The Property Profession And Evolving Financial Service Reforms In Australia - An Industry Perspective

Refereed Paper

Vince Mangioni
University of Technology, Sydney
Ph: 61 2 9514-8900
vincent.mangioni@uts.edu.au

Abstract

The demand on property professionals and the services they provide in Australia has continued to increase over the past 15 years. This evolution has resulted in the tightening of existing regulatory regimes and the introduction of new regimes to address the expansion in the provision of property investment advice.

This paper identifies the evolution of services and advice provided by the various property and investment advising professions in Australia and monitors the regulatory regimes governing these professions. A survey has been used to define the perspectives of the professions involved and the perceptions of their respective regimes. A review of the expanding role of property professionals in the provision of property investment advice and the requisite changes needed in order for these professions to adapt is provided in conclusion.

Keywords: Financial service reform, investment advice, selling advice, valuations

Introduction

As property grows as an investment vehicle, with an increase in this asset class included in retirement planning, greater focus is now concentrated on the price paid for property and the relativity of that price to value and the suitability of the property as an investment. In addition, consideration has also begun to centre on the quality and suitability of property purchased for investment purposes and the risks associated with inappropriate property being purchased, particularly by investors nearing, or entering retirement with limited capacity to replace their capital.

This paper in reviewing the regulatory regimes of property and related professionals considers the issues confronting property investors, the level of understanding about the attributes of advice that contribute to decisions to invest, the information available and the quality of advice provided to property investors. The paper brings to the fore the present uses of selling methods through investment seminars the use of agency and valuation advice and the disparity in regulation of these professions in meeting the objectives of investors.

Literature

The following literature has been segmented into issues and professions and provides a summary of issues confronting each involved in their services relating to property investment and the financing of property investment.

Superannuation and property

Following the introduction of superannuation choices and the need for self sufficiency in retirement, the increase in retirement planning has resulted in an increase in the investment in superannuation and the advent of an advisory industry comprising a number of professionals. Figure 1 shows the size and increase in superannuation assets held in Australia over the past decade.

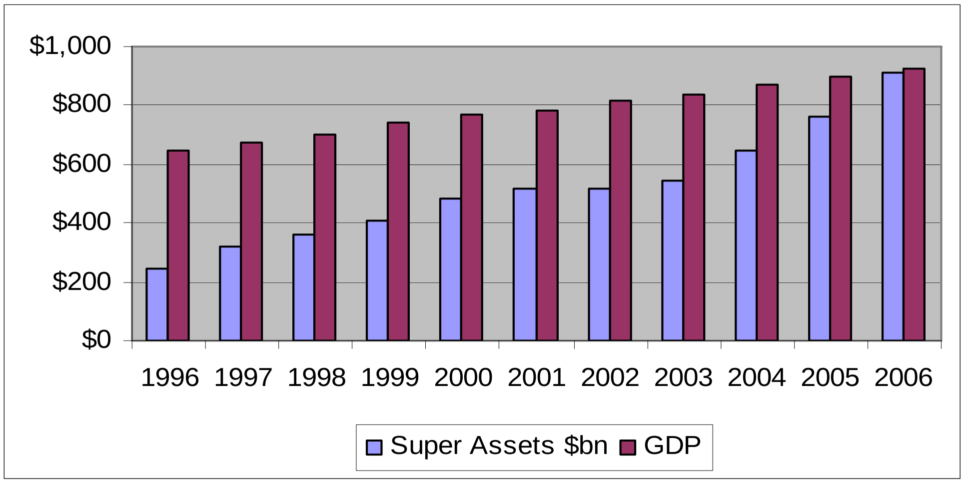
The advent of investment advising and retirement planning advice has prompted Government in Australia to regulate the providers of this advice to ensure superannuation achieves the performance objectives of the aging Australian population. Since the licensing of investment advisers by Australian Securities and Investment Commission (ASIC) in 2001 the numbers of licenses issued have increased significantly. ASIC (2006) have issued over four thousand Australian Financial Services Licenses since 2001.

Table 1: Financial Services Licenses Issued

2005-06	2004-05	2003-04	2002-02	2001-02
4,415	4,135	3,853	626	35

Source: Australian Securities & Investment Commission 2006

Figure 1: Value of assets held in Australian superannuation v Aust GDP



Source: Australian Prudential Regulation Authority 2007

Investment in property directly through bricks and mortar and indirectly through property trusts and superannuation fund allocation has resulted in an increase in property in superannuation over the past ten years. Mangioni (2006) notes an increase in direct residential property investment in both structures and unstructured superannuation. Further noted, was an increase in property investment advising industry, which has remained unregulated until 2004. What has not been adequately defined to date, it the amount of superannuation allocated to direct property investment taken into retirement.

Real estate agents

Inquiries into the regulatory framework governing real estate agents have been undertaken by ASIC and a joint State and Commonwealth working party. The purpose of these inquiries is to determine the effectiveness of legislation governing real estate agents and to attempt to bring into line the role of real estate agents against those of financial and investment advisors. Each of the inquiries mandates are as follows:

> "The existing regulation of real estate agents should be reviewed. Real estate agents providing investment advice should be required to hold a financial advisors licence unless the review clearly establishes the adequacy of existing regulation" (Australian Securities Investment Commission ASIC 1999:7).

> "Many real estate agents give general financial advice to potential buyers of investment properties. Typically, this takes the form of advice about the likely capital appreciation or rental incomes from a property - basically, its investment return potential. Sometimes

> agents' advice will include some general taxation advice as well, such as the benefits of negative gearing." (Ministerial Council on Consumer Affairs, MCCA 2004:15).

Whilst the review of real estate agents is a primary focus of this review, ASIC is aware and concerned with the activities of sales persons who are not licensed or registered under State or Territory regulatory regimes, but who are involved in the sale of real estate to property investors. These people are referred to as "real estate marketeers" or “real estate marketers" (ASIC 1999).

Valuers

In determining the benefit of valuation advice and the value it adds to banks and lending practices, Hunt (1999) raised the concern of the actual value adding of valuations, when most valuations come back at the purchase price. The issue of concern for the lender is that while the valuation figure may reflect the risk, it does not singularly identify the risks. A point-in-time value implicitly encompasses any risk the valuer may perceive within their valuation figure. This issue is compounded with short-form valuation reports in which the opinion of the valuer is not articulated.

The Parliamentary Joint Committee on Corporations and Financial Services (2005) have highlighted the need for valuations obtained for lending to be provided to borrows. This is seen as a safeguard for investors where they have paid above market value of the property. In contrast to the Australian system of the valuer being engaged by the lender after exchange of contracts, Schofield (2006) highlights the UK model of the valuer being engaged prior to the exchange of contract and the availability of their advice to borrowers.

At the opposite end of the spectrum, ASIC (2007) are examining valuer involvement in valuations provided to developers in raising capital to undertake developments. This is the subject of an inquiry into the collapse of three property development companies in which retirees and investors lost life saving investing on unsecured investments. In some cases valuations have been found to be 100% in excess of the value of the property at the date of valuation, or have been valued on the basis of completion.

Investment advisers / Financial planners

In relation to direct property investment, O'Brien & Herman (2002:1) state that “Despite potential downside, there are opportunities for financial planners to recommend good investment opportunities with solid returns, provided these investments are properly understood and supported by strict investment guidelines and rigorous independent research." Defining sound property advice, O'Brien & Herman (2002) highlight the need for property to be able to generate sufficient capital appreciation over a 10 year period. Also highlighted are the differences in return profile between new and established residential property.

New property has lower maintenance costs, tax advantages and fewer tenancy problems. This is in contrast to established residential property, which they identify the merits being increasing scarcity and higher gains. Qualifying the investor profile of new residential property, the authors draw reference to the lack of time and tax advantages drawing time-poor investors in the highest tax bracket to new residential property. The merits of capital gains are raised with a benchmark average to 8 – 10 percent for Sydney and Melbourne; however, this is not benchmarked against the gains from established property. The importance of high gearing and negative gearing is stressed by them as being more favourable in the earlier part of one's career whilst earning steady income.

Moral hazard is an issue identified by Parliamentary Joint Commission on Corporations and Financial Services (2005) and is defined as the issue confronting an adviser who is dually remunerated, or stands to gain some form of benefit from both investor and developer or their intermediary in their dual role of advising the investor on the merits of a specific property, in which they are remunerated by the selling party for undertaking that role. The absence of provisions within the Corporations Act 2001, allows financial advisers to be remunerated by both developer or their intermediary and investors. Whilst some investment advisers provide a rebate to the investor for remuneration paid by the developer, others only accept remuneration from investors.

Mortgage Lenders

The lending market for housing has expanded to provide easier access to money for investment in property. The RBA (2003) has listed home equity loans, split-purpose loans and deposit bonds as being innovations that have assisted home investors into the market.

The advent of mortgage originators in the early 1990s has led to a more competitive market for investors who have multiple sources of finance available to them, each which different lending criteria. Over the past decade, Mortgage Originators and Mortgage Brokers have advanced the Australian home lending market. Originators raise funds by issuing securities in the money markets, better known as securitisation. Brokers, help borrowers find and arrange home loans (Productivity Commission 2003). The increase in household debt has been significant in Australia, compared with international standards. Australia over the past decade, has moved from the lower end of the debt-to-income range to be much closer to the top.

One of the areas of concern to regulators in Australia, following on from the lessons in the United States, is in the area of 'equity stripping' of people's homes, this is achieved through reverse mortgages. Gilber and Reed (2003:3) explain,

> "Complete home ownership is often achieved in the middle to later years of the working life, when the mortgage is paid out. After retirement has commenced and a regular cash inflow has ceased, a reverse mortgage can commence. Over time, this will decrease the level of equity in the house, although the loan is structured so not all the equity is removed."

Property investment seminars

The growth in property development over the past ten years saw the growth in the means for distribution through investment seminars as a conduit for sale. This activity has seen the proliferation of the property investment seminar industry unfold. The property marketeer may find it difficult to identify and communicate with potential buyers, until and unless a potential investor has recognised the need for such a major financial undertaking (Gibler and Nelson 1998). The process of maximising the greatest number of people that may be candidates as potential buyers may be through property investment seminars.

The API (2003) indicated that many of the *fraudulent practises* operating commence with a free wealth-creation seminar, that leads to yet another seminar which costs investors up to $15,000. The next step is to coax the investors into property that have been vetted by the seminar organisers. Elaborating on the soliciting of Loaded Prices & Two-Tier Marketing, the API (2002) highlights the use of initially free and subsequent paid seminars used to lure people to the marketing strategists of new developments.

Investment seminars have proliferated over the past decade, with increasing intensity over the past 2-3 years. "Seminar workshops and courses are frequently advertised and promoted as 'educational' services only and as not involving the giving of advice. ... promoters generally offer to arrange finance for people who cannot afford to pay for seminars and other materials from their own resources." (MCCA 2004:18). It was further noted that one seminar operator earned up to $37.5m in turnover in one year, (MCCA 2004).

The regulatory issue

One of the primary issues confronting regulators of the professions involved in property and investment advising, is the array and disparity of regulation and legislation governing these respective professions. Table 2 provides a snapshot of the professions, their jurisdictions and the regulations governing them.

Table 2: Professional Jurisdictional Regulation

Profession	Jurisdiction	Regulation
Valuers	State	Office of Fair Trading
Real estate agents	State	Office of Fair Trading
Mortgage Brokers	State	Office of Fair Trading
Banks	Commonwealth	Aust Prudential Regulation Authority
Investment advisers/ Financial Planners	Commonwealth	Australian Securities Investment Commission
Investment Seminars	Nil	N/a

Table 2 as a snapshot does not provide the breadth of professions and the absence of regulatory rigor needed to provide consistency across the property marketing, financing and advising professions. This profession has evolved as a standalone profession requiring licensing under the Australian Securities and Investment Commission.

Research method and rationale

A survey of the professions highlighted in this paper as well as financiers has been used to assess the perception and adequacy of the regulatory regimes governing each of the professions. The purpose of the survey is to assess concurrence and differences between the selected professions in the three key areas. These areas are the relationship between market value and price at which property is recommended to investors, the regulation of property and investment advising professions and the way these professions are remunerated. The response rate to the survey is highlighted in Table 3. The basis of the inclusion of these professions in the survey follows:

> **Valuers** were selected in their present capacity of undertaking mortgage valuation work and for other traditional valuation purposes. In their role as mortgage valuers, their inclusion in the survey also provides an interesting addition as to whether valuers would support valuations prior to purchase, which might assist the purchaser and also serve the needs of the lender. In essence, the question considered is: what impact could the change of property purchasers engaging valuers prior to purchase have on the concentration of mortgage valuation to panel work?
>
> **Selling agents** have been selected for their traditional role in the marketing and sale of residential property to investors. The impact of the information and advice they provide to prospective purchasers and investors is now under the scrutiny of Government. The effect of the selling agent on a more informed and experienced investor in the property purchase process is relevant to this study.

Financial planners are a growing profession who are recognised through licensing to provide investment advice. This advice may relate to property, or any other form of investment. They represent the sovereignty of advice giving as being a stand-alone profession. Their role in providing property investment advice will continue to emerge and grow as finance and access to funds from equity in property and other assets afford diversification of investment. In the sale of new residential property they are assuming an increasing role in the advice and recommendations they provide to investors.

Lenders, excluding mortgage brokers, have been included as the requirement for finance is integral to the property investment process. The provision of finance and the cost and structure of that finance is an important component to the success of the purchase and on-going performance and return from a property. The perspective of the lender is an important consideration in determining whether the client, as well as the lender, may be better served by valuation advice being sought prior to purchase rather than after.

Table 3: Summary of Survey responses

Participants	Surveys Sent	Surveys Returned	Invalid Surveys	Response % Excl Invalids
Valuer	70	58	5	76%
Real Estate Agent (selling)	70	42	3	56%
Buyers Agent	40	13	0	33%
Financial Planner	70	19	0	27%
Accountant	70	20	1	27%
Solicitors / Conveyancer	70	23	3	29%
Lender (Brokers excluded)	70	33	0	47%
Totals	**460**	**208**	**12**	**43%**

Survey statements and rationale

1) *Financial planners who make property investment recommendations to clients should recommend their client seek independent advice as to the price they pay for a property.* There are two inseparable parts to this statement and the answer. Firstly, do financial planners feel they are qualified to provide advice as to the value of property? Secondly, what is not known from the survey is which planners surveyed accept dual fees or commissions from investor and investment funds. The potential for bias to exist in the second issue if the planner does take a dual fee or commission cannot be separated from the first issue as to whether the planner may feel qualified to provide this advice.

2) *Real estate agents and valuers should be regulated at the Federal level of Government by the Australian Securities and Investment Commission and not at the State level of Government under the Department of Fair Trading in each State.* This statement pits agents and valuers views against financial planners who are currently each governed at different levels of Government under different legislative regimes.

3) *National legislation is needed which includes a provision that real estate agents, valuers and financial planners are permitted to act for and receive a fee, commission or reward from one side only (purchaser or developer) in relation to the same property transaction.* The Federal level of governance of financial planners was stricter than the State regulation of agents and valuers. Nevertheless, one fatal flaw of omission exists in the Federal legislation governing financial planners. That omission is the prohibition for a financial planner to accept a fee or commission from both investor and fund or developer in the case of property advice and transactions. This statement could be juxtaposed against the previous statement.

Statement 1 - Financial planners who make property investment recommendations to clients should recommend their client seek independent advice as to the price they pay for property.

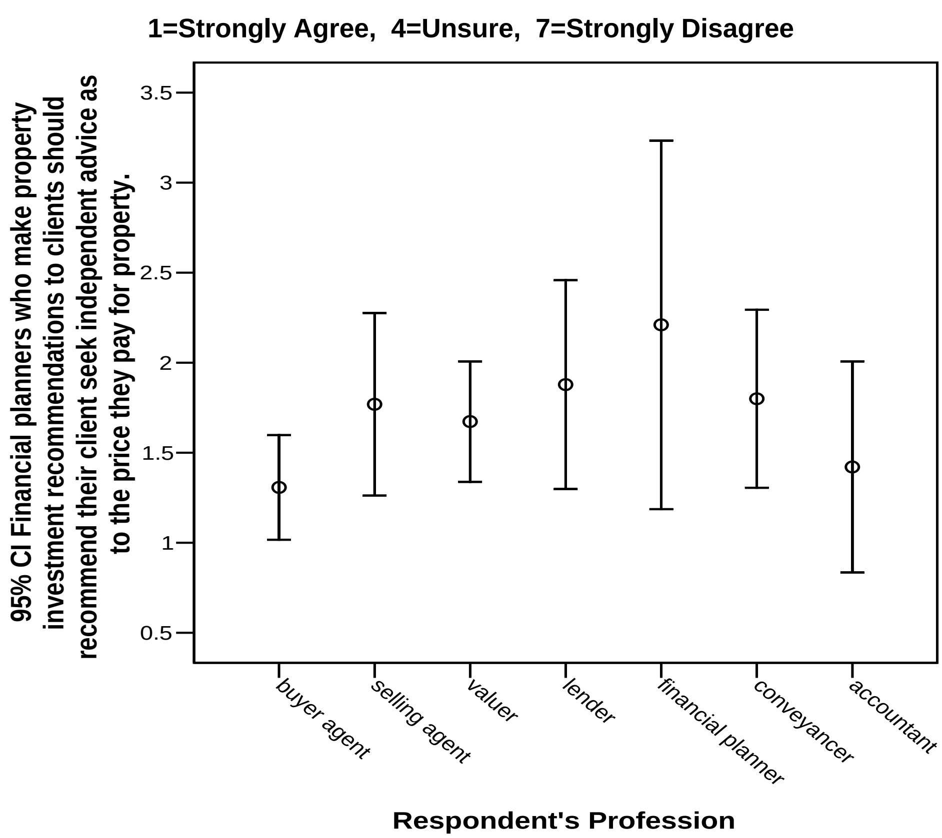
Mean Analysis

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Min	Max
					Lower Bound	Upper Bound		
Buyer agent	13	1.31	.480	.133	1.02	1.60	1	2
Selling agent	39	1.77	1.564	.250	1.26	2.28	1	7
Valuer	52	1.67	1.200	.166	1.34	2.01	1	7
Lender	33	1.88	1.635	.285	1.30	2.46	1	7
Financial planner	19	2.21	2.123	.487	1.19	3.23	1	7
Conveyancer	20	1.80	1.056	.236	1.31	2.29	1	5
Accountant	19	1.42	1.216	.279	.83	2.01	1	6
Total	195	1.74	1.424	.102	1.54	1.94	1	7

ANOVA Result

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	9.540	6	1.590	.779	.587
Within Groups	383.639	188	2.041		
Total	393.179	194			

Graph – Mean Distribution



Result Summary

All professions surveyed had a confidence interval endorsing the benefits of financial planners recommending property investors seek independent advice as to the price they pay for property. The P-value of the ANOVA is 0.587, which demonstrates that there is no significant disagreement between the professions in relation to the benefits of this recommendation. This statement is specifically targeted at financial planners and the confidence interval within the planners group is wide, ranging between 1.2 and 3.25.

Discussion

Further observations include the responses of buyer agents who assist purchasers locate and negotiate the purchase of property and financial planners who make specific property investment recommendations to purchasers. Buyer agents have the lowest and narrowest confidence interval of all professions. The Parliamentary Joint Committee on Corporations and Financial Services (2005) highlight the evolution of the buyer's agent and raises concerns about the activities and advice provided by this profession to investors.

Clarification of the role of buyer agents has been provided from this profession, which distinctly defines the merits of advice solely relating to the inherent and external features of the property. This is in contrast with financial planners who are more focused on tax and financial aspects of the property investment and how the financial attributes of property relates to the specific circumstances of the investor.

In contrast to buyer agents, financial planners have the widest range of all the professions. Discussion in a financial planner focus group has highlighted a level of resistance to planners not being able to discuss the inherent and external features of property. It was viewed that this information was obtainable from simple observation.

Statement 2 - Real estate agents and valuers should be regulated by ASIC at the Commonwealth level, not by Office of Fair Trading at State Government level.

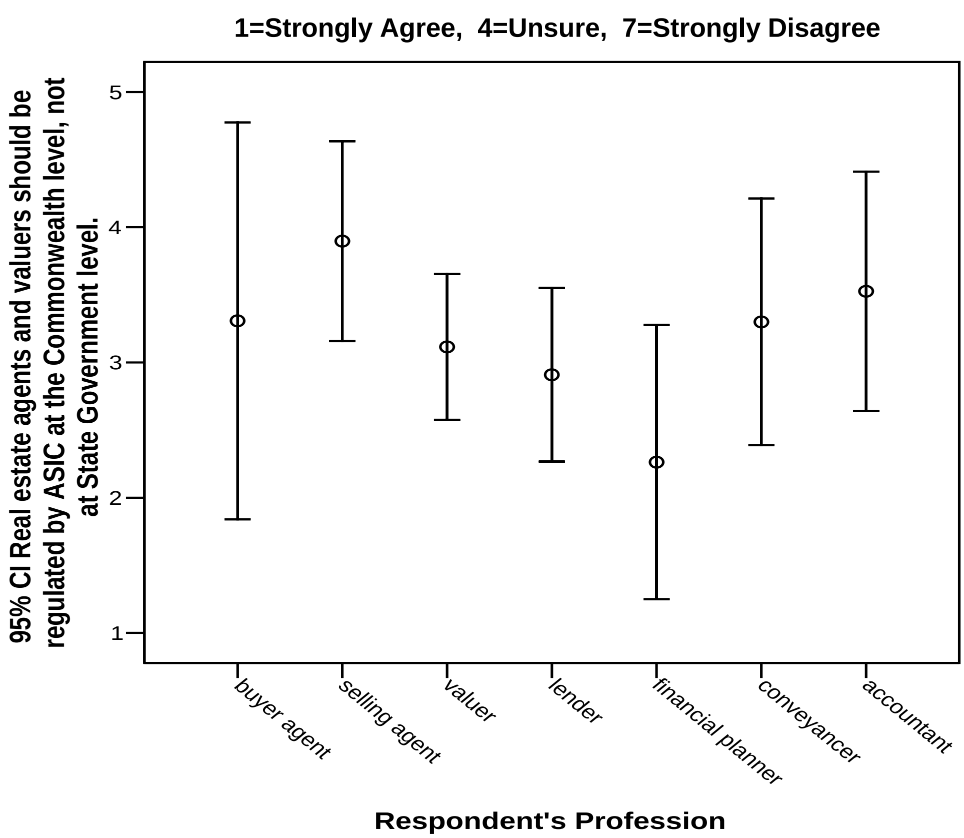
Mean Analysis

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Min	Max
					Lower Bound	Upper Bound		
Buyer agent	13	3.31	2.428	.674	1.84	4.78	1	7
Selling agent	39	3.90	2.280	.365	3.16	4.64	1	7
Valuer	52	3.12	1.937	.269	2.58	3.65	1	7
Lender	33	2.91	1.809	.315	2.27	3.55	1	7
Financial planner	19	2.26	2.104	.483	1.25	3.28	1	7
Conveyancer	20	3.30	1.949	.436	2.39	4.21	1	7
Accountant	19	3.53	1.837	.421	2.64	4.41	1	7
Total	195	3.23	2.054	.147	2.94	3.52	1	7

ANOVA Result

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	41.057	6	6.843	1.656	.134
Within Groups	777.015	188	4.133		
Total	818.072	194			

Graph – Mean Distribution



Result Summary

The means of the professions vary, with selling agents unsure about the statement and financial planners registering a mean that most supports the statement. The P-value of the ANOVA is 0.134 indicating that there is no significant difference between the professions in relation to this statement. Of note, is the mean distribution of buyer agents, which is widest of all the professions.

Discussion

In part, it has been observed that the response from property professionals, agents and valuers is driven by uncertainty, or lack of understanding of the Commonwealth regulations governing financial planners. The review of State and Commonwealth legislation governing these professions has provided a greater level of accountability and compliance on financial planners when compared with property professionals.

The policing of financial planners by ASIC has been far more extensive than the policing of real estate agents by Offices of Fair Trading in various States of Australia. This is evident from two silent shopper surveys conducted by ASIC on the quality of investment advice provided by planners. In addition, there has been an increase in the level of complaints lodged with ASIC and ACCC against real estate agents regarding advice given to investors since 2002.

Statement 3 - National legislation is needed for real estate agents, valuers and financial planners that only permits them to act for and receive a fee, commission or reward from the purchaser or developer only in the same property transaction.

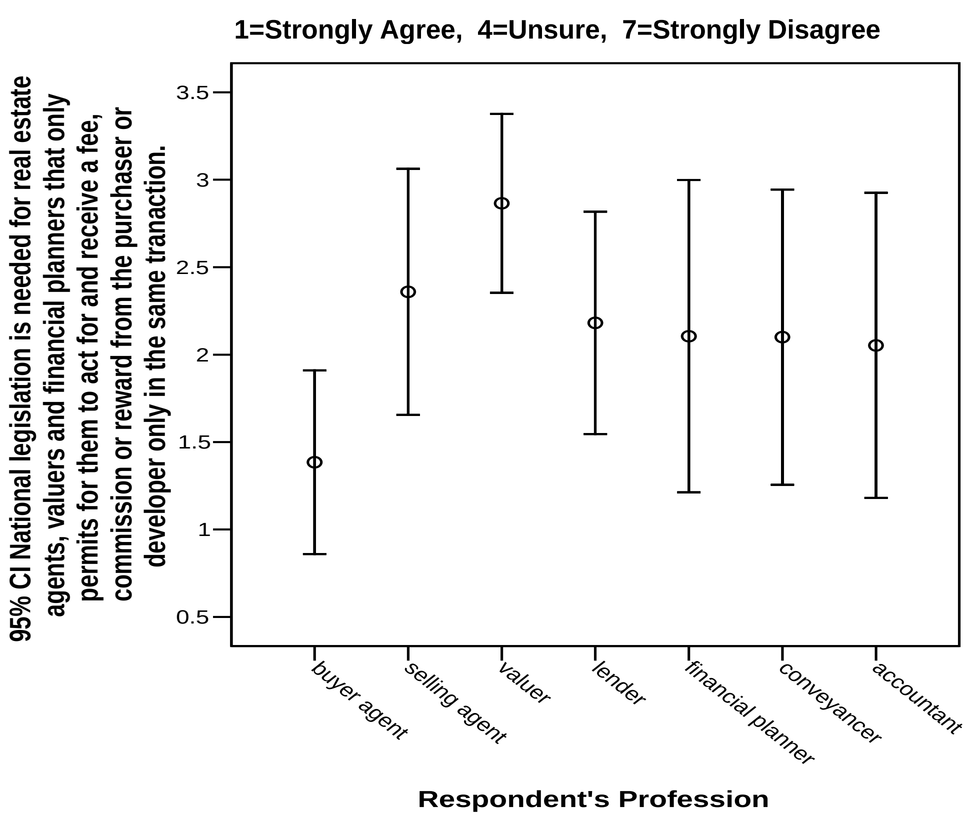
Mean Analysis

	N	Mean	Std. Deviation	Std. Error	95% Confidence Interval for Mean		Min	Max
					Lower Bound	Upper Bound		
Buyer agent	13	1.38	.870	.241	.86	1.91	1	4
Selling agent	39	2.36	2.170	.348	1.66	3.06	1	7
Valuer	52	2.87	1.837	.255	2.35	3.38	1	7
Lender	33	2.18	1.793	.312	1.55	2.82	1	7
Financial planner	19	2.11	1.853	.425	1.21	3.00	1	7
Conveyancer	20	2.10	1.804	.403	1.26	2.94	1	7
Accountant	19	2.05	1.810	.415	1.18	2.92	1	7
Total	195	2.32	1.867	.134	2.05	2.58	1	7

ANOVA Result

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	30.732	6	5.122	1.492	.183
Within Groups	645.555	188	3.434		
Total	676.287	194			

Graph – Mean Distribution



Result Summary

The means of all professions endorse the statement to varying degrees, with the valuers mean at the upper end of the range of the professions. Buyer agents are at the opposite end of the professions showing the highest level of agreement with the statement. Buyer agent agreement with the statement is reflected in the mean distribution of the group which is between 1 and 2 with a mean of 1.5. This is in contrast with valuers with a mean of 3. The P-value of the ANOVA is 0.183 indicating that there is no significant difference between the professions in relation to this statement.

Discussion

In New South Wales, agents and valuers regulations permit these professions to act for one party in the buying and selling of property. On occasion, valuers may be engaged by a mutual party for the transfer of property. The fact that this level of regulation exists may have prompted valuers to register marginal agreement with the statement. It has been observed, through meetings with agent and valuer study groups, that these professions have not been aware of the gap in the Corporations Act 2001, which allows investment advisers and financial planners to accept a fee, commission or charge from each side of a transaction. Whilst this gap exists, it is not usual that all planners and advisers engage in the practise of accepting commissions from both investor and developer, which is reflected in the wide mean distribution within this profession.

Overall, the survey shows uniform acceptance of professionals acting for one side only in a property transaction. If property is included as an investment class under the Corporations Act, it may be timely for this matter to be addressed consistently across all professions.

Conclusion

As the role of the investment advisers as a standalone profession gain acceptance by both professions and regulators responsible for the administration and policing of these professions, greater reliance and expectations are now being placed on these agencies. At present the evolving regulation of Financial Service Reforms has not been fully synthesised by property and other professions directly and indirectly involved in property marketing, transaction and information based services. As greater reliance is placed on professions involved in investment advising and retirement planning, the relevance of investment advice and the quality of that advice will continue to come under greater scrutiny. To some extent, the ability for regulators to understand and measure the progressive success and quality of information and services provided to property investors will continue to be an evolving challenge. Whilst uniform governance of all related professions may provide some level of consistency of compliance, greater focus is need on the precipitators governing property investment recommendations and bases that underpin those recommendations.

References

Australian Property Institute. 2002, *Loaded Pricing and Two Tier Marketing*, Australian Property Institute, Melbourne.

Australian Property Institute (Vic) 2003, 'Loaded-pricing and two-tier marketing', *Australian Property Journal*, vol. 37, no. 5, pp. 335-337.

Australian Prudential Regulation Authority 2007, *10 years of superannuation data collection 1996-2006,* Sydney

Australian Securities and Investment Commission, Annual Report 2006 Sydney

Australian Securities and Investment Commission 2007, *Inquiry into the collapse of Property Development Companies*, ASIC.

Australian Securities Investment Commission 1999b, *Review of the financial advising activities of real estate agents - Interim Report*.

Gilber, M.K., & Reed, R. 2003, 'The case for Reverse Mortgages in Australia - Applying the USA Experience.' *9th Annual Pacific Rim Real Estate Society Conference*, Brisbane.

Hunt, B. 1999, 'Is risk analysis a valuers domain', *Australian Property Journal*, no. Feb 1999, pp. 385-388.

Mangioni, V. 2006, *Do Valuations Assist Residential Property Investors Prior To Purchase?* Unpublished Thesis, UTS

Ministerial Council on Consumer Affairs Working Party 2004, *Property Investment Advice Discussion Paper*, Brisbane.

O'Brian, J., & Herman, D., 2002, *Guidlines for financial planners and investment professionals - New Residential Property Investments*, Property Investment Research, viewed 29-8-03 2003.

Parliamentary Joint Committee on Corporations and Financial Services 2005, *Property Investment Advice - Safe as Houses*, Parliament of Australia, Canberra.

Productivity Commission 2003, *First Home Ownership - Issues Paper*, Commonwealth of Australia, ACT.

Reserve Bank of Australia 2003, 'Do Australian Households Borrow Too Much?' *Talk to the Sydney Institute*, Sydney.

Schofield, I., 2006, Royal Bank of Scotland, *Personal Interview,* Barcelona