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**Renovating the system – changes to real estate practices in Australia**

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*"South Australians have sent our Government a message. They want real estate practices to be more transparent. They want agents to be more accountable and the improved conduct they want should also apply to private sales"*

Michael Atkinson, Attorney General, SA October 2003

**Abstract**

This paper which arises out of an examination of real estate practices in South Australia in 2003 reviews some of the recent changes to state legislation including those in New South Wales, Victoria, Queensland, South Australia and the Australian Capital Territory with regard to industry practices in the residential market. These include advertising, estimation of selling price, auction procedures, and conflicts of interest. Some of these changes arise from reviews of state legislation based on the National Competition Policy and others a means of delivering substantial improvements in the protection afforded to consumers when purchasing residential real estate.

**Introduction**

This paper arises out of a review of real estate practices in South Australia (SA) in 2003 and examines some of the recent changes to state legislation including those in New South Wales (NSW), Victoria, Queensland, SA and the Australian Capital Territory (ACT) with regard to industry practices in the residential market. Regulation of the real estate industry is taking place throughout Australia with states such as NSW and Victoria recently enacting legislation designed to make the real estate market more transparent and to deal with misleading conduct by land agents. Other States including SA have indicated that they are also anticipating legislative reforms. Practices under review include advertising, estimation of selling price, auction procedures, sales agency agreements and conflicts of interest.

Some of these changes arise from reviews of state legislation based on the National Competition Policy Review agreed to by the Council of Australian Governments in 1995. However in the main they have been undertaken as a means of delivering substantial improvements in the protection afforded to consumers when purchasing residential real estate. Research into the auction process in particular (Reed *et al*/2002) also supports the need for revision of certain industry practices in order to ensure market values are achieved and consumers are not disadvantaged. The items that have been selected for discussion in this paper include the practices of bait pricing, over quoting, the conduct of auctions and conflicts of interest

## **Bait pricing**

Bait pricing is the term given to the practice whereby agents advertise a property by reference to a price or price guide that is significantly less than the agent's estimation of the market value of the property and what the vendor is prepared to accept for the property. The argument against such advertising is that it attracts a proportion of buyers only interested in purchasing a property at a price well under the property's value. On the basis of such misleading advertising prospective purchasers may be lured into paying for pre-auction building inspections and waste time inspecting properties, arranging finance and attending auctions only to discover that the property sells for a considerably higher price outside of the price range they can afford.

In NSW the recently enacted *Property, Stock and Business Agents Act 2002* Section 73 now states that an agent must not falsely understate the estimated selling price of a property in the course of marketing that property. It provides that a statement in the agency agreement of the agent's estimate of the selling price of residential property can be used as evidence of the agent's true estimate of that selling price. The section makes it an offence to advertise an estimated selling price that is less than the estimate recorded in the agency agreement.

Recently passed Victorian legislation (May 2003) directly prohibits an agent from making a representation of the estimated selling price that is less than the estimated selling price required to be recorded in the agency agreement.<sup>1</sup> Several other jurisdictions have general prohibitions against misleading representations about the value of, or price payable for, land similar to that contained in SA's *Fair Trading Act*. Some jurisdictions, including Tasmania, also have conduct rules prohibiting agents from advertising properties for a price different from that authorized by the vendor<sup>2</sup>.

In SA bait pricing is generally prohibited under the *Land Business (Sale and Conveyancing) Act* (LABSACA) s 36 as well as the *Fair Trading Act* with prohibition on false representations for the purpose of inducing another person to purchase land or business. Proposed changes in SA to the *Land Agents Act 1994* would also make it illegal as of 2004 for agents to advertise a property for sale for a price below the estimated price required to be recorded in the agency agreement, or the lower prices of a permitted range. Agents would be prohibited from advertising a property for a price range that exceeds 10 percent of the lower amount of the range and be prohibited from making representations of prices as "\$x plus", "low to mid \$hundred thousands" or "mid to high \$hundred thousands".

## **Over quoting**

It is commonly acknowledged that a primary factor determining which agent a vendor selects can be the price the agent indicates a property is worth, or that the agent will achieve for the vendor with the agent's marketing campaign. Over quoting is described as the practice whereby agents inflate the appraisal price of a vendor's property in order to persuade the vendor to list the property with them. What usually follows over quoting is a process of informing or "conditioning" a vendor in order to bring down their expectations to a more realistic level. This process has been seen as significantly detrimental to vendors, who may, for example, enter into a contract to purchase a new house for a certain price based on an inflated expectation of what they can expect to receive for their existing property. In addition it is suggested that vendors will in fact receive significantly less for a property when it is eventually sold if it is overpriced when initially advertised for sale.

Various jurisdictions have addressed the issue of over-quoting by enacting specific prohibitions against agents misrepresenting the market value of a property. In Queensland if an agent gives an opinion on

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<sup>1</sup> (Vic) *Estate Agents Act 1980* ss 47C (not yet commenced).

<sup>2</sup> (Tas) *Auctioneers and Real Estate Agents Act 1991* s 48.

market price, the agent must not accept instructions to act unless the agent has given the vendor a written statement setting out the material facts upon which the opinion is based. It is also an offence to make a false representation about the value of a property and the onus of proof is reversed such that it is on the person making the representation to establish that the person had reasonable grounds for making the representation.<sup>3</sup>

In the recently enacted NSW legislation there is a specific prohibition against misrepresenting the market value of a property and a power for the regulator to require an agent to substantiate a price estimate or representation. The Rules of Conduct prescribed under the NSW legislation also require agents to prepare an inspection report containing matters such as the price at which the property is to be advertised for sale.<sup>4</sup>

Recent legislation passed in Victoria includes a requirement that the agent set out the agent's estimated selling price or price range (restricted in size to 10 percent of the lower amount of the range) and enables the regulator to require an agent to provide evidence of the reasonableness of an estimated selling price or range recorded in an agency agreement.<sup>5</sup> It is required that the estimated selling price must be the amount the agent believes that a willing but not anxious buyer would pay for the property, or a range within which that amount is likely to fall.

In SA there is protection under the general prohibition on false or misleading representations concerning the price payable for the land contained within the *Fair Trading Act* (FTA) ss 59, 75. However new legislation proposed for SA in 2004 will also require agents to set out in a sales agency agreement their estimate of the selling prices of the property as well as the reserve price where sale is by auction and the vendor's desired price.

### **Dummy bidding**

One real estate practice that has achieved a great deal of media attention is that of "dummy bidding" which refers to bidding at an auction by those who have no genuine intention to buy. The real estate industry at large would distinguish this from vendor bidding whereby the vendor bids either on their own behalf or through an auctioneer or agent up to but not including a preset reserve selling price. Such bidding by an auctioneer on behalf of a vendor has been described colloquially as the "pulling of bids". Most in the industry would agree that dummy bidding at auctions is misleading and that it should be specifically prohibited. However views regarding vendor bids are more equivocal. Many in the industry would argue that vendor bidding creates momentum in auctions and that the vendor bid equates to the vendor's counter offer in a private treaty negotiation. As such vendors should not be placed in a worse position in auction sales than they enjoy in private treaty sales negotiations.

However others recognise that many auctions especially in the recent buoyant market, may only attract one genuine bidder and that the reserve is flexible and often adjusted during the course of an auction. Prospective buyers may be effectively bidding against themselves and where a reserve is set unrealistically high (ie over the agent's estimated market value), the vendor may bid over an estimated market value of the property (Reed *et al* 2002).

Most states have considered that while it can be accepted that the vendor bid has a valid role in protecting the vendor's right to negotiate the best deal possible on their property, to the extent that any such undisclosed bid achieves this by misleading bidders, reform is warranted for consumer protection. Thus as a minimum there should be a requirement for vendor bids to be disclosed and

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<sup>3</sup> (Qld) *Property Agents and Motor Dealers Act 2000* s 574; *Real Estate Agency Practice Code of Conduct* cl 14.

<sup>4</sup> (NSW) *Property Stock and Business Agents Act 2002* ss 72-75; *General Regulation Sch 1 (Rules) rr 3, 4.*

<sup>5</sup> (Vic) *Estate Agents Act* ss 47A, 47B, 47D.

recorded as vendor bids. The number of such permitted bids has varied but most jurisdictions have of late sought the registration of all bidders, the recording of bids including vendor bids and the recording of an agreed reserve price.

NSW has recently enacted legislation requiring all bidders to register and that auctioneers only take bids from registered bidders who are identified by displaying a number assigned on registration. Bids are to be recorded in a bidders record with reference to that identifying number. Vendors are restricted to one bid only on their behalf provided the auction conditions notify that the seller or auctioneer reserves the right to bid and the auctioneer identifies the bid as taken by or on behalf of the vendor or auctioneer.<sup>6</sup> In Queensland auctioneers are required to use their best endeavours to register all bidders.<sup>7</sup>

Amendments have recently been passed to Victorian legislation specifically prohibiting the making and accepting of dummy bids and undisclosed vendor bids. All vendor bids are to be made via the auctioneer and the auctioneer will be required to declare the bid as a vendor bid by using the words "vendor bid". If a property is passed in and the highest bid was a vendor bid, agents will be precluded from stating the amount of the highest bid without also stating that the bid was a vendor bid.<sup>8</sup>

Property auctions in the ACT are also to be changed significantly by a recently introduced bill which will prohibit dummy bidding and restrict the number of vendor bids to only one<sup>9</sup>. It is also proposed to introduce a requirement for bidders to register similar to the requirements introduced in NSW. If the Bill is passed the regulations are expected to start in July 2004.

In SA it can be argued that dummy bidding by agents is prohibited already under the *Fair Trading Act*, which provides that it is an offence to make a misleading representation in relation to the price payable for land. However it has been determined that a more specific prohibition against dummy bidding is required for certainty. Under new proposed legislation for 2004 it will be an offence for any person to make or procure a dummy bid as well as for an auctioneer to knowingly take or procure a dummy bid. These changes will require amendment to the *Land Agents Act 1994* (for agents & auctioneers) and the *Land and Business (Sale and Conveyancing) Act 1995* for members of public. Bidders will be required to register and auctioneers will be required to identify all bids with reference to the bidders registration number, which is to be clearly displayed. One bid only is to be permitted on behalf of the vendor, which is to be clearly identified as a vendor bid. The agent/sales representative is to be required to record the agreed reserve and document any changes to the reserve, in writing prior to commencement of the auction. The agent/sales representative is to be required to make and keep a record of all bids made at auction, and identify which bids were vendor bids. Agents are to be required to retain the register of bidders, record of bids and documentation evidencing the reserve for a reasonable period of time to facilitate the later scrutiny of the auction process.

## Dutch Auctions

Despite all the attention given to dummy bidding and accompanying legislative changes many within the real estate industry would suggest that more complaints are received in relation to private treaty sales than auctions especially from people who have missed out on purchasing properties. It has been suggested that people who have made an unsuccessful offer on a property often make such complaints, in that they were not given an opportunity to increase their offer. They may argue that they would have been prepared to pay more if given the opportunity to make another offer or if it had been made clear that the vendor would be considering multiple offers. These complaints, as well as

<sup>6</sup> (NSW) *Property, Stock and Business Agents Act 2002* s. 67.

<sup>7</sup> (Qld) *Property Agents and Motor Dealers Act 2000; Regulations; Auctioneer's Code* cl 32.

<sup>8</sup> (Vic) *Sale of Land Act 1962* ss 41, 46 (not yet commenced).

<sup>9</sup> (ACT) *Civil Law (Sale of Residential Property) Bill 2003* cl 29.

anecdotal evidence, suggest that purchasers are concerned that agents have not presented their offer to the vendor, or have favoured another offer over theirs. They may not understand that, particularly a buoyant market, agents can receive multiple offers on a property and will generally not enter into further negotiations other than with the party who has made the best offer. Indeed to do so may invite allegations of "Dutch auctions" (ie that may include disclosing details of offers to other interested buyers who have put in offers also). Purchasers may also fail to understand that the most favourable offer may not necessarily be the highest, rather an offer with the best conditions, for example a lower cash, unconditional offer may be accepted over a higher offer that is made subject to finance.

Although the term "Dutch auction" describes various legitimate forms of auction, in the sense used by the real estate industry the term refers to a practice whereby the agent discloses details of an offer to another interested party, potentially to assist that party to secure the property, or makes representations to an interested party to the effect that significant interest has been shown in the property or that the vendor will only be interested in a higher offer (whether or not this is true) in an attempt to induce the interested party to increase their offer. The interested party has no way of knowing whether these representations are true or whether in fact by increasing their offer they are in fact bidding against themselves. Thus private treaty sales, especially when marketed within a large price range, can disadvantage potential purchasers because there is no specified price at which a purchaser could actually purchase a property. Rather an offer must be made with reference to an advertised price range, which may be so large as to be a useless guide to the market value of the property. This lack of transparency may encourage "Dutch auctions", or private auctions.

The writer is not aware of any restrictions in state legislation as yet, against the advertising of property with respect to a specific price range, outside of the proposals for SA, although there are prohibitions against misleading advertising. In SA, as a means of protecting against "Dutch auctions", it has been proposed, as of 2004 that agents should be required to submit all written offers to the vendor and to retain the offers for a reasonable period to enable these to be inspected by the regulator in the event of complaint. Further it should be an offence for an agent to disclose details of an offer on a property to any person interested, or potentially interested, in purchasing the property. Amendment to the *Land and Business (Sale and Conveyancing) Act 1994* will require that all offers to purchase residential property must be made in writing and signed by the purchaser. Also, where relevant, agents should provide information to all persons making offers explaining how offers, including multiple offers, will be treated by the agent.

### **Conflicts of interest**

Many in the industry would suggest that one of the most significant causes of improper behaviour in the real estate industry is conflict of interest. Even in standard agency practice it has been suggested there is potential conflict between an agent's interest in maximising commission by maximising turnover of properties and a vendor's interest in securing the best price for their property. There are also potential conflicts between agents and conveyancers and, in particular, between agents and developers. Although in most jurisdictions legislation prohibits agents from doing conveyancing work and working in the same business as a conveyancer, many conveyancers are wholly or largely dependent on particular agents for referral of conveyancing business and therefore their independence may be at risk.

In SA it is standard industry practice for developers to give the listing of a developed property or properties back to the agent that introduced them to the initial property. Thus, if a property the agent is commissioned to sell is sold to a developer, the agent stands to earn commission not only on the sale of that property, but on the sale of any subsequent properties sold by the developer on completion of the development. This may amount to a secret commission or benefit to the agent and

creates an incentive that can conflict with the agent's duty to the vendor. This leads to a temptation to recommend a developer's offer over other interested parties' offers. Other situations of conflict between agents and developers include where an agent purchases a property before listing then sells to an associated developer and where the agent is also a developer or speculator, presumably acquiring properties directly from vendors with a view to developing them or on-selling for a profit.

It could be argued that market forces would adequately address potential conflicts between agents and developers because an agent perceived to have too close a relationship to one developer would not be approached by other developers and vice versa. However there is nevertheless scope for vulnerable consumers to suffer loss as a result of such agent/developer conflicts.

It been noted also that there is an emerging trend in the industry for agents to establish related companies or divisions that are developers, mortgage brokers or investment advisers. The recently enacted *NSW Property, Stock and Business Agents Act 2002* includes a provision requiring agents to disclose any benefit received or expected to be received in connection with the sale of land. Although this provision appears primarily aimed at situations where agents refer clients to other service providers for services such as finance or legal or valuation advice, it appears that it may also include disclosure of any benefit the agent expects to receive in connection with the sale.<sup>10</sup>

Recent amendments to the Victorian legislation also include a requirement for agents to disclose any benefits received in connection with incurring expenses, eg advertising expenses, on behalf of the client.<sup>11</sup> However the legislation also allows agents to share commissions with other professionals such as financial planners.

Under proposed changes to legislation in SA agents will be required to disclose to the vendor any actual or potential conflict of interest the agent has in connection with the sale of the property. This includes disclosure of any relationship with a person to whom the agent has referred a client for services ie mortgage broker. There will also be amendments to the *Land and Business (Sale and Conveyancing) Act 1995* to broaden the definition of 'prescribed relationship'. The current prohibition on agents having an interest in land they are commissioned to sell is to be extended to all situations where they have not actually been commissioned to sell the land and where no agent acts for the vendor. This means they would need to obtain the vendor's informed consent based on an independent valuation, and a Ministerial exemption, before purchasing the land. The new conflict of interest provisions are to be supported by training of agents to enable them to identify the conflicts.

## **Conclusion**

In the main the response from the real estate industry in SA to the proposed changes in legislation has been fairly positive. Most believe that many of the changes will do much to enhance the real estate industry while significantly improving consumer protection both for vendors and for buyers. The Real Estate Institute of SA (REISA) Auction Committee moved early, before the release of any government proposals, to prohibit dummy bidding, to clarify vendor bids and to encourage voluntary registration of bidders. However the changes which have received widest criticism are those to the auction process. In particular the restriction of disclosed vendor bids to a single bid which the REI in most states suggests is unworkable, will jeopardize the auction system and is a "reaction to hype" (Lindsay, 2003). Many suggest also that adequate policing of the auction system will be impossible and prosecution of offenders difficult. However one REI spokesperson from Victoria (Harley, 2003) has cited the success of the Canadian based Ritchie Bros Auctioneers who, despite the adoption of the no vendor bidding whatsoever, is now listed in the US and turning over \$A2.2 billion a year. On the other

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<sup>10</sup> (NSW) *Property, Stock and Business Agents Act 2002* s 47 (not yet in operation).

<sup>11</sup> (Vic) *Estate Agents Act 1980* ss 48A-48E (not yet in operation).

hand The State Opposition in Victoria has suggested similar state legislation in the USA requiring the declaration of all vendor bids has led to an increase in real estate fees and contributed to a fall in property prices (Harley, 2003). The number of sales by auction in SA has fallen in the last 3 months. Whether this is in response to the proposed new legislation, a slower market or both is uncertain. However this may be exactly what some buyer advocates are looking for - what they describe as less "market manipulation" with vendors less willing to chance their hand at auction and average properties no longer being auctioned (Harley, 2003).

## References

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