Questionnaire pilot can be found at:
http://www.communitiesscotland.gov.uk/stellent/groups/public/documents/webpages/pubcs_019920.pdf

The Act gave Ministers powers to make regulations governing the details of the scheme within the framework established in the Act.

In February 2007, a consultation on draft regulations about the Single Survey and Property Questionnaire was published by Communities Scotland. The consultation paper 'Consultation on Regulations: Better Information for House Sales' can be found at:
http://www.communitiesscotland.gov.uk/stellent/groups/public/documents/webpages/cs_019862.hcsp#TopOfPage

Following the Scottish elections in May 2007, the new administration appointed researchers to analyse responses to the consultation. A report on responses to the consultation was published in August 2007 and is available at:
Full report:
http://www.communitiesscotland.gov.uk/stellent/groups/public/documents/webpages/cs_019860.pdf
Summary Digest:
http://www.communitiesscotland.gov.uk/stellent/groups/public/documents/webpages/cs_019861.pdf

Scottish legislation relating to the buying and selling of houses has so far governed the conveyancing and contractual elements. The provisions in the Act for the first time govern the buying and selling process outside the legal contract of sale between the parties, introducing statute law

[1] http://www.opsi.gov.uk/legislation/scotland/acts2006/20060001.htm
[2] http://www.scotland.gov.uk/Topics/Housing/Housing/16193/PolicyandLegislation/HousingImprovementTask/HomePage

into a traditional system which has become established by custom and practice over an extended period.

4. Rationale for government intervention

The primary focus of the Housing Improvement Task Force (HITF) in proposing the single survey was to improve the condition and quality of private sector housing by increasing house buyers and sellers awareness of house condition, repair and maintenance. Sellers would be able to rectify defects before the house is put on the market and buyers would be aware of any repairs that were required to be carried out to the property before they purchased it.

The HITF found that the current system was unfair to prospective buyers in that they could commission a number of surveys for different properties and still be unsuccessful in purchasing one. Also, the current system allows for the setting of artificially low upset prices by sellers in order to stimulate interest in the property which can result in prospective buyers spending money on an unnecessary survey or valuation report for a property outside their price range.

The HITF recommended that a "single survey" scheme should be market-led and piloted. This survey would be made available to all involved in the house buying and selling process and would provide a comprehensive guide to the condition of the property, together with a valuation.

The Single Survey Pilot demonstrated that the current system will not work on a voluntary basis. However, it did show that the Single Survey has a positive influence on the house buying process**.**

The HITF recognised that there might ultimately be reasons why a legislative approach would be desirable to provide consistency across the market and recommended that this option be held in reserve.

In February 2005, the then Scottish Executive undertook further consultation with all the members of the Steering Group and a wider range of stakeholders, many of whom had participated in the pilot. These discussions confirmed that there were no other alternatives to the Single Survey that would meet the three objectives identified by the Housing Improvement Task Force.

Variants of the traditional system have developed in recent years, whether as a response to the threat of regulation or to other influences. In particular an increasing number of houses are offered at a fixed price and an increased number of offers are made subject to survey. Such changes do not cover the whole market and could be a temporary reaction to circumstances. They do not satisfy all the objectives in

paragraphs 1-3 because they do not inform the prospective purchaser about the condition and value of the property prior to them submitting an offer. Nor do they address the problem of setting artificially low upset prices. On this basis, Ministers do not consider that these changes affect the rationale for government intervention.

5. **Consultation**

Consultation was carried out on the HITF's paper **"**Stewardship and Responsibility: A Policy Framework for Private Housing in Scotland". A copy of the responses can be found at:
http://www.scotland.gov.uk/Topics/Housing/Housing/16193/PolicyandLegislation/HousingImprovementTask/final-report-march2003

Arrangements for the Single Survey Pilot were developed in consultation with the Single Survey Pilot Steering Group, that included representatives from the Royal Institution of Chartered Surveyors, the Law Society of Scotland, the Scottish Consumer Council, the National Association of Estate Agents and the Council of Mortgage Lenders. Papers from the meetings of this group can be found at:
http://www.scotland.gov.uk/Topics/Housing/Housing/16193/BuyingSelling/18223/Singlesurveypilot/SSSGMeetingPapers

Following the recommendations of the Housing Improvement Task Force for a document-based Purchaser's Information Pack, (now referred to as "Home Report") further research was conducted by DTZ Pieda that examined options for such a pack. A copy of the research report can be found at:
http://www.scotland.gov.uk/Topics/Housing/Housing/16193/BuyingSelling/18223/PIPsection/PIPresearch

Consultation was carried out for the Housing (Scotland) Bill. The responses to the paper "Maintaining Houses - Preserving Homes Consultation" can be found at:
http://www.scotland.gov.uk/consultations/housing/mhphcr-00.asp

The development of the proposals for the Single Survey and Property Questionnaire have been conducted with members of the Purchaser's Information Advisory Group (PIAG), that included representatives from the Royal Institution of Chartered Surveyors, the Law Society of Scotland, the Scottish Consumer Council, the National Association of Estate Agents and the Council of Mortgage Lenders. Further informal consultation was conducted on behalf of PIAG with a range of property professionals in relation to the Property Questionnaire. Papers from the meetings of this group can be found at:
http://www.scotland.gov.uk/Topics/Housing/Housing/16193/BuyingSelling/18223/AdvisoryGroup/PIAG1agenda

In February 2007, a consultation on draft regulations about the Single Survey and Property Questionnaire was published. The consultation

paper ‘Consultation on Regulations: Better Information for House Sales’ can be found at:
http://www.communitiesscotland.gov.uk/stellent/groups/public/documents/webpages/cs_019862.hcsp#TopOfPage

Following the Scottish elections in May 2007, the new administration appointed researchers to analyse responses to the consultation. A report on the responses to the consultation titled “Consultation on regulations to give better information for house sales: A report on responses” was published in August 2007 and is available at:
Full report:
http://www.communitiesscotland.gov.uk/stellent/groups/public/documents/webpages/cs_019860.pdf
Summary Digest:
http://www.communitiesscotland.gov.uk/stellent/groups/public/documents/webpages/cs_019861.pdf

Consultees made a range of comments on technical aspects of implementing the Single Survey and Property Questionnaire. The Scottish Government have subsequently discussed and agreed changes to the detail of the regulations with members of PIAG. The Scottish Government have agreed changes to the Property Questionnaire initially with a sub-group of PIAG members, and then the full group. The Scottish Government have also agreed changes to the criteria for the accessibility section of the Single Survey with Ownership Options in Scotland and the Residential Faculty of the Royal Institution of Chartered Surveyors. The prescribed format of the whole Single Survey has been discussed and agreed with the Residential Faculty of the Royal Institution of Chartered Surveyors. The Scottish Government have had further discussion with the Energy Saving Trust on the content and registration process for the Energy Performance Certificate, which is a key component of the Single Survey. The Scottish Government have also met with a representative of The Society of Chief Officers of Trading Standards in Scotland (SCOTSS) to discuss and agree the way forward for introducing the enforcement measures prescribed in the 2006 Act .

6. Options

Option 1
Do nothing

If no regulations were put in place, the policy objectives of the legislation would not be met unless the market adjusted by itself in a way that satisfied the objectives. Even if an equivalent to the Single Survey approach was available to sellers and agents through the market, the pilot has shown that it would not be adopted voluntarily on any significant scale.

It has been suggested that the "offers subject to survey" approach solves the problems the Single Survey is trying to address. Although it addresses the problem of multiple valuations in most cases it fails to address the other two objectives identified by the HITF, namely providing better information of property condition and addressing the setting of artificially low asking prices. "Offers subject to survey" provide survey information (usually only a Scheme 1 Mortgage Valuation) only after an offer has been accepted for the property and The Scottish Government believe buyers should be informed about the property before they submit an offer. Therefore the "offers subject to survey" approach is not an appropriate solution to the policy objectives for introducing the Single Survey.

If no action is taken to change the present system, there will still be a need to implement the requirements of European Union Directive 2002/91/EC to produce energy performance certificates for houses that are sold. This means that there will be a need for a second inspection of the house in addition to the current inspection for valuation and survey purposes.

Option 2
To regulate as proposed in the consultation paper

The consultation paper to which this RIA relates[3] proposed a package of measures centred on requirements for the seller to provide prospective buyers with a Single Survey, including a valuation, and a Property Questionnaire. The package covered by the regulations is described in pages 3-5 of this paper and full details of the proposals are contained in the consultation paper, but the main elements relevant to the cost-benefit analysis that follows are:

[3] http://www.scotland.gov.uk/Consultations/Current

- The Property Questionnaire is completed by the seller at the start of the sale process. It shows key information that the buyer's solicitor will wish to be satisfied about, but not the relevant documents. It is provided to the surveyor.
- The seller commissions the surveyor to provide a Single Survey. The surveyor inspects the property and uses the Property Questionnaire information to provide a survey broadly equivalent to a scheme 2 survey comprising a valuation, a technical assessment, an assessment of accessibility and an energy efficiency assessment.
- When the property is marketed, potential buyers are given the Single Survey and the main parts of the Property Questionnaire within 9 days of their request.
- When the buyer has been identified, the surveyor provides a transcript summary of the survey in the form required by the buyer's particular lender.
- The solicitors for the parties confirm the matters in the Property Questionnaire and conclude missives.

This approach meets the first policy objective given on page 3, particularly because buyers will have better information on condition and value at the crucial point of deciding whether and how much to offer. It also meets the second policy objective because the buyer does not commission the survey. It meets the third objective because the buyer will make a judgment on the valuation, not on the upset price.

Option 3
To regulate without a valuation in the Single Survey.

In the existing Scottish system, valuations provided by a professional valuer are used for two main purposes:

- to help prospective buyers in consultation with their agents to decide how much to offer for the property; and
- to meet the requirements of lenders providing mortgage finance who may want to be reassured that the value of the property exceeds that of the loan.

If the valuation was not required in the Single Survey, prospective buyers would continue to obtain valuations in order to decide how much to offer, with no return for their payment where their offer was unsuccessful. The second objective on page 3 would not be met.

If the valuation was not required in the Single Survey but buyers instead made offers subject to survey, they would be offering in the absence of information on value and the first objective would not be met.

In some cases, sellers may also currently commission valuations from professional valuers to help decide the upset or asking price, but it is more common for them to base this on advice from their selling agent.

If the valuation was not required in the Single Survey, there is no reason to suppose that more sellers would commission valuations prior to marketing, and the third objective would not be met. Prospective buyers would have to commission an additional scheme 1 mortgage valuation, for the purposes of budgeting, bidding, and arranging mortgages. Buyers (and therefore their commissioned surveyor) would have access to the detailed Single Survey – this could reduce the cost of the second survey, and would mean maintenance issues could be easily incorporated into the valuation produced.

Fixed costs associated with surveyor callout fee would mean that separating the property survey and valuation would result in greater total cost than having the two combined – even if, as in 'offers subject to survey,' only one buyer commissioned a valuation.

As with the 'do nothing' option, property valuations would come late in the transaction process. Thus the issue of artificially low upset prices would not be addressed.

Option 4
To regulate for a document based Purchaser's Information Pack as proposed by the Housing Improvement Task Force.

The HITF gave consideration to other types of information, in addition to the Single Survey that might usefully be made available to prospective purchasers when a property is put on the market. The Task Force concluded[4] that there would be considerable advantages in agents of sellers of residential properties compiling a standard "Purchaser's Information Pack"(now referred to as "Home Report"). Under the current process, the buyer obtains certain information about the property only after an offer has been accepted. By providing information at the outset, the process can be made faster, more transparent and consumer friendly.

[4] 'Stewardship and Responsibility: A Policy Framework for Private Housing in Scotland – the Final Report and Recommendations of the Housing Improvement Task Force,' paragraph 171 p42, Scottish Executive, 2003

The HITF's proposal was that the pack should include the relevant documents. A document-based pack would have the disadvantage of delaying the start of the marketing process, as it may take some time to assemble the documents from a range of data sources. It would also involve the seller of the property incurring additional costs to source the documents, some of which may have to be refreshed (such as an updated property search) for the purposes of the conveyancing process, incurring further expense to the transaction.

It is intended that the inclusion of the Property Questionnaire would have a similar effect to that of the document-based pack. It would ensure that buyers are provided with better information about a property in which they are interested. It would provide surveyors with more information before they visit the property to carry out a survey. The Property Questionnaire is also intended to make the conveyancing process easier. Under the current system, some issues often only come to light at a late stage in the transaction process, and can lead to delays in concluding missives and in the most extreme cases, result in sales falling through altogether.

Other variants and further options

Options 3 and 4 are the main alternatives to the basic options 1 and 2. Their impact on the range of interests affected, when compared with the relative impact of options 1 and 2, is considered to be relatively small.

There is also a range of possible variations on the main options 2, 3 and 4 including:

- regulating for only the Single Survey;
- regulating for only the Property Questionnaire; and
- variations on individual regulations such as changing the amount of detail in either prescribed document, the setting of a shelf-life, deciding not to prescribe who can provide a Single Survey, regulating to be more restrictive about who can provide a Single Survey, requiring the central registration of documents etc.

These possible variations have not been included in this RIA. It is considered that they are not realistic options or that they are not sufficiently significant when set against the assessment of the main options for the purposes of the RIA.

In the light of these considerations, the following cost-benefit analysis focuses on a comparison between options 1 and 2 – do nothing and the proposals in the draft regulations.

7. Cost benefit analysis

Costs and benefits have been quantified as far as is possible from the available published evidence. The analysis is therefore subject to the availability and accuracy of data. It should also be noted that this is a complex area involving significant economic benefits and costs that are difficult to quantify. These have been included descriptively in the text, and should be borne in mind alongside any quantified estimates.

7.1 The nominal cost of repair

Estimating nominal cost

The 2002 Scottish House Condition Survey reported levels of housing disrepair at £6.5bn, of which £4.15bn fell within owner-occupied stock (SHCS 2002:116).[5] The Financial Memorandum to the Housing (Scotland) Bill estimated that **£460m**[6] of this disrepair is transferred between owner-occupiers each year – equivalent to an average of £3,270 per property sold.

Further to this, DTZ Pieda (2002) found 19% of all purchasers had faced unexpected repair and maintenance costs averaging £4,000 during their first year of occupancy. A further 8% were preparing to spend an average of £2,700 on previously-unexpected repairs. This indicates that an 'unexpected repair' bill of at least **£130m** is transferred to new owners each year.[7] Moreover, this estimate is limited to repair costs discovered in the first two years of occupancy. Further unexpected repair costs are likely to be uncovered in subsequent years, up to a maximum of £460m, as set out above.

Market failure: sellers' incentives

RICS estimates that 90% of house purchases in Scotland are made using 'scheme 1' mortgage valuation inspections, and as such impart minimal information on property condition.[8] Some commentators have suggested that the proportion of 'scheme 2' Homebuyer Survey and

[5] 'Scottish House Condition Survey: National Report' 2002.

[6] In line with Green Book and Cabinet Office guidance, all prices have been inflated to 2005-equivalent levels using HM Treasury's GDP deflators. This is to facilitate comparison between figures researched in different years. A consequence of this is that key figures may be different from historic data included in the Financial Memorandum to the Housing (Scotland) Bill (SP Bill 40). This analysis is compatible with, and updates, the analysis presented in the Financial Memorandum.

[7] Aggregating these figures assuming 130,000 transactions per year. This is based on the average annual transaction volume for the period 2000 – 2005, excluding Right to Buy sales. Source: Scottish Executive Statistical Bulletin - Housing Series, November 2006.

[8] Quoted in Tribal 'The Potential Impact of the Single Survey on the property industry' 2006:11

Valuation reports commissioned may have increased slightly with the introduction of the 'offers subject to survey' approach in some areas of the country, but the vast majority of current purchases are likely to progress using 'scheme 1' mortgage valuation inspections. This means that the price most buyers offer may not be influenced by the less obvious maintenance and repair requirements of the property. With the 'offers subject to survey' approach, buyers have very little information at all in relation to the condition and value of the house before they submit an offer.

The DTZ Pieda (2002) research indicates buyers discover substantial repair and maintenance issues in newly purchased homes. If buyers had known about these problems in advance of purchase, it is possible that they would have adjusted bids or property choice to take account of them. This means some sellers benefit from passing on 'hidden' maintenance costs to buyers. There may therefore be a *disincentive* for sellers to tackle such disrepair in the run-up to a sale.

Market failure: buyers' response

In markets where consumers conduct frequent, comparable, transactions, economic theory suggests that buyers accurately adapt their expectations as they gain experience. If this held true for the housing market, buyers would realise that sellers are – on average – more likely to sell houses with 'hidden' maintenance costs than 'hidden' benefits. The prices buyers offer would adjust accordingly.

Predominantly, however, an individual's participation in the housing market will be characterised by infrequent and very large transactions, involving eclectic property types and ages. This complicates a buyer's ability to develop accurate expectations.

Adverse maintenance incentives facing sellers in the run up to sale, combined with limited opportunity for buyers to adapt their expectations, means that hidden maintenance costs will continue to flow to buyers across the market as a whole.

The economic costs of market failure

<u>Persistent optimism</u>

As described above, the nature of the housing market implies most buyers will be unable to develop accurate expectations: most buyers will display *persistent optimism*. As such, they will not accurately plan for unexpected disrepair. A consequence of this is that household

resources will have to be sourced or diverted at short notice to finance repair, incurring greater economic costs compared with sourcing resources over a longer period. Further, risk in itself bears a cost to individuals and unexpected financial losses have greater welfare impacts than unexpected financial gains. This means the incidence of unexpected repair costs on buyers will have a disproportionately large impact on their welfare.

Risk premium

Some buyers may develop sufficient market experience to accurately adapt their expectations, and thus avoid the economic costs associated with persistent optimism. These buyers will incorporate uncertainty over property condition into a mental 'risk premium' (additional to any market price) whilst forming their bids. This process decreases housing market efficiency, and increases the economic transaction costs involved in house purchase. Again, this economic cost is *additional* to the simple numerical value of unexpected repairs.

Prolonged process

Further, the lack of information flowing to buyers until late in the transaction process can cause delays in conveyancing. For instance, extension work or new build on a property incurs a legal requirement on the seller to provide planning permission documents. Such requirements may only be recognised late in the process. Delays can be incurred as the seller and solicitor assemble the appropriate documentation.

7.2 The preferred option: redressing market failure

The costs described above stem from adverse incentives facing sellers in the run up to sale. These adverse incentives are a product of asymmetric information between seller and buyer during the transaction process. As discussed earlier in this document, this information asymmetry is not redressed by current practice in the market. Buyers tend to commission a basic mortgage valuation inspection – which contains minimal information on property condition – towards the end of the transaction process. This applies whether a buyer employs the 'traditional' route of commissioning a surveyor prior to submitting an offer, or whether the buyer submits an offer 'subject to survey.' Uncertainty as to the success of any bid, and the connected possibility of having to commission inspections or surveys for several properties, acts as a disincentive for buyers to purchase more comprehensive surveys.

Further, the fact that surveys are commissioned late in the purchasing process means a buyer may well have invested significant time and resources before information on the condition of the property becomes available. This reduces the usefulness of a more comprehensive survey, as it increases the implicit cost of a buyer switching properties on the basis of newly-revealed information – a factor exacerbated by the 'offers subject to survey' approach. Given these considerations, it is reasonable to assume that under the 'do nothing' option, these market failures will remain, together with the associated welfare and transaction costs.

The introduction of the Single Survey, and Property Questionnaire, should improve the flow of information to buyers, and will do so at an early stage in their involvement with a property.

The Property Questionnaire will be completed by sellers prior to the marketing of a property. This will contain information on issues such as alterations, extensions, and shared services. This information will be available to solicitors and buyers at the very start of the marketing process, and has been designed to act as a 'trigger' for selling solicitors to begin assembling relevant documentation. This will reduce the potential for delays later in the process.

The Single Survey will detail the urgency with which different maintenance issues need addressing. Further, as the Single Survey will be pitched at a level of information similar to the current 'Scheme 2' Homebuyer's Survey and Valuation report, the surveyor's valuation will reflect any 'atypical' costs or benefits implicit in the property, rather than rely on 'standard' examples of its age and type on the market.

Buyers will be able to take the Single Survey's additional information on disrepair into account when forming bids and deciding on properties. Increased buyer information will reduce the adverse incentives facing sellers. Sellers will have the opportunity to adjust their pre-sale maintenance practices accordingly, improving average marketed house condition. Buyers will face reduced search and bid costs relative to the 'do nothing' option, facilitating better matching between buyer and property. Further, the flow of information available from the Single Survey and Property Questionnaire means buyers will face reduced uncertainty during the transaction process, reducing the economic costs associated with persistent optimism, risk premium, and prolonged transactions. This will improve the efficiency of the housing market, in turn improving consumer welfare.

7.3 Distributional analysis

For the purposes of this analysis, the parties involved in the house buying and selling process are grouped as follows: house buyers (including first-time buyers); house sellers; house movers (households who are simultaneously buying and selling); selling agents (including solicitors and estate agents); the surveying profession; mortgage lenders and Government. This analysis examines the relevant costs and benefits accruing to each of these groups, under the 'do nothing' option and the preferred Single Survey option. The distribution of quantified costs and benefits only considers first-round effects of the Single Survey, that is, where the initial costs and benefits fall. However economic theory suggests that regardless of where an initial change in transaction costs is borne, the final distribution between groups – second round effects – will be determined by the balance between supply and demand in the market. These second round effects are not quantifiable at this stage.

Option 1 - Do nothing

Buyers

DTZ Pieda (2002:31)[9] indicates that the average cost of the buying process is £**1440**[10] per transaction (excluding stamp duty), and the annual volume of Scottish house sales is approximately 130,000.[11] Thus the annual gross transaction costs facing Scottish buyers stands at approximately **£190m**.

RICS has estimated that 90% of surveys commissioned in Scotland are simple scheme 1 mortgage valuations[12]. Research from DTZ Pieda (2002:17) estimated that each buyer commissioned an average of 1.57 surveys per transaction. The adoption of 'offers subject to survey' in property hotspots may have reduced this figure. This analysis presents a range of survey frequencies to reflect this, with 1.1 and 1.57 representing the minimum and maximum number of surveys commissioned per buyer. Combining these figures with cost data from DTZ Pieda (2002) gives an average survey expenditure of between

[9] DTZ Pieda 'The House Buying and Selling Process in Scotland' 2002

[10] In line with Green Book and Cabinet Office guidance, all prices have been inflated to 2005-equivalent levels using HM Treasury's GDP deflators. This is to facilitate comparison between figures researched in different years. A consequence of this is that key figures may be different from historic data included in the Financial Memorandum to the Housing (Scotland) Bill (SP Bill 40). This analysis is compatible with, and updates, the analysis presented in the Financial Memorandum.

[11] Scottish Executive Statistical Bulletin: Housing Series, November 2006. Tables 5 and 10 give total residential transactions and annual Right to Buy sales. The figure presented here is the average annual transaction volume for the period 2000 – 2005, controlling for Right to Buy sales.

[12] Quoted in Tribal 'The Potential Impact of the Single Survey on the property industry' 2006:11

£210 and **£300** per buyer; equivalent to an annual total of between **£25m** and **£40m**.

DTZ Pieda (2002) found 19% of purchasers surveyed had faced unexpected repairs and maintenance costs averaging £4,000 during their first year of occupancy. A further 8% were preparing to spend an average of £2,700 on previously-unexpected repairs and maintenance. The remaining 73% did not incur unexpected maintenance costs. Averaging this figure for all purchasers, we see an estimated unexpected first-year maintenance cost of £980 per buyer.

Aggregating from this using average annual transaction volumes gives an indicative value of unexpected disrepair passed to buyers of **£130m** each year. However, this figure is limited to costs discovered in the first year of occupancy. The median length of tenure in a Scottish owner-occupied house is 9 years (SCHS 2002:56). As such, it is highly likely that further unexpected repair and maintenance issues will come to light in the ensuing 8 years. To reflect this, a range is presented to indicate the potential scale of costs transferred to buyers, as a result of market failure, **from £130m and up to £460m**[13] each year.

These figures must be caveated:

- Firstly, the net cost to buyers of unexpected disrepair will be partially mitigated by some buyers purchasing unexpectedly well-maintained houses. The lack of information flowing to buyers in the 'do nothing' option means house prices do not reflect maintenance condition. Also, the condition of a house does not wholly depend on sellers' pre-sale maintenance decisions. As such, some sellers may inadvertently market houses in unusually good condition, to the benefit of some buyers. <u>This would reduce the net impact of unexpected repairs incidental on buyers.</u>
- Secondly, sourcing or diverting household resources at short notice – to finance unexpected repair – incurs greater economic costs compared with sourcing resources over a longer period, to carry out planned repairs. Further, risk in itself bears a real economic cost to individuals. Moreover, unexpected financial losses have greater welfare impacts than unexpected financial gains. Thus, unexpected disrepair will have a disproportionately high impact on welfare relative to the incidence of unexpectedly well-maintained houses. <u>This would increase the net impact of unexpected repairs incidental on buyers.</u>

[13]This figure is based on the 'comprehensive cost of disrepair' transferred to new buyers each year (Source: Financial Memorandum to the Housing (Scotland) Bill (SP Bill 40)).

Buyer Summary:
Currently, Scottish house buyers spend between **£25m** and **£40m** on property inspections and surveys, and incur unexpected repair costs which may be between **£130m** and **£460m** annually.

Sellers

As described above, the lack of information on property condition flowing to buyers means sellers have an incentive to avoid less obvious pre-sale maintenance work, and instead simply transfer disrepair to buyers. The impact to buyers has been estimated as between £130m and £460m annually. However, the associated benefit accruing to sellers from this situation will be of a strictly *lesser value* than this cost incurred by buyers.

Substitution, rather than avoidance, of maintenance

Evidence from the US housing market (Harding, Miceli and Sirmans, 2000)[14] suggests that, rather than actually avoiding maintenance spending in the run-up to a sale, sellers divert spending away from less observable, critical repairs and towards more readily apparent repairs.

This would exacerbate the market failure at work. Rather than reducing their maintenance spending in the run up to a sale, sellers may simply spend *more* on work that will be *superficially noticeable* to buyers, whilst reducing their expenditure on less noticeable repairs. Consequently, the problems and likelihood of unexpected repairs are exacerbated for buyers, as the repair work for which they have the least information is likely to be particularly neglected, and the disparity between superficial appearance and actual property condition will be increased.

Further to this, the costs imposed on buyers by having to undertake less noticeable repairs are likely to be *greater* than the benefits flowing to sellers from passing repair costs on. This is because buyers incur additional economic costs due to the 'unexpected' nature of these repairs. Examples of these costs could be the additional cost of financing repairs at short notice, and the additional welfare impact of unexpected financial losses.

The extent to which buyers costs exceed sellers' benefits in the 'do nothing' option is impossible to estimate due to over-riding technical and empirical difficulties, and as such has not been quantified in this RIA.

[14] John Harding, Thomas Miceli, and C.F. Sirmans 'Do Owners Take Better Care of Their Housing Than Renters?' in *Real Estate Economics* v28 pp663-681 (2000)

Seller summary:
Sellers face **£0** surveying costs under the 'do nothing' option. The net benefit of deferred maintenance expenditure accruing to sellers under the 'do nothing' option is unquantified, but is **less than the net cost facing buyers.**

Movers

Movers are households that are simultaneously buying and selling a residential property. They therefore face the net costs and benefits associated with both buyers and sellers.

Each mover spends between £210 and £300 on surveys, may sell their property for a higher or lower price than its maintenance condition would reflect, and equally faces uncertainty as to whether the property they purchase will be in good or bad condition. This uncertainty of outcome will have a negative net impact per mover, as buyer costs outweigh seller benefits.

Surveyors

Tribal (2006:12) estimates current demand provides enough work to support 158 and 226 full-time-equivalent surveyors in Scotland.[15] 750 surveyors currently carry out residential surveys as some part of their work, suggesting residential surveys constitute a small proportion of their total workload. The estimates outlined above indicate total revenue to surveyors from residential surveys to be between **£25m** and **£40m**. This gives an average annual revenue stream of between £36,400 and £52,000 per surveyor from residential surveys.

Solicitors and estate agents

Average solicitor's fees facing Scottish house buyers are approximately £1080 (DTZ Pieda, 2002). Data on average solicitor's fees facing sellers are currently unavailable. Gross annual revenue for solicitors from house buyers stands at £**140.4m**. Data on estate agent fees and market share are also lacking.

[15] Tribal's model includes figures based on the estimation of 1.1 surveys commissioned per buyer. Here, their calculations have been extended to provide a range from 1.1 to 1.57 surveys commissioned per buyer.

Government

Under the 'do nothing' option, government faces no administrative costs other than those relating to private sector contract enforcement. However the effect of poor maintenance in private sector housing, arising from a lack of quality information on property condition, places a greater demand for financial assistance from government in the form of repair grants or other forms of assistance.

Preferred option

Buyers – change in cost

Under the proposed policy, it is envisaged that the need for buyers to commission valuations or surveys will be greatly reduced – the Single Survey commissioned by the seller or selling agent should be sufficient. Thus, it is expected that buyers' transaction costs will be reduced by an average of between **£210** and **£300**. Survey costs will, however, vary with the price, age, and other property characteristics. Thus, the actual saving realised by buyers under the new system will depend very much on the nature of the property being purchased.

It is important to caveat this saving: mortgage lenders currently operate 'panels' of surveyors from whom they will accept valuations. It is possible that in a small number of cases, the seller's choice of surveyor may not be on purchaser's lender's panel, and the purchaser may have to provide an additional valuation, either through the lender's automated valuation model (AVM), a desk-based valuation, a 'drive-by valuation' or by commissioning a mortgage valuation report. It is likely, however, that sellers will try to facilitate the transaction process through engaging surveyors accepted by most major mortgage providers. Further, it will be to the advantage of surveyors to position themselves to provide surveys that are as widely accepted as possible.

There are other, limited, circumstances that may result in additional valuations being carried out on a property; for instance where a lender is offering a particularly high loan-to-value ratio mortgage, or where a property remains unsold for a prolonged period in a hot market. These are expected to be limited in scope, and will simply represent market response to unusual circumstances.

Buyers – change in benefits

Provision of a Single Survey and Property Questionnaire will mean buyers having access to upgraded house condition information earlier in

the transaction process. This will have significant financial and economic benefits linked to maintenance condition, upset prices, and search costs.

The effect on maintenance

The Single Survey will provide a schedule detailing the urgency with which different maintenance issues need addressing. This will improve the information available to buyers and sellers in relation to the condition of a property and reduce the economic cost associated with financing unexpected repairs at short notice. Further, provision of such a schedule will improve individuals' welfare through reducing exposure to unexpected losses. Therefore, the Single Survey will *reduce the cost of maintenance*, and *reduce exposure to risk*.

Buyers will no longer be limited to superficial judgements on property condition, and will incorporate the enhanced information conveyed by the Single Survey to inform their choice of property and level of bid. A seller will, therefore, no longer be advantaged by spending money on noticeable – rather than critical – repairs. In this way, the introduction of the Single Survey will act to *improve the accuracy of buyer expectations*, and to correct the adverse incentives facing sellers. These improved incentives will affect approximately 10% of all private sector housing stock each year, as houses are brought to market. Thus *the maintenance condition of the private sector housing stock will improve over time.*

The effect on upset prices

The Single Survey is intended to address the practice of marketing properties at unrealistically low prices, in order to attract higher levels of interest in a property. This practice reduces the economic efficiency of the housing market, as initial prices do not convey realistic cost information. Purchasers would therefore waste time and resources investigating properties based on misleading price information.

The Single Survey policy will mean that a valuation reflecting both local housing market conditions and atypical property maintenance costs will be available to prospective buyers at the very start of the house buying process. Thus, it will be a simple matter for a buyer to compare the 'upset price' of a marketed property with its Single Survey valuation. This should reduce or remove the advantage gained by selling agents through setting unrealistically low initial prices. As such, it will *reduce the search costs of prospective buyers*, increasing economic efficiency.

The effect on transaction length

The Property Questionnaire will signal any requirement for specific documentation to a seller's solicitor early in the transaction process. As such, documents can be assembled in parallel to, rather than sequential to, other aspects of the transaction process, saving time and resources for both buyers and sellers. As such, the Property Questionnaire will reduce the risk of delays in conveyancing.

Buyer Summary: change in costs

Thus, under the proposed Single Survey, buyers as a group will experience a first-round gross transaction cost saving of between **£25m** and **£40m** annually**.** This is subject to the caveats detailed above.

First-time Buyers

Based on 2005 market share,[16] between **£7.25m** and **£10.35m** of this cost saving will accrue specifically to first-time buyers.

Buyer summary: additional benefits

- Reduced unexpected maintenance costs, through accurate expectations and improved maintenance condition of marketed stock.
- Reduced additional costs of short-notice repair financing
- Reduced search costs
- Improved welfare through reduced exposure to financial risk
- Improved welfare through reduced risk of delays in conveyancing.

Sellers – change in cost

Early estimates of the cost of a Single Survey were placed at around **£440** for an average Scottish house (HITF 2003:135).[17] This is based on a cost estimate for an average 'Scheme 2' Homebuyer's Survey and Valuation report, conducted on an average Scottish house in 2002. This figure is for illustrative purposes only, and the following caveats apply:

1. RICS Scotland has made it clear that survey costs will vary with the age, type and price of the property.
2. The Scottish private sector housing stock has altered very little since 2002, and thus it is reasonable to assume the amount of

[16] Source: Scottish Executive Statistical Bulletin: Housing Series, November 2006

[17] Housing Improvement Task Force: 'Stewardship and Responsibility: A Policy Framework for Private Housing in Scotland' 2003. This price has been inflated in accordance with Treasury guidelines to 2005-equivalent level.

surveyor work implicit in a residential survey is also relatively unchanged. In a market where supply responded rapidly to changes in demand survey costs might be expected to have risen only in line with retail price inflation. However, the surveying industry faces barriers to entry through professional qualification and registration requirements. Therefore, it is likely that survey costs will have risen above the general UK inflation rate during recent strong house price growth. This would be reflected by a lack of fee scale adjustment despite rapid house price inflation. Equally, if the market were to experience a downturn, costs would be likely to decline. For this reason, a 20% confidence interval has been imposed on this cost estimate, giving a cost range of £360 to £520 for an average Single Survey.

Sellers will also be required to complete a Property Questionnaire prior to marketing their property. This is expected to incur a minimal, if any, cost and take very little time to complete. More detailed information on this will become available once testing of the Property Questionnaire is completed.

Seller summary:

Sellers will face an additional average cost of between **£360** and **£520** over the 'do nothing' option. This is equivalent to between £46.8m and £67.6m annually. Sellers will spend some small amount of time completing the Home Report prior to marketing their property.

Sellers: additional effects

- Sellers will receive a price for their property reflective of its maintenance condition. As such, they will not face adverse maintenance incentives.
- The benefit previously accruing to sellers from deferred maintenance spending will be reduced. This benefit reduction will be smaller than the cost reduction experienced by buyers.
- The effect of Property Questionnaire will be that sellers face reduced risk of delays in conveyancing.

Movers – change in cost

As is outlined above, it is expected that buyers will save an average of between £210 and £300 per purchase, and sellers will spend between £360 and £520 per purchase, relative to the 'do nothing' option. Thus, the total transaction cost will increase by between **£60** and **£310** per

property. However, as outlined above, movers are *net losers* from the low-information environment of the 'do nothing' option. Therefore, the additional transaction cost of the preferred option has to be balanced against the additional benefits rendered by the Single Survey and Property Questionnaire.

Movers: additional effects

- Movers will face reduced search and bid costs when hunting for a property. This will facilitate better matching between household and property, increasing the efficiency of the housing market.[18]
- Movers will also face reduced uncertainty in the transaction process, which will further increase economic efficiency. This improves welfare through reduced exposure to financial risk.
- Movers will face reduced unexpected maintenance costs on their new properties, but will also accrue less benefit from deferred maintenance spending on their old properties. The benefits will outweigh the costs of this change.
- Increased housing market efficiency means a greater proportion of the potential benefit from house buying and selling flows to consumers.

Based on 2005 market share,[19] movers were involved in 87.7% of all second-hand housing market transactions.

Cost change: industry impact

Surveyors

Under the Single Survey, total demand for residential surveying work will increase relative to the 'do nothing' situation. Modelling by Tribal (2006)[20] suggests demand will support between 350 and 385 full-time-equivalent surveyors. This compares with current demand supporting between 158 and 226 full-time-equivalent surveyors. Based on the cost estimates described above, the total annual spend on surveying fees will rise from between £25m and £40m to between **£57.6m** and **£83.2m**.

At a Scottish national level, there are enough qualified surveyors active in the housing market to meet this increase in demand. There will be some areas of more acute demand: demand is expected to outstrip

[18] In economics, this is referred to 'allocative efficiency'. This means 'the proficiency of a market at optimally allocating resources within a society.'
[19] Source: Scottish Executive Statistical Bulletin: Housing Series, November 2006
[20] Tribal's model includes figures based on the estimation of 1.1 surveys commissioned per buyer. Here, their calculations have been extended to provide a range from 1.1 to 1.57 surveys commissioned per buyer.

supply in Tayside, and Dumfries and Galloway (although there is some doubt over the accuracy of figures available for the latter). Further, in the Highlands and Islands, Aberdeen, and the North East, demand is expected to rise to around 90% of current active capacity. In no areas does the projected demand rise above the reservoir supply of qualified surveyors currently inactive in the residential housing market. However, this does mean localised hotspots of surveyor demand will place upward pressure on survey prices in these areas in the short run, relative to areas of plentiful surveyor supply. In the long run, supply-side adjustments will reduce any regional price disparities.

Selling agents: solicitors and estate agents

It is expected that there will be little direct effect on the total demand for solicitors and estate agents' services under the Single Survey relative to the 'do nothing' option. The Home Report will facilitate the compilation of all necessary documentation by the seller's solicitor, through timely signalling of relevant information. The advantage of such a policy to solicitors is evidenced in that many firms currently promote their own Property Questionnaires to sellers, for the very same reason. Clear advantage for the wider market will come through standardisation and access to prospective buyers – however, this change is expected to have a relatively minor effect on selling agents relative to the 'do nothing' option.

There may be significant competitive pressure on selling agents to provide deferred-payment services for the Single Survey. Currently, selling agent's fees are deferred until completion of the sale: competitive advantage will clearly be available for agencies that can provide the same service for Survey fees. One method of providing such a service is for selling agents to develop 'in-house' surveyor capacity. Another will be for agents to outsource survey work, using standard credit market products to allow both the seller *and* the selling agent to defer survey payment until conclusion of the transaction. Larger firms are more likely to be able to develop in-house surveying capacity; however it is an empirical question as to whether the cost of maintaining such capacity will be more or less competitive than the cost of using credit markets. As such, there is no reason to assume natural advantage will flow to larger firms under the preferred option.

Lenders

As under the 'do nothing' option: they will continue to control which surveyors are considered acceptable for mortgage valuations, through the continued operation of 'lender panels'.

Government

As under the 'do nothing' option, government faces no administrative costs other than those relating to private sector contract enforcement. £500,000 has been earmarked for training, information and set-up costs on introduction of the policy: ongoing funding will not be required. Further, the resulting improved maintenance condition of the private sector housing stock may reduce pressure on the public purse through some reduction in the need for financial assistance for repairs.

7.4 The potential market impact of altered costs under the Single Survey

(a) Supply

Under the proposed Single Survey, survey costs are incurred by sellers, rather than buyers, and at the start of the house selling process. This raises two issues:

1) Single Survey cost as a barrier to sale

As the cost of the Single Survey must be borne *before* the seller's asset is realised, it may be seen as an obstacle to some prospective sellers – specifically those selling due to adverse financial circumstances.

An indication of the size of this group of sellers can be proxied by looking at tenure flows from home-ownership to the social rented sector. Bramley (2005, table 2.2) estimates the size of this flow to be approximately 6,600 annually for Scotland.[21] This constituted 5% of all sellers in 2005. For such sellers, who may be on the threshold of having their house repossessed by their lender, it is anticipated that the lender may be willing to assist the seller in funding the Single Survey and Property Questionnaire to enable the sale of the house to go ahead. This is expected to be more attractive to the lender than repossessing the property and incurring the duty to provide a Single Survey and the full cost of selling the repossessed house.

[21]Bramley: 'Scottish Local Authority Housing Need and Affordability Model' 2005 Update

Further to this, the DETR report 'Key Research on Easier Home Buying and Selling' (1998) highlights that credit products, enabling sellers to defer costs until realisation of their assets, are a common feature of the Scottish housing market. As outlined above, selling agents will also be under considerable pressure to provide deferred-payment services. Homeowners are, by definition, asset holders. Credit products and deferred payment services mean that, as long as the asset is worth more than the total selling costs, homeowners will be able to sell – regardless of immediate financial circumstance. To contextualise, the average cost of a Single Survey represents approximately one third of one per cent of the average value of a Scottish home in 2005.[22] This conclusion is further supported by the ODPM research paper 'The Potential Impact of the Home Information Pack in Low Demand Low Value Housing Markets' (2003) which concluded that the market will, and should be allowed to, find its own solutions to the provision of, and payment for, the Home Information Pack.

2) Introduction of the Single Survey affecting the supply of houses to the market

It has been suggested that sellers may accelerate the marketing of their houses prior to the policy's introduction in an attempt to avoid either the cost of the Single Survey or the requirement to provide the information in the survey to potential purchasers.

Home Information Packs ("HIPs") in England and Wales are a quite different to the Single Survey in Scotland. There are also different reasons for the introduction of HIPs and the Single Survey in Scotland, reflecting the need to address the different problems which exist within the respective house buying systems. However, to the extent that both approaches require the seller of a house to provide information at the start of the marketing process, a parallel can be drawn with the recent introduction of Home Information Packs in England and Wales.

Research commissioned by the Department for Communities and Local Government (DCLG) in England and Wales concluded in November 2007 that:

> "Although prices may fall (or rise) during the next twelve months [from 31 July 2007], as in other markets this will be overwhelmingly driven by the fundamental drivers of supply and demand, rather than by HIPs. The idea that HIPs would be the main or key

[22] Source: DCLG Table 515. Available at http://www.communities.gov.uk.

> determinant of the direction of the housing market remains, in our view, unfounded." [23]

Following the introduction of Home Information Packs, figures released by the Royal Institution of Chartered Surveyors in November 2007 showed a 26% fall in the number of 3-bedroom or larger properties coming on to the market in October 2007 compared with the previous year. The DCLG research concludes in its update of November 2007 that:

> "[HIPs] implementation to date has been against a backdrop of an already weakening housing market and new factors the full impact of which are not yet fully apparent. It seems likely that what we observe is a market that had begun to slow in 2007 and upon which HIPs may have had an additional modest, but material effect on listings activity, but no discernable impact on transactions, mortgages, or prices…..we still expect the effect on listings due to the implementation of HIPs to have largely washed through within three to six months of its introduction"

The research finds that in England and Wales around 60% of sellers put their houses on the market because of the pressure of personal circumstances or after they have offered for another property and that the decision to market and sell their house is therefore unlikely to be sensitive to policy changes such as the introduction of HIPs. The research also argues that if HIPs lead to a greater efficiency in the general housing transaction process then one might expect to see a new equilibrium with a slightly lower price than would otherwise have been the case. This would be favourable since the lower prices involved would effect greater transaction efficiency.

It has also been suggested that, more generally, there may be a reduction in the number of speculative sellers marketing their properties. The DCLG research referred to a survey conducted by Countrywide Estate Agents which concluded that only 4% of the houses available for sale are listed by sellers who are 'testing the market'. On the basis of this evidence, any effects from changes in the behaviour of speculative sellers in marketing properties when the Single Survey is introduced are likely to be very slight.

The following factors are also relevant to the supply of houses listed for sale during the introduction phase of the Single Survey:

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[23] Source: DCLG, Home Information Packs - Housing Market Analysis (Annex 3 update), November 2007, available at: http://www.communities.gov.uk/documents/housing/pdf/556789

- Analysis of Scottish housing market transactions in 2005 indicate 87.7% of all sellers[24] were 'moving' house – and were therefore *simultaneously* buying and selling a property. Such a seller might market a house earlier than he or she would otherwise have done, in order to commence marketing before the date the requirement to commission a single survey came into force. But he or she would also have a motive to buy from among houses marketed after that date with a single survey which was 'free' to the buyer. So a temporary effect on listings would not necessarily roll through to the same effect on transactions.
- Even within the residual 12% of sellers who are leaving owner-occupation (rather than simply moving house), only a limited number will have meaningful incentive to market early and avoid the Single Survey's introduction. Those within this residual group with well maintained properties may profit from the Single Survey. Another portion will be comprised of executor sales, either of the estate of the deceased or of repossessed houses, and as such will be constrained in timing the marketing of a property. Amongst the remainder, the second-round effects of increased buyer demand (marginally higher house prices) will potentially offset any increase in sellers' costs (which will in any case be limited to between 0.3 and 0.4 of one per cent of the price of an average Scottish house).[25]

Summary:
The considerations set out above support the view that the introduction of the Single Survey will neither represent a binding constraint on sellers' behaviour and that any effect on the supply or prices is likely to be small and temporary. To minimise any potential short term effect, the Single Survey will be introduced at a quiet time of year for the housing market (as suggested by the Council of Mortgage Lenders). Although house prices may rise or fall following the introduction of the Single Survey, such changes are much more likely to be determined by wider macroeconomic factors such as the supply of and demand for housing, and changing interest rates.

(b) Price

The introduction of the Single Survey will alter the timing and level of information flowing to buyers, and the timing, and incidence, of transaction costs between buyers and sellers. These changes may influence house prices in the following manner:

[24] Source: Scottish Executive Statistical Bulletin: Housing Series, November 2006
[25] Source: DCLG Table 515. Available at http://www.communities.gov.uk.

a) Buyers will adjust bids in light of new information on property condition. Well-maintained houses will attract higher bids; poorly maintained houses will attract lower bids. The market failure described above implies that, initially, average property condition will be below the average 'expected' property condition of buyers. This will reduce average bids from buyers in the short term.

b) This effect may be partially or totally offset by increased buyer demand arising from reduced search and bid costs, and reduced buyer uncertainty, on introduction of the Single Survey.

c) Further, the introduction of the Single Survey will reduce adverse incentives facing sellers to under-maintain in the run-up to sale. Pre-sale maintenance practices will adjust accordingly, which over time will improve the average condition of the housing stock. Accurate information on house condition means prices will adjust as this occurs.

d) The cost of commissioning the Single Survey will be borne by sellers; some, or all, of this cost may then be passed to buyers through house price adjustment. Economic theory indicates the strength of this effect will depend on the specific balance between demand and supply in the market, which will vary by property, by area, and with time.

Summary:
The change in transaction costs are insignificant relative to house value, and the extent to which these changes feed into house price will in turn be offset by gains in market efficiency.

8. Small firms impact test

Those in the property industry affected by the process of buying and selling houses in Scotland are surveyors, solicitors, estate agents, lenders and builders carrying out repair work.

The majority of **lenders** are not small firms although a small number of small lenders operate in Scotland. **Builders** doing repair work may find an increase of work commissioned by sellers, and an increase of work commissioned by buyers who are better able to budget. On the other hand repairs carried out in these ways are likely to arrest decay and so cost less than the eventual repair had the owner delayed. It is not possible to quantify these opposing effects. It is considered that their net effect is likely to be small in the context of the overall building repair and improvement market.

Communities Scotland commissioned research from Tribal consultants on the impact of the Single Survey on the property industry as a whole[26]. This has informed the following assessment of the impact on small firms.

Surveyors' firms cover a range of work including residential valuation and surveying for the housing market. They are predominantly small firms, in terms of numbers of firms. The overall impact of the Single Survey will be a significant increase in business.

The residential surveying market has undergone significant consolidation over the last 15 years, driven by lenders' preference to rely on surveys from 'panels' of known and assessed firms[27]. The Single Survey will encourage sellers to use surveyors who are on a wide range of lenders' panels. This is likely to have a consolidating effect and may therefore accelerate the existing trend towards consolidation. On the other hand, there appears also to be a trend towards the use of small firms on an agency basis by larger firms on lenders' panels, for example in rural areas. It should also be noted that the trend towards consolidation has not occurred solely through a reduction in small, independent firms. Small surveying firms, and self-employed surveyors, have increasingly formed alliances or 'federations' to gain access to as many lender's panels as possible. Tribal reports 90% of all residential surveying work is carried out *either* by the large surveying firms or the federations.

[26] "The potential impact of the single survey on the property industry" Report by Tribal Group – January 2007
[27] "The potential impact of the single survey on the property industry" page 29

Given the overall increase in work, the constrained supply of the professional expertise required and the fact that the work is geographically distributed across the country, these trends are considered likely to alter the balance between small and large surveying firms, but through a process of absorption and agency arrangements and the growth of federal arrangements rather than by the closure of small operations

Of those **solicitors**' firms that carry out residential work, a proportion have an estate agency function as well as a conveyancing function. The great majority of solicitors work in small firms. Many small firms now participate in federal arrangements such as the Solicitors' Property Centres, in particular to improve their marketing operations.

For the most part, the Single Survey shifts a solicitor's dealings on survey and valuation issues from the buyer's agent in legal/conveyancing mode to the seller's agent in estate agency mode. This will change the relationship between the agent and the surveyor and could also affect the relationship with the lender. It could bring a corresponding change in the nature of the service that the agent provides to the client. This could mean that agents that do not have an estate agency function provide a narrower range of services to clients. It could also mean that they expand to include an estate agency function. Firms working more closely with neighbouring firms and sharing resources is another way forward.

The Single Survey brings the payment to the surveyor forward in the process. The market may well respond by developing methods for sellers to delay payment. Smaller firms tend to be more risk-averse. They are also likely to have fewer financial options available to them, even though the actual cost of delaying payment for an average transaction will be small. Some Solicitors' Property Centres are understood to be developing such methods for their clients and this may also apply to other organisations to which small solicitors' firms are affiliated. It is therefore considered that, although customer demand for delayed payment may be more difficult for small firms to satisfy, market adjustments are likely to assist them.

Estate agent firms as distinct from solicitors providing estate agency services are predominantly small firms. Estate agents dominate the market for estate agency services in certain areas of Scotland, such as Glasgow and West Central Scotland. Under the proposed Single Survey, estate agent firms will see a significant increase in work associated with the commissioning of surveys as the process of commissioning surveys has been brought forward in the process.

Some estate agent firms currently incorporate both estate agency and surveying functions and the introduction of the Single Survey could be seen as an incentive for other firms to expand their functions by either merging with a surveying company or establishing an in-house surveying team. This might enable those with and in-house surveying function to capture more of a market share. An alternative to establishing in-house surveying functions for estate agent firms could be for them to enter into competitive strategic arrangements with surveying firms.

9. Legal aid impact test

A legal aid impact test has been applied for the purposes of the Regulation and no implications for the courts or in relation to legal aid have been identified.

10. Test run of business forms

The format of the Single Survey is based closely on that used during the Single Survey pilot and was tested for a period of 8 months in the Scottish market during 2004/05. The evaluation of the pilot concluded that 'the Single Survey was viewed [by professionals and the public] as a good product providing useful information for potential purchasers'.

The version of the report used in the Single Survey Pilot was, in turn, was based on a report used and owned by Colleys, a firm of surveyors which is a subsidiary of Halifax/Bank of Scotland (HBoS). Feedback from Colleys' customers who used the report showed that:

- 92 per cent of customers thought the report looked good;
- 95 per cent of customers thought the report was clear and understandable; and
- 95 per cent of customers said the report helped them to make decisions about a property in terms of its condition, value and any repairs that were needed.

Members of PIAG agreed to the use of the piloted product as the basis for the mandatory report. The Residential Faculty of the Royal Institution of Chartered Surveyors (RICS) also agreed to this approach.

Following a public consultation which asked respondents to provide comment on the format of the draft Single Single Survey, The Scottish Government has worked closely with the Royal Institution of Chartered Surveyors and has updated the format of the document. Although many minor changes have been made to improve the report, the report still contains the same core information. There are no further plans to test the revised format of the Single Survey.

The format of the Property Questionnaire was tested by selling agents and solicitors in the buying and selling process for a period of 25 weeks from 23rd October 2006 until 16th April 2007. Suggestions were made by selling agents, solicitors, and sellers, to shorten and simplify the Property Questionnaire and The Scottish Government has worked closely with members of PIAG to do this. There are no further plans to test the revised format of the Property Questionnaire.

11. Competition assessment

Estate agents/solicitors

There are currently no estate agents or solicitors in Scotland who have more than a 10% share of the market for estate agency services. The introduction of the Single Survey and Property Questionnaire is not expected to alter existing barriers to entry as there are unlikely to be higher set-up costs than currently apply. All firms providing those estate agency services will be working with a new product in the Single Survey. An approach similar to the Property Questionnaire is currently in use by some firms but the requirement to adopt this approach is unlikely to distort the market as the indications are that it does not have a significant impact on costs. The prices charged by agents for ensuring the provision of the prescribed documents will be market led.

The market for estate agency services in Scotland is very competitive. It could be argued that larger firms could have a competitive advantage by offering a 'no up front costs' service, bearing the cost of the survey between its receipt and the completion of the sale transaction. But smaller firms may also be able to provide this service, either individually or by forming closer links within the industry to share the risks and costs. The formation of such links already happens with marketing operations, for example in the Solicitors' Property Centres, and allows a continuing level of competition between small firms, without the necessity to merge in order to provide such operations cost-effectively.

Research has indicated that some estate agents, which unlike solicitors are not restricted in their ability to carry out surveying functions too, may see the introduction of the Single Survey as an incentive to expand company functions and for vertical integration with surveying firms or surveyors. According to Tribal, only Countrywide and one other estate agency currently have any in-house surveyors and vertically integrated firms are currently the exception in Scotland. The introduction of the Single Survey may accelerate this process rather than create the conditions for it to happen.

The Solicitors' Property Centres are aware of the threat that faces their members from the large agencies, and in particular new entrants to the Scottish market, irrespective of the introduction of the Single Survey. They are working to support them, by investigating which new approaches they can take in the market.

Surveyors

Two surveying firms currently dominate the market in Scotland. There are, however, over 300 surveying practices who currently operate in this competitive market. Under the current system, the main reason for choosing a particular surveyor/firm is whether the surveyor is on the panel for the buyer's lender. After the introduction of the Single Survey the choice will be made by the seller, whose motivation will be to use a surveyor likely to be on a wide range of (overlapping) lenders' panels in order to maximise the utility of the survey to prospective buyers.

There may in consequence be a tendency towards consolidation of surveying practices, particularly of independents seeking association with practices that are on the majority of panels. The Surveying profession has seen significant consolidation over the past few years – with large surveying firms, and federations of smaller firms, coming to dominate the residential surveying market - and this trend continues. The effect of the Single Survey may be to accelerate this consolidation process – either through the extension of federal arrangements, or through more traditional company mergers, or a combination of the two.

It is not expected that the introduction of the Single Survey will lead to higher set-up costs for new or potential firms than exist at present. All firms who wish to act as providers for Single Surveys will have to satisfy certain criteria and will have to apply to Scottish Ministers for approval to be act as a provider. Scottish Ministers are required to approve regulations allowing firms to act as providers. However, those criteria are essentially the same as the criteria that apply currently to Chartered Surveyors, and thus are similar to the barriers that any current entrant to this market is likely to have to deal with in order to be able to compete effectively in this market.

The content of the Single Survey is similar to that of a Scheme 2 Homebuyer's Survey and Valuation Report and therefore firms, both old and new, will not have to go to the expense of designing a new product. Furthermore, their qualified staff should adapt to the demands of the Single Survey with relatively little training investment.

Lenders

HBOS Plc currently has over a 20% share of the market and Abbey National Plc currently have just over a 10% share. The finance industry is highly regulated to prevent monopolies. It is not considered that the introduction of the Single Survey will have an impact on competitiveness within this market.

Conclusion

The comments in this section are supported by research commissioned by Communities Scotland[28] which concluded that the introduction of the Single Survey will not necessarily reduce competition. Entry by new businesses could increase competition. The research also indicated no prospect of the growth of monopoly power or dominant positions, nor of the facilitation of anti-competitive behaviour as a result of the introduction of the Single Survey.

[28] "The potential impact of the single survey on the property industry" page 3

12. Enforcement, sanctions and monitoring

Sections 109 – 112 of the Housing (Scotland) Act 2006 designate the local weights and measures authority as an enforcement authority for the purposes of the introduction of the prescribed documents (the Single Survey and the Property Questionnaire). The Act gives the enforcement authority the power to require production of the prescribed documents for inspection and the power to issue a penalty charge notice if a person has breached the duties in relation to the prescribed documents. Section 111(4) of the Act also gives Scottish Ministers the power to make regulations about penalty charge notices. Finally, Schedule 3 (2) of the Act gives Scottish Ministers the power to specify in regulations the amount, not exceeding £500, of the penalty charge. Following discussions with representatives of Trading Standards, the draft regulations specify that the amount of the penalty charge should be £500, a sum considered to be in proportion to the statutory duty to provide the prescribed documents.

The regulations state that persons who may prepare the prescribed document set out in Schedule 1 are surveyors registered with or authorised to practice by the Royal Institution of Chartered Surveyors or other persons with similar professional qualifications. Further groups could be added in amending regulations at a later stage. Ministers will assess the case for prescribing potential providers against published criteria. It is proposed that the following criteria for prescribing providers of Single Surveys are used:

- Complaints handling procedure
- Professional indemnity insurance
- Conflicts of interest
- Lifelong learning
- Professional competence
- Disciplinary process
- Membership registration and renewals
- Inspection and reporting requirements
- Provision of a Lender's Report to a lender of a purchaser
- Performance reporting / monitoring and quality control

The last of these criteria places a requirement for the provision of monitoring and quality control procedures. Bodies or groups that apply to be prescribed as providers of Single Surveys in Scotland will need to demonstrate that they have adequate monitoring and quality control procedures in place.

There will be a strong element of self-monitoring built into the system. As the prescribed documents become established in the house buying and selling system, house buyers in particular will come to expect to receive the prescribed documents when they enquire about houses for sale. If the documents are not provided to them, it is likely that they will take action to ensure that they are provided. They may choose, for example to inform the local weights and measures authority to enforce the duty on the seller or selling agent.

In addition, the surveying profession also has forms of self-regulation in place if a complaint is made against a surveyor. Every RICS member must have a complaints procedure. If, after following that process, a client still has an unresolved complaint, the client can refer the case to the Surveyor's Ombudsman. The Surveyor's Ombudsman Scheme was launched by the RICS in Scotland in January 2004. The Ombudsman can award compensation for loss or expenses of up to £25,000 or for stress and inconvenience of up to £500.

13. Implementation and delivery plan

The Single Survey and Property Questionnaire will be introduced to the house buying and selling process in late 2008. Although a precise date has not yet been set, it is likely that this will take place towards the end of the year, recognising the concern of the Council of Mortgage Lenders in particular, that the prescribed documents should be introduced at a time of year when the housing market is relatively quiet.

The Scottish Government will continue to work closely with key stakeholders to develop and publish guidance designed to help them prepare for the new system of buying and selling homes. Members of PIAG have been provided with a project plan which sets out the key milestones for the implementation of the Single Survey and Property Questionnaire during 2008. They will be provided with updates on progress at regular PIAG meetings.

Training and awareness for Chartered Surveyors

All valuations carried out by RICS members must be undertaken in accordance with the RICS Appraisal and Valuation Standards (the "Red Book") definitions and standards. The Red Book regulates a surveyors individual conduct. Where necessary, the Scottish Government will provide support to the RICS for the amendment of the Red Book Rules prior to the introduction of the Single Survey and Property Questionnaire in late 2008.

The Scottish Government will work closely with the Royal Institution of Chartered Surveyors to ensure that chartered surveyors have access to the necessary training and awareness in good time for the introduction of the Single Survey in particular. Individual chartered surveyors will need to be made aware of a number of issues including:

- what the regulations mean;
- the Single Survey format and its contents;
- the scope of a Single Survey inspection; and
- the terms and conditions under which a Single Survey must be delivered

In advance of the introduction of the Single Survey, firms of chartered surveyors will need to give consideration to a number of issues, including:

- the provision of Professional Indemnity Insurance;

- having the necessary internal systems in place to deliver the Single Survey product to clients and the required information to lenders where appropriate; and
- having an appropriate marketing strategy in place.

The Scottish Government will also maintain contact as necessary with the Surveyor's Ombudsman to ensure that he is informed of progress and any issues that may affect his role.

Training and awareness for other property professionals

The Scottish Government will work closely with representatives of other property-related professions, such as the Law Society of Scotland, the National Association of Estate Agents and the Council of Mortgage Lenders to ensure that their members are fully aware of the changes being introduced, their roles and responsibilities in the house buying and selling process, and the enforcement regime and how it will operate.

In some cases, it may be appropriate to deliver training and awareness sessions and guidance through the existing networks of these organisations that is tied in with existing Continuing Professional Development arrangements. In other cases, it may involve bespoke awareness sessions and guidance being delivered through direct contact with individual firms. The Scottish Government will discuss and agree the best method of delivery of the relevant information and guidance with each organisation.

The Scottish Government will keep all the relevant professionals aware of the progress being made through a website dedicated to the implementation of the Single Survey and Property Questionnaire. Guidance and training materials and regular updates on progress will all be available on the website.

Delivery of energy performance certificates for marketed properties

The Scottish Government has worked closely with the Royal Institution of Chartered Surveyors ("RICS") and the Scottish Building Standards Agency ("SBSA") to develop an approach for the inclusion of Energy Performance Certificates ("EPCs") in Single Surveys that meets the requirements of EU Directive 2002/91/EU. As a result of this, RICS has entered into a protocol agreement with the SBSA to become providers of EPCs.

The SBSA is currently in discussion with the Building Research Establishment ("BRE") to specify the requirements that all providers of software that generate EPCs will have to meet. RICS members will be able to obtain appropriate training from EPC software providers to allow them to prepare and produce EPCs. The Scottish Government will continue to work with the Scottish Building Standards Agency and RICS throughout 2008 to ensure that RICS members are ready for the introduction of Single Surveys that include EPCs in late 2008.

All EPCs that are produced for marketed properties will be registered on the Home Energy Efficiency Database (HEED) held by the Energy Saving Trust ("EST"). The Scottish Government is currently in discussions with the SBSA and the EST on a testing of the registration process in spring 2008 to ensure that the appropriate systems are in place by the launch date in late 2008.

Publicity and communications

A programme of information provision to the general public will be undertaken during the second half of 2008 to ensure that house buyers and sellers are aware of the changes to the house buying process and their roles and responsibilities within it. A website dedicated to the introduction of the Single Survey and Property Questionnaire will also provide members of the public with access to the relevant information and guidance.

Enforcement regime

The regulations make provision for a civil penalty of £500 to be imposed where a person has breached the duty to provide the prescribed documents under the 2006 Act. The Scottish Government has held discussions with the Society of Chief Officers of Trading Standards in Scotland ("SCOTSS") to examine the most appropriate way to administer the enforcement regime. The Scottish Government will work closely with SCOTSS to prepare guidance on enforcement which will be distributed to each local authority in Scotland.

The Scottish Government has also discussed training and awareness sessions for Trading Standards Officers. The Scottish Government has agreed that this training will be provided jointly by Communities Scotland and SCOTSS at a number of training venues in autumn 2008. This will ensure that Trading Standards Officers are aware of their roles and responsibilities.

14. Post implementation review

The Scottish Government will monitor the progress and impact of the Single Survey and Property Questionnaire in the early stages of the implementation of the new regulations and will undertake a formal review of the impact of the Single Survey on the Scottish housing market after the requirement has been in force for 2 years.

15. Summary and recommendations

In view of the overall benefits, it is recommended that Option 2 should be implemented as this approach meets the 3 key policy objectives given on page 3. The following table sets out a summary of the costs and benefits for Option 2.

Costs	Benefits
Research has indicated that purchasers had faced unexpected repairs and maintenance costs averaging £4,000 during their first year in occupancy.	Buyers may adjust their bid for a property as they will have detailed information about the about the condition of properties before they submit an offer. Sellers may decide to carry out repairs before marketing the property for sale.
Seller will have no costs for completing Property Questionnaires.	The information in a Property Questionnaire will act as a "trigger" for selling agents/ solicitors to begin assembling documentation which should assist with the conveyancing process and will save time and resources for both buyers and sellers.
Research has indicated that the average cost of buying process is £1440 and that each buyer commissions an average of 1.57 surveys per transaction (although the practice of "offers subject to survey" operated in some areas of Scotland may have reduced this figure).	The introduction of the Single Survey should reduce the occurrence of buyers instructing multiple surveys for properties. It is expected that buyers' transaction costs will be reduced by an average of between £210 & £300 although survey costs will vary with the price, age, and other property characteristics.
Based on 2005 market share, first time buyers will experience a first-round gross transaction cost saving of between £7.25m and 10.35m.	First time buyers will get a Single Survey free and will not suffer unnecessary wasted expense on surveys for properties that they have unsuccessfully submitted an offer for.

It is expected that buyers will save on average of between £210 and £300 per purchase and sellers will spend between £360 and £520 per transaction. The total transaction cost will increase by between £60 and £310 per property.	The additional cost should be balanced against the benefits rendered by the Single Survey and the Property Questionnaire.

16. Declaration and publication

I have read the Regulatory Impact Assessment and am happy that the benefits justify the costs.

Signed by the responsible Minister _____

Date _____

Stewart Maxwell
Minister for Communities and Sport