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Buyer beware

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One of the most amazing trends in real estate over the past few years has been the growth in the use of buyers' advocates.

It's not that they are being used that's amazing - in fact, that's an inevitable result of the way in which real-estate buyers are kept in the dark and fed manure by vendors' agents and the property information system.

What is amazing is that almost all buyers' advocates charge a percentage of the sale price; and even more astonishing is that clients are paying it.

The Eureka Report has surveyed 20 firms that represent buyers in property negotiations. Half of them admit to charging 12.5 per cent of the value of the property, a portion charged an undisclosed percentage of the final price, and the rest would not disclose their fees.

Assuming the non-disclosers also charge a percentage, which is a pretty safe assumption, it means that more than 90 per cent of buyers' advocates actually have a stake in driving the price paid by their clients higher.

Vendors paying a percentage of the value to their agent is understandable: you want to give your agent an incentive to get the price up. But on the buying side as well?

Why on earth would you pay your negotiator more for failure - for failing to get the property for a cheaper price?

By paying a percentage of the value of the house, buyers are ensuring that the more they pay for the property, the better their advocate does.

A similar problem exists in merchant banking, only worse.

The banks acting for both sides of most takeovers are paid a percentage of the transaction value; both sides therefore have an incentive for the price to be as high as possible.

The reason it's worse in merchant banking is that most agency contracts in takeovers provide that there is no fee if there is no transaction, which means the "defending" merchant bank has



Picture: *Gabriele Charotte*

a powerful incentive to ensure that the company is sold.

It is not quite so bad as that with real estate buyers' advocates, but it's close.

Nearly all the firms surveyed charge a fixed retainer, plus a percentage of the value if the client actually buys a house.

That means the "advocate" is slightly less inclined to ensure that its client buys a house - any house - in order to get paid in the first place, but the system sucks anyway.

The problem seems to be that most buyers' advocates are former real-estate (vendors) agents who are accustomed to charging 1.52 per cent or more for their services in selling properties.

The commission structure for the new buy-side agent industry has simply been transferred from the sell-side.

One firm, Capital Property Buyers Agents, even says that its fee is the "standard fee that the selling agent would receive for the sale of the property".

Is it just me, or has the world gone topsy-turvy? Agents for both the buyers and the sellers have an interest in driving prices as high as possible. How can buyers know that the negotiation has gone their way when their agents are being paid in the same way as the vendors' agent?

For the buyers' agents, there are two main benefits of this policy: They get to charge more: 2 per cent sounds so much better than, say, \$20,000 on a million-dollar house; in fact, no one would pay that much if that's how it was quoted. The fee goes up most years automatically with any rise in the general value of real estate, which tends to average 6.8 per cent a year (more in booms and less in times like the present), or about two to three times the inflation rate.

There is no law against buyers' advocates charging what they can, in any way they like.

Demand for their services is rising exponentially. This is because the information cards are stacked against buyers, in that data on real-estate sales tends to be about four months behind the market and general, rather than specific.

And because property is not a security, it is not regulated by the Australian Securities and Investment Commission. (Not that this would necessarily be any protection against sharks - just ask the clients of financial planners.) The only way buyers can stamp out the practice of their advocates demanding a set percentage of the sale price is to revolt.

Instead of paying them more for a job badly done, perhaps buyers should insist on fixing a fee by offering 1 per cent of the amount they are prepared to spend, irrespective of the final sale price.

Another option might be they agree on a likely sale price with the advocate, then pay, say, 5 per cent - even 10 per cent - of the difference if the advocate secures it for less.

That way the buyer could be sure the advocate is really on their side.

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