CHAPTER 4

Buyer beware - a plea from the Committee

4.1 In this report, the Committee has endeavoured to set out a regulatory scheme which will give property investors the same protection given to investors in other asset classes. By imposing a licensing regime, and the regulation of commercial behaviour and practice by licensees, the Committee hopes both to develop the legitimate property investment advice industry, and to force property spruikers out of the market.

4.2 There are, however, inevitable limits to what can be achieved by a regulatory scheme. In 2004, the Senate Economics Committee aptly quoted the Appeals Court of Massachusetts, which stated:

> What is unfair is a definitional problem of long standing, which statutory draftsmen have prudently avoided. It is impossible to frame definitions which embrace all unfair practices. There is no limit to human inventiveness in this field.[1]

4.3 No regulatory scheme, without being tyrannical in nature, can completely shut down the use of deceit and manipulation in commercial practice. While the proposed regulations will make operation more difficult for spruikers, it is inevitable that they will remain and do their best to skirt this, or any other, regulatory scheme.

4.4 Once the regulatory scheme is in place, it will remain necessary for consumers to be alert, to look to their own interests, and to approach anything which looks "too good to be true" with a healthy scepticism.

4.5 In this context the Committee notes the pertinent suggestion by the Real Estate Institute of Australia that the recommendations of the 2004 Consumer and Financial Literacy Taskforce be enhanced to include 'a stronger focus on property investment (which receives less coverage than investment in other asset classes)'.[2]

4.6 The Committee recommends that the Government take heed of this suggestion when implementing the Taskforce's recommendations.

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1 *Levings v Forbes & Wallace Inc* 8 Mass.App.Ct 498, 396 N.E.2d 149, quoted in Senate Economics References Committee (2004) *The Effectiveness of the Trade Practices Act 1974 in Protecting Small Business*, p.35.

2 REIA, *Submission 4*, p. 9.

Recommendation 7

4.7 **The Committee recommends that in implementing the recommendations of the 2004 Consumer and Financial Literacy Taskforce, the Government includes a stronger focus on property investment.**

Recommendation 8

4.8 **The Committee recommends that the Government continue and expand its programs to enhance financial literacy among consumers and to increase financial advice available to consumers.**

4.9 The Committee makes the following specific appeals to Australians considering property investment.

Seminars are marketing exercises

4.10 Legitimate property investment seminars are usually held by legitimate property dealers trying to encourage investors to invest in property, and in particular to do so through them. The seminars are a marketing exercise. Of course, marketing is legitimate – our economy is awash with well-regulated marketing strategies enticing consumers to buy all manner of things. But seldom are consumers asked to pay to receive advertising. We do not pay an admission price to watch television advertisements. We do not pay to receive junk mail. The product sellers pay for their marketing. Why should marketing property investment be any different?

4.11 Be wary if the seminar presenter encourages you to enrol in further training or educational courses. These can be expensive. Investigate the course content carefully and the credentials of the people delivering the course content. Even with advertised 'money-back-guarantees', many consumers have experienced difficulty in obtaining refunds.

Check the internet

4.12 In many cases, people who have been stung by spruikers tell their stories online. The Australian Consumers Association (www.choice.com.au) regularly provides warnings about spruikers. Your States or Territory's Department of Consumer Affairs or Fair Trading may do the same. Profit from the experiences of others.

Choose your own lawyer and accountant

4.13 You should immediately be suspicious if a property promoter offers to arrange a lawyer to give you legal advice and do the conveyancing for you, or an accountant to give you tax advice. If the lawyer or accountant is receiving multiple – maybe dozens – of referrals from this developer, then whose interests will they have at heart? Will they provide you with good advice, or will they act in a way which ensures the continuing flow of referrals?

4.14 If you choose your own lawyer and accountant, hire them and pay them yourself, you know which side they are on.

Get your own valuation

4.15 Don't believe what the promoter tells you about the real price – and don't believe the bottom line number on a valuation provided to them. If you choose and hire a valuer yourself, and they answer only to you, then you have the security of knowing whether you are paying a fair price. "Two-tier marketing schemes" are only able to exist because people believe inflated information about the value of a piece of property.

4.16 At the very least get a copy of the valuation done by the bank or lending institution, and immediately ask questions if that valuation is appreciably different from the purchase price. But if the promoter is also arranging finance through his own sources, be sceptical of the valuation provided by that linked institution. It is always better to get a valuation from an independent valuer. There may be a cost involved, but at least you will have a much better idea of the real value of the property.

4.17 The Committee received evidence that the disclosure of valuations by lending institutions to prospective borrowers would be of significant benefit to consumers. Such disclosure would alert borrowers if the price they were paying was significantly in excess of the valuation. It would make 'two-tier marketing' by property spruikers much more difficult. Apparently banks and credit unions provide their valuations to borrowers if they insist, but it is not a commonplace practice.

4.18 The Committee agrees with this evidence, and recommends that the disclosure of valuations by lending institutions to prospective borrowers should be made mandatory.

Recommendation 9

4.19 **The Committee recommends that the disclosure of valuations by lending institutions to prospective borrowers be made mandatory.**

Get your own finance

4.20 Beware of linked finance arrangements. Beware of any finance arranged by anybody other than yourself or your own financial advisers. If you cannot independently go out and arrange finance from a finance provider completely external to the property investment scheme, then this is a very strong signal that you should think carefully whether this investment is right for you.

4.21 Property investment by its nature usually involves large amounts of money. Be wary of taking on high debt levels. Realise that property is usually a long term investment and allow for the fact that interest rates and other economic factors may go against you, at least for a term of the projected investment.

Don’t be rushed

4.22 During its inquiries, the Committee formed the view that one of the simplest ways to tell a property spruiker from a legitimate property investment adviser is to observe whether they are trying to rush the consumer into making a deal. A legitimate property adviser will have no difficulty in allowing a consumer time to reflect and consider their options. A legitimate property adviser will have no difficulty in allowing a consumer time to arrange their own valuation, finance and lawyer. Even if a deal falls through while these processes are underway, it is better to miss out on a deal than to rush into an ill-considered investment decision. Missing out on a deal will not lead to financial ruin – but an ill-considered investment may well do so.

4.23 If your "adviser" is trying to rush you into making a deal, you should think about why. Are they trying to stop you from getting an independent valuation? Are they trying to stop you from getting independent financial advice? Are they trying to rip you off? The answer, unfortunately, is likely to be yes.

Demand advice about downside risk

4.24 Every investment without fail carries downside risk. Markets can both rise and fall. A legitimate property investment adviser will be able to describe to you the risks associated with an investment. A spruiker will focus on the potential gains, and will be dismissive of risk. There are always downside risks. If your adviser won't tell you about them, it is legitimate to ask what they don't want you to know.

Understand that your home is at risk

4.25 A substantial number of investors secure their investment loan with equity in their home.

4.26 In principle, there is nothing wrong with a consumer borrowing against the equity in their home. But if you do so, you must understand that if the loan goes into default, your home is at risk. If something goes wrong, and you have secured the loan against your home, then you could lose your home.

4.27 Home equity is important. The considerations are even wider than the significant physical and physiological elements involved in people living in their own homes. Home equity is very often the core of a family's wealth and more than the titleholder have a legitimate interest, such as spouse or partner and offspring.

4.28 The Committee feels that, given the social and economic importance of home equity, a suitable cooling-off period, say 14 days, should apply to any loans for investment in property which are underwritten by equity in the borrower's home.

Recommendation 10

4.29 **The Committee recommends that any loans for investment in property which are secured by home equity should be subject to a waivable 14 day cooling off period.**

Summary

4.30 The Parliament could not, without being draconian, implement regulations to cover every possible source of unfair spruiking conduct. Consumers must not simply rely on regulators. Instead, a partnership between consumers, regulators and industry bodies is required. The scheme proposed by this Committee is likely to make operation more difficult for spruikers, but no amount of regulation can remove the need for the buyer to beware.

Recommendation 11

4.31 **The Committee recommends that ASIC conduct targeted advertising and educational campaigns to alert consumers to the risks associated with property investment in general, and with get-rich-quick spruikers in particular.**

Senator Grant Chapman

Chairman