Law Institute Victoria

25 February, 2005

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Mr Anthony Marinac
Acting Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Suite SG.64
Parliament House
CANBERRA ACT 2600

Dear Mr Marinac,

Inquiry into Regulation of Property Investment Advice

I refer to your letter dated 15 December 2004 in relation to the effectiveness of the current regulation of the property investment advice industry.

I advise that the Law Institute of Victoria has prepared the attached submission in response to your request for comments on the possible reform.

If you have any queries regarding the submission, please contact myself or Nadia Venier of the Property and Environmental Law Section on 9607 9522.

Yours sincerely,

V.E. Strong.

Victoria Strong
President
Law Institute of Victoria

Submission

Property & Environmental Law Section

To: The Secretary, Parliamentary Joint Committee on Corporations and Financial Services

Submission on inquiry into regulation of property investment advice industry

A joint submission from: the Commercial Law Section and the Property and Environmental Law Section of the Law Institute of Victoria

Date: 25 February 2005

Queries regarding this submission should be directed to:

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1. Background

The Parliamentary Joint Committee on Corporations and Financial Services (the 'Committee') resolved to inquire into the regulation of property investment advice by the Commonwealth.

By letter dated 15 December 2004, Ms Sarah Bachelard, Committee Secretary, invited the Law Institute of Victoria (**LIV**) to make submission on the inquiry's terms of reference. The LIV welcomes the opportunity to provide comments on the subject of regulation of property investment advice and provides the following comments.

We note that the inquiry is in the initial stages of developing the Government's approach to reviewing property investment advice regulation. Consequently, the comments provided in this submission are general in nature. Elaboration can be provided once the recommendations of the inquiry are released. The LIV welcomes continued involvement in the consultation process and the opportunity to comment on specific proposals.

In preparing this submission, the LIV has taken the definition of "property investment advice" to mean the specific behaviour of recommending the purchase of real property to (usually non-corporate) consumers, and does not include the provision of general financial advice or investment in unit trusts. It has been assumed that the thrust of this inquiry is to address the practice of property investment promoters whose controversial and aggressive schemes have been the focus of recent public attention.

2. Summary

The LIV contends that a coordinated regulatory regime is required to address the current deficiency existing in regulation of the aggressive property promotion industry. This deficiency is evidenced by the numerous property investor schemes that continue to flourish with little consumer recourse available.

A consumer information campaign coupled with a central bureau providing information and advice would be an essential supplement to the proposals.

The LIV cautions that any legislative reform must be carefully adopted to ensure the bona fide property market is not impacted and existing consumer rights available within each State and Territory relating to the sale and purchase of land are not detracted from.

The LIV recommends that a compulsory insurance scheme be implemented to protect consumers in the course of receiving property investment advice.

3. Effectiveness of current (including *Trade Practices Act* 1974, the *ASIC Act* and the *Corporations Act* 2001) of the property investment advice industry in protecting consumers

The current system does not prevent unconscionable behaviour and the selling of properties at inflated prices. At one extreme, there appear to be numerous promoters selling or arranging the sale of properties at inflated prices to "uneducated" purchasers on the premise that the purchaser is making a sound financial investment and on the path to becoming a millionaire. There appears to be no effective control on these types of activities.

The LIV perceives the shortcomings of the current system to be:

(a) REGULATION

- An absence of specific legislation directly aimed at the "how to become a millionaire" promoters.
- A conflict and crossover of jurisdiction exists between ASIC, ACCC and State-based consumer affairs departments. There is confusion over whether a Commonwealth or State level approach is warranted. This leads to each authority claiming it is the responsibility of the other authorities and leads to no regulatory authority taking any action and no provision of consumer assistance. Regulatory and prosecutory powers should be given to one specific authority to deal specifically with this type of behaviour.
- Typical property investment schemes target investors in Victoria and New South Wales to buy properties in South East Queensland. Accordingly, there may be issues about which jurisdiction has authority and may warrant either a Federal approach or a coordinated response between the States and Territories.
- Existing regulation of estate agents and financial planners is not effective in this area.
- Schemes by the "how to become a millionaire" promoters that involve the sale of tangible, real property rights appear to avoid the provisions of the *Financial Services Reform Act 2001* (Cth) as this applies to investment in intangible assets.

(b) REMEDIES

- The current procedures to claim civil remedies pursuant to the *Trade Practices Act* 1974 and State fair trading Acts are expensive, complex and time-consuming which is off-putting to most purchasers seeking redress.
- The onus of proof rests on the purchaser to establish that misrepresentation or unconscionable conduct has taken place.
- The purchaser faces the difficulty of overcoming the documentary evidence. Typically the only documentation given to the purchaser is a contract of sale which stands alone (Parol Evidence rule).

4. Types of behaviour sought to be controlled

In paragraph (b) of the terms of reference the Committee seeks feedback as to allegations that property investment advisers engage in certain (undesirable) behaviour. Our members and their clients have witnessed all the behaviours set out in (i) to (v) inclusive namely:

(i) Characterisation of their activities (for instance, as "education seminars") in order to avoid regulation;

(ii) Habitual use of high pressure selling techniques in order to induce investment decisions;

(iii) Failure to disclose interests they may have in properties they are selling;

(iv) Failure to disclose commissions and fees associated with their services; and

(v) Failure to provide appropriate disclosure of the downside risk associated with the property or financial products they recommend.

In our members' experience a typical scenario of aggressive property investment advisers may involve the following:

(a) Members of the public are invited to attend a seminar on "How to become a Millionaire". Various examples are given of people who have become millionaires in a short time. Attendees are offered a "special offer" of free entry.

(b) The target audience is typically professional persons (medical industry, executives etc) who have a good income and good equity in their home.

(c) The audience is given a glossy presentation to show how easy it is to make money buying real estate and is given various "case studies" of people who have apparently made it rich applying these systems.

(d) The figures used in the samples are often questionable because they:

- do not take into account periods of non-occupancy;
- give inflated figures for rentals;
- fail to take into account maintenance and repair costs;
- are based on a premise that the market will continue to rise at boom rates;
- do not take into account management fees;
- present depreciation of chattels as if this will continue at the same rate in following years as in the first year (in fact chattel depreciation allowances drop quickly and reduce dramatically after the first couple of years); and
- do not take into account what will happen if the property market falls.

(e) Having convinced the audience that they can become wealthy easily, the promoter then goes on to say that he or she has researched the market and found the best properties to invest in (regularly these turn out to be in South East Queensland).

(f) Attendees are then offered one-on-one interviews to assess their own circumstances.

(g) Provided the attendee has a reasonable income and equity in his or her home, the attendee is told that he or she qualifies and is then taken to see the property.

(h) This may involve a flight to Queensland where the attendee will be met at the airport and driven straight to a display unit in a development. There the attendee is again informed that he or she will become a millionaire "in no time" and a great deal of pressure will then be exerted to sign contracts then and there.

(i) If the purchaser is unwilling to sign, high-pressure techniques are applied and greater pressure is brought to bear to sign on the spot.

(j) Typically a salesman will jot down figures on a piece of paper to "demonstrate" how much money will be made but will refuse to hand over a copy of those figures to the investor.

(k) Investors are escorted to and from the airport so that they do not have the opportunity to look at alternative properties or speak to an independent person for impartial advice.

(l) Once the contract is signed the promoter then arranges the finance and also arranges the conveyancing for the investor so that the investor never obtains independent advice.

(m) The bank is willing to give the loan because the investor has sufficient income and more particularly because the investor has sufficient equity in his or her own home. Even though the bank may value the investment property at less than the purchase price, the combined security is sufficient for the bank's purposes.

(n) The investor is not told the bank valuation for the property.

(o) The earnings from the property may not be what were promised, but having already purchased the property, the investor is forced to deal with the situation.

(p) The investor may not learn that he or she has paid too much for the property until an attempt is made to sell it.

(q) In the worst cases the investor may not be able to afford to keep the property and has to sell in the short term at a substantial loss.

Other areas in which the promoter may obtain extra profit from the purchaser are:

(a) The promoter will often either arrange the finance directly for the purchaser or will refer the purchaser to a finance broker.

(b) Most purchases involve straightforward loan applications as the purchasers have a reasonable income and equity in their home. Many purchasers could quite simply obtain finance from their usual banker the cost of which might be $500 - $600 or could be free (if on a professional type package with their bank).

(c) The promoter will not want the purchaser to go to his or her own bank because the promoter does not want the purchaser to obtain independent advice. (Many bank managers are aware of this type of scheme and the potential for inflated prices. Even if the circumstances do not cause the manager to be concerned, it is more likely that the purchaser will be told what the bank's valuation was if the purchaser goes to his or her own bank. It should be noted that it is not usual for any bank to release its actual valuation report to a borrower. In fact unless a borrower specifically asks, he will not usually be given the amount of the bank's valuation. It is more likely however that a borrower will be told of the amount of a bank's valuation if the borrower goes through his or her own usual bank and banker).

(d) Typically the promoter or his referee finance broker will charge several thousand dollars in brokerage fees. This is extra money for the promoter over and above the inflated property price. Where the purchaser is referred to an "independent" broker, there will likely be a "referral fee" paid back to the promoter.

(e) Likewise the purchaser will typically be referred to a solicitor or conveyancer "recommended" by the promoter. Again it is likely that the purchaser will be charged an inflated fee and that a "referral fee" is paid back to the promoter.

It appears to the LIV that such promoters are able to operate outside any current effective regulation.

Our members are aware of promoters using "massaged" figures and examples to lead investors to potentially unrealistic expectations of income and capital growth and employ high pressure sales techniques to obtain signatures on "stand alone" contracts which have no written reference back to the representations made by the promoter.

Often promoters fail to disclose their own interest in the properties. In some cases the promoter may be the owner of the property (directly or indirectly) and having purchased the property for much less, resells the property at an inflated price to the investor.

In other cases the investor may enter into an agreement with a developer by which a developer allocates a certain number of units to the promoter. The promoter adds his own margin to the properties over and above the market value and sells at an inflated price to the investors.

Where promoters receive "referral fees" from finance brokers and/or solicitors or conveyancers they will not be likely to disclose them to the investor.

The promoter will usually only promote the scheme as if the market will continue to rise at boon rates and will not advise of problems associated with a falling market.

5. Whether it is appropriate for property investment advisers to simultaneously sell an interest in property and financial products enabling such purchases.

The LIV considers that it is inappropriate for property investment advisers to simultaneously sell an interest in property and financial products enabling such purchases. Investors should receive independent advice on financing issues. There should also be transparency between any relationship the property investment adviser has with the provider of financial products which discloses any benefits exchanged. Without transparency and/or independence there is an increased risk of collusion to the detriment of the consumer.

6. Advantages and disadvantages of possible models for reform of property investment advice industry including:
- **i. National coverage through uniform state and territory legislation;**
- **ii. Commonwealth legislation; and**
- **iii. A scheme of self-regulation of property investment advisers on a national basis.**

It is common for transactions involving property investment advice to cross State boundaries (eg investors sought in Victoria and New South Wales to purchase properties in Queensland). The LIV therefore endorses either a federal system or, given the possible constitutional issues which may exist with this approach, a system of uniform state, territory and federal legislation (options i. and ii. above).

Whilst the LIV considers that there is a need to reform the laws to regulate and deal with property investment advice, such reforms need to deal specifically with behaviours currently associated with property investment advice and regulation should not affect:

(a) Licensed estate agents acting in the usual course of business who may offer limited investment advice to assist with the sale of properties on behalf of their vendors;

(b) Bona fide financial advisers who offer advice in relation to property investment as part of their services.

(c) Promoters who offer a bona fide service as a purchaser's advocate to purchase properties where there has been full disclosure of fees paid by the purchaser to the promoter. The LIV recognises that many potential investors do not have the time or understanding to research and buy investment properties. It is perceived that there is a market for advisers to offer to provide investment advice and arrange the purchase of properties for fully disclosed fees. Such buyer's advocates would appear to have to hold an estate agent's licence and an investment adviser a financial advisers licence.

The LIV recommends that an authority (whether an existing authority or a new authority) should be given specific powers and authority to regulate the property investment advice industry and to prosecute persons involved in unconscionable behaviour. Specific direction needs to be given to avoid the existing problem of regulatory authorities declining to act because of perceived demarcation issues.

Self-regulation is not appropriate in the case of aggressive property promoters. The type of behaviour in question appears to fall outside the normal boundaries of licensed estate agency or financial advisory. It appears unlikely that self-regulation by promoters of these schemes would be effective.

7. Whether current legal processes provide effective and easily accessible remedies to consumers in dispute with property investment advisers.

The LIV supports the establishment of a more accessible system for obtaining remedies, perhaps utilising tribunals such as the Victorian Civil and Administrative Tribunal rather than the Courts. Further the procedure in an action for remedy should be changed to give a purchaser more scope for remedy where a purchaser has been persuaded to enter into a contract by a promoter in the manner set out above. Possible changes are in such circumstances could be:-

(a) a change in the onus of proof where it is established that the purchaser was introduced to the property by a promoter of such a scheme;

(b) a change in the rules of evidence which allows the investor to rely upon representations made by a promoter notwithstanding that they do not form part of a written contract;

(c) giving a purchaser in such circumstances to right a avoid a contract at any time before settlement;

(d) giving a purchaser in such circumstances the right to set aside a transaction and receive all monies back even after settlement has occurred where the promoter is the owner of the property;

(e) giving a purchaser in such circumstances the right to damages (being the difference between the contract price and the real market value plus consequential losses).

8. Possible methods for reform

The LIV proposes the following options for reform:

(a) Imposing a requirement for written disclosure of any promoter to each attendee conducting an "investment seminar" as to:
- what the promoter hopes to get out of the seminar;
- what the promoter will get out of the sale of any property as a result of the seminar; and
- what interest the promoter has (directly or indirectly) in the property being sold.

(b) Imposing a requirement for pre-contractual disclosure 7 days before a contract can be signed detailing all amounts that the promoter is to receive as a result of the sale. (Reference is made to the existing agent disclosure requirements for the sale of property in Queensland). The document should also contain prominent warning notices advising the purchaser to seek independent valuation and legal advice.

(c) Imposing a requirement for the promoter to provide an independent valuation report together with the pre-contractual disclosure.

(d) Imposing a requirement for the promoter to give the investor copies of any figures prepared to demonstrate the financial aspects of a transaction to an investor.

(e) The creation of an automatic reversal of onus of proof in any claim for civil remedies where there is a failure to provide the required disclosure or documentation.

(f) A prohibition on promoters arranging finance in the same deal.

(g) Where a promoter refers an investor to a finance broker or solicitor or conveyancer, a written letter of referral should be given specifying the amount of any referral fee to be paid and also containing a warning notice to the investor about obtaining independent advice.

(h) Ensuring remedies are available against a promoter company and its directors.

(i) Implementing a compulsory insurance scheme to protect consumers in the course of receiving property investment advice.