

The Allen Consulting Group

Real Estate Agency Market Segmentation Study

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Report to the Estate Agents Council

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The Victorian market for estate agency services — segmentation model overview

Introduction

This report presents the Allen Consulting Group's research, analysis and findings of its study into segmentation in the market for estate agency services in Victoria. The report is provided to the Estate Agents Council (EAC), to assist its review of the licensing framework under the *Estate Agents Act 1980* and Regulations, as requested by the Minister for Consumer Affairs.

Objectives

The study's objectives are to identify and describe segmentation in the market for estate agency services, and for each segment, to:

- examine the transactions, characteristics and functions of suppliers and consumers in the market;
- identify the risks to participants in the market for estate agency services and the available protections; and
- assess competition, including the impact of changes in the regulatory arrangements over the last five years.

The Victorian market for estate agency services

The role of estate agents is to facilitate property transactions by bringing together parties to such transactions in an effective and efficient way.

Estate agency services consist of appraising, purchasing, selling, managing or renting real estate for others. For the purposes of this study, the activities considered to comprise 'estate agency services' are:

- property sales;
- leasing and managing property;
- buyer advocacy;
- business broking;
- real estate advisory services; and
- specialist services that form sub-activities of any the above (e.g. auctioning).

Evidence supports the notion that there is a market for estate agency services, and that there exists a market in Victoria.

Segmentation within Victoria's market for estate agency services

A segmented market consists of a number of smaller components between which there is little overlap or interaction. Within the context of this study, a segmented market would imply the market for estate agency services is comprised of a number of smaller components each based on the provision of services to consumers with similar needs, characteristics or preferences.

The approach used to identify segmentation in the market for estate agency services in Victoria is to apply the following criteria:

- *transaction characteristics*, which are those factors that distinguish different transaction types that occur within the market, and whether there are significant differences between identifiable categories of transactions;
- *purchaser characteristics*, and whether these characteristics differentiate some market participants from others; and
- *service provider characteristics*, and whether these and other characteristics differentiate some market participants from others.

In a segmented market the interactions of these elements creates a distinct set of transactions to which a clearly identifiable group of participants with similar characteristics are a party. These transactions are part of the broader market, however there is limited interaction between the parties to other transactions, with prices and levels of service in one segment having little relevance or impact on other segments.

Identifying the existence and boundaries of segmentation should consider the following questions relating to both the demand and supply sides of the market in Victoria.

- Are there groups of purchasers of estate agency services that have specific and similar characteristics?
- Are there groups of providers of estate agency services who have similar characteristics, and who have limited interaction with other groups?
- Are the total number and value of transactions within a specific activity or group of activities of sufficient size for them to be considered a segment?

The analysis finds there to be segmentation in the market for estate agency services within metropolitan Melbourne, comprised of a residential segment, a commercial segment (comprising of commercial, retail and industrial), and a business broking segment. This segmentation construct does not extend to rural and regional Victoria, where estate agents tend to be non-specialist, in all but the largest regional centres.

The characteristics of each of these segments are summarised below.

Metropolitan residential segment

The provision of residential estate agency services, which includes the sale, purchase and management of residential property, is widely considered to be a distinct segment.

The metropolitan residential segment is the most significant segment within the market for estate agency services in Victoria, in terms of the proportion of estate agents involved in the segment, and the proportion of industry income for which it accounts.

Purchasers of estate agency services within the residential segment typically undertake fewer transactions than those in the commercial segment. The relative lack of sophistication of purchasers is less acute for leasing and managing property, where landlords generally have a level of expertise, an ability to assess risk and reward, and to assess the relative merits of different investment strategies.

Residential estate agents generally compete on price, service, reputation and local presence. The importance of local knowledge and experience has implications for the degree of effective competition.

Metropolitan commercial segment

The provision of 'commercial' estate agency services exhibits the characteristics of a distinct segment.

Purchasers of commercial estate agency services are viewed as being more sophisticated and experienced than residential purchasers, and as 'very demanding and footloose'. The most notable distinction between commercial and residential vendors and landlords is that the former are generally involved in a greater number of commercial transactions, and therefore are able to draw on a greater volume and type of information about the adequacy of service providers. At the same time, the size of commercial property transactions creates a more litigious environment so purchasers of estate agency services frequently support the advice provided by estate agents with advice from other experts (such as legal, financial or accounting).

While ongoing relationships are important, purchasers of commercial estate agency services are more willing (and able) to consider alternative providers. Therefore, property sales and leasing and management are not as complementary as in the residential segment, meaning that agents involved in a commercial purchase or sale have a reduced chance of then also being involved in any subsequent leasing and management transactions.

A 'commercial agent' will execute transactions across a range of commercial sectors (including commercial, retail and industrial). Agents working within this segment require specialist skills to successfully compete for business — most large commercial agencies only recruit staff who have tertiary and higher qualifications in business and property and provide specialist on-the-job training.

Rural and regional estate agency services

This report concludes that while the rural and regional sector is an important component of the Victorian market for estate agency service, it does not constitute a distinct segment of the market based on the criteria adopted in this study. In contrast, it comprises a series of smaller geographic 'markets'.

The specialisation and groupings of agents and purchasers of estate agency services that create segmentation in the metropolitan area are less evident or absent in the rural and regional sector. The sector is characterised by diversified and discrete markets clustered around larger population bases. The diversity and geographic separation of distinct regional and rural markets means the notion of segmentation effectively breaks down beyond metropolitan Melbourne.

Specialisation by estate agents is a key indicator of segmentation in the model used in this study. The volume of demand in metropolitan Melbourne makes specialisation viable for agents. In rural and regional markets, however, there is less specialisation as lower population densities limit the opportunities for agents to target particular types of property, transaction or client groups. Therefore, estate agency businesses must diversify their operations to remain viable.

As a result, rural and regional agents generally deal with a wider range of properties — residential, commercial and rural — and offer a full range of services and transactions to a diverse mix of property clients (sellers/buyers and landlords/tenants). While there is a degree of specialisation in larger regional centres, the boundaries are fluid and there is dubious value in distinguishing such activities from a policy perspective.

Furthermore, purchasers of estate agency services (commonly vendors and landlords) in rural and regional markets do not have similar and common characteristics. Agents are generally engaged by a wide range of vendors and landlords, each with particular expertise and experience and differing needs, not merely in terms of the types of property they own, but also with respect to the services, advice and support they need. Rural and regional agents also deal with a variety of property purchasers and tenants who similarly, have differing needs and preferences and thereby influence activities and services provided by agents.

Competition in rural and regional markets is influenced by proximity and local knowledge for all but the most specialised transactions (such as regionally based shopping centres and significant farming businesses). Due to the larger distances between rural and regional markets, estate agents tend to compete within certain geographical areas; there is little evidence of competition between agents located in separate regional markets (unless branch offices of the same agency are located in each).

Therefore, prices and services in one market tend to have less impact on other regional markets as a result of limited (or no) effective competition between agents in different geographic markets. In other words, purchasers of estate agency services are less able to substitute the services of an agent in one geographic market for those of an agent in another market, unless the markets are adjacent.

Business broking segment

Business broking is viewed as being a distinct and specialist segment. Business brokers rarely perform other types of estate agency services, and estate agents seldom offer business broking alongside other estate agency services, except in regional areas. Data suggests that there is a higher concentration of specialist business brokers in Melbourne, while business broking becomes a non-specialist activity, undertaken as one of several activities that estate agents engage in, in outer Melbourne and regional areas.

Business broking requires estate agents to have specific skills and experience, different to those of an estate agent dealing primarily in other forms of property. The nature of the service implies a need for knowledge of finance and accounting, experience in the management of a business, and relevant legislation.

Specialisation within the business broking segment is typically based on transaction value. Stakeholders suggest the existence of three distinct sub-segments:

- transactions of less than \$1 million, which are generally handled by property agents who offer a range of other services;
- transactions of \$1million – \$50 million, which are undertaken by a range of different service providers; and
- transactions of more than \$100 million, which generally involve investment banks.

The degree of effective competition is linked to the value of a transaction. For instance, there are likely to be fewer competitors for lower value transactions, and this is a sub-segment in which a broker's local presence carries more weight. Transactions of around \$1 million were viewed as the point at which business broking could reasonably be considered a 'truly national market'.

Findings and conclusions

The Victorian estate agency services market exhibits the characteristics of a segmented market. This is apparent in the clear distinction between residential, commercial (comprising commercial, industrial, retail), and business broking segments within metropolitan Melbourne, albeit with some porous boundaries. However, this segmentation construct does not extend to rural and regional Victoria, where estate agents tend to be non-specialist in the services they offer, beyond servicing an identifiable geographic region (noting that there may be some degree of specialisation in large regional centres).

Segmentation has important implications for market outcomes, and in particular, the degree of effective competition within a market (and as a result, pricing and service outcomes). For example, distinct segments imply there is limited interaction between the various market participants that operate within those segments.

The concept of segmentation is important from a policy and regulatory perspective. For example, a segmented market might require a different response to the exercise of market power — such as the promotion of greater competition for certain activities — than a market where all service providers are able to undertake all activities. Furthermore, the nature and extent of market failure might differ across segments, an example of which is the degree of information asymmetry between buyers and sellers. This implies that a different regulatory response could be considered.

This analysis has found that while segmentation exists, it is the result of the characteristics of market participants, rather than a direct product of the regulatory framework. In other words, licensing requirements provide for a base level of competence and professional conduct that *all* agents must demonstrate, irrespective of the estate agency services they provide. However, business success depends on the ability of agents to demonstrate expertise in other areas, either knowledge of a particular location or activity.

Therefore, regulation is important as it provides a degree of protection to many purchasers of estate agency services. However, agents would still need to acquire certain skills and experience in the absence of current licensing requirements in order to differentiate themselves from other suppliers and to meet the needs of prospective clients. As such, licensing requirements create some barriers to entry in the market for estate agency services, particularly for other service providers who possess valued skills as part of their other activities. However, the extent of effective competition is also driven — to a greater extent — by other factors. As an example, residential agents cannot compete for the majority of commercial transactions, even though residential and commercial agents are subject to the same legislative requirements. Similarly, residential agents operating in certain locations cannot easily relocate to other locations, even though potential customers will be aware they have satisfied legislative requirements and are obliged to conduct their business in a particular manner.

Chapter 1

Introduction

This chapter introduces the estate agency services market segmentation study, discussing its purpose, objectives and context.

This report presents the Allen Consulting Group's research, analysis and findings of its study into segmentation in the market for estate agency services in Victoria. The report is provided to the Estate Agents Council (EAC), to assist its review of the licensing framework under the *Estate Agents Act 1980* and subordinate legislation, as requested by the Minister for Consumer Affairs.

The study's objectives are to identify and describe segmentation in the market for estate agency services, and for each segment, to:

- examine the transactions, characteristics and functions of suppliers and consumers in the market;
- identify the risks to participants in the market for estate agency services and the available protections; and
- assess competition, including the impact of changes in the regulatory arrangements over the last five years.

The study's Terms of Reference are set out in Box 1.1.

Box 1.1

TERMS OF REFERENCE

To meet the EAC's requirements, the objectives of this study are to:

- define the market for the provision of estate agency services in Victoria, taking into consideration supply and demand characteristics;
- identify and examine the nature and extent of segmentation in the estate agency service market and, where applicable, reference arrangements in other states;
- describe the industry participants and functions characteristic of each market segment including the individuals and types of businesses;
- describe the transactions characteristic of each market segment in terms of the size (in dollar terms), number, nature and complexity of transactions;
- describe the consumers characteristic of each market segment including the likely harms arising for those consumers and the consumer protections available;
- assess the nature and extent of competition within each market segment, including the impact on competition of changes in regulation affecting estate agency during the last five years; and
- identify the issues and implications of the market segmentation arrangements as a factor to be considered in reviewing industry licensing arrangements.

Source: Consumer Affairs Victoria on behalf of the EAC 2006.

1.1 Study context

This study originates from a review being undertaken by the EAC on behalf of the Minister for Consumer Affairs. In late 2005, the Minister asked the EAC to consider and report on the feasibility of creating greater competition within the estate agency services industry. In particular, the EAC was asked to examine the costs and benefits of relaxing the present requirements on lawyers, accountants and other suitably qualified professionals to obtain an estate agent's licence.

After undertaking a preliminary assessment, the EAC submitted an Interim Report to the Minister (*Licensing System Review 2006 — Interim Report*), which noted there were a number of issues requiring further information before the review of the licensing arrangements could proceed.

In particular, the EAC considered further information was required on the nature and extent of segmentation within the market for estate agency services. Accordingly, one of the EAC's recommendations was:

That the EAC commission research on the most appropriate way of 'segmenting' or 'structuring' the real estate industry. The research would build on, extend and update the research previously conducted for Consumer Affairs Victoria by KPMG in 2000. (The new research would require a deeper investigation of the industry, particularly in relation to the structure of the commercial real estate sector). It would include strong engagement with the sector to develop and test the segmentation model (the EAC 2006, p. 20).

The Minister approved the EAC's study proposal, given its role within the broader Licensing System Review:

For the Review to proceed and for the EAC to be in a position to provide considered advice, it will be essential to approach this Review in the same way, that is, consider each of the industry's component parts. This will allow (a) the key principals that underpin regulation and consumer protection to be tested against each segment of the market and (b) the EAC to make recommendations specific to that segment of the industry (the EAC 2006, p. 18).

As noted in the EAC's recommendations, this study builds upon earlier work conducted into the Victorian market for estate agency services, most notably the *National Competition Policy Review of Victorian Legislation Relating to the Regulation of Estate Agents* undertaken by KPMG in 2000. Among other findings, this review proposed that estate agency services in Victoria could be segmented into five key markets, namely: residential sales, business sales, commercial sales, residential property management¹ and commercial property management. An element of the current study is to assess the extent to which this model applies to the Victorian market in 2007, and describe in further detail the characteristics of any segments, should they be found to exist (Consumer Affairs Victoria on behalf of the EAC 2006).

¹ The term 'property management' is used in this study to refer to the leasing of a property and the ongoing management of a leased property.

1.2 Methodology

The Allen Consulting Group applied a methodology comprising of four stages to achieve the outcomes required by this study. The stages were:

- *Desktop research* — an analysis of quantitative sources — such as the Australian Bureau of Statistics (ABS), the Valuer-General Victoria, Consumer Affairs Victoria (CAV), IBISWorld and the Business Licensing Authority — as well as a review of relevant literature. In particular, this stage reassessed the findings of the *National Competition Policy Review of Victorian Legislation Relating to the Regulation of Estate Agents* undertaken in 2000.
- *Industry consultation* — industry stakeholders were consulted through two mechanisms: a survey of estate agencies and discussions with industry stakeholders. A survey was sent to 150 estate agencies in Victoria (selected in consultation with CAV and the EAC and on the basis of the relative proportions of estate agency activity). Responses were used to examine market structure, business behaviour, competition and trends in the market. The Allen Consulting Group also consulted a number of industry stakeholders, including estate agents, industry peak bodies, and government and statutory agencies. Discussions were guided by an Issues Paper, which expanded upon the study's Terms of Reference.
- *Consumer consultation* — the Allen Consulting Group held discussions with consumer stakeholders, guided by a consumer-specific Issues Paper.
- *Reporting* — reporting activities included interim presentations to the Steering Committee and the EAC, and the delivery of draft and final reports.

The project team benefited from the input of the EAC Steering Committee throughout the course of the study. A list of stakeholders consulted is included in Appendix C.

The industry and consumer Issues Papers are included in Appendix E.

1.3 Report structure

The remainder of the report is set out as follows:

- *Chapter 2* — defines the market for estate agency services and its participants, describes the range of services transacted, and profiles the market in Victoria;
- *Chapter 3* — discusses the concept of segmentation, considers potential bases of segmentation, and builds a framework in which to consider segmentation in the market for estate agency services in Victoria;
- *Chapter 4* — describes the characteristics of the metropolitan residential segment of the market for estate agency services in Victoria;
- *Chapter 5* — describes the characteristics of the metropolitan retail, commercial and industrial segment of the market for estate agency services in Victoria;
- *Chapter 6* — describes the characteristics of estate agency services in regional and rural areas of Victoria;

- *Chapter 7* — describes the characteristics of the business broking segment of the market for estate agency services in Victoria;
- *Chapter 8* — summarises the findings of the study, makes conclusions regarding the existence of segments within the market, and identifies the issues and implications of market segmentation to be considered in reviewing industry licensing arrangements; and
- *Appendices* — including supplementary descriptive information about the market for estate agency services in Victoria, the licensing requirements under the *Estate Agents Act 1980*, a listing of stakeholders consulted to inform this study, Issues Papers used to guide consultations, and interjurisdictional licensing arrangements.

Chapter 2

Market definition

This chapter defines the market for estate agency services and its participants, describes the range of services transacted, and profiles the market in Victoria.

Key points

The role of estate agents is to facilitate property transactions by bringing together parties to such transactions in an effective and efficient way.

For the purposes of this study, the activities considered to comprise 'estate agency services' are:

- property sales;
- property management;
- buyer advocacy;
- business broking;
- real estate advisory services; and
- specialist services that form sub-activities of any the above (e.g. auctioning).

Evidence supports the notion that there is a market for estate agency services, and that there exists a market in Victoria. The market in Victoria has the following characteristics:

- *number and location of agents* — as at 30 June 2007, there were 7767 licensed estate agents and 9224 agents' representatives in Victoria. There is a higher concentration of estate agents in metropolitan Melbourne than regional Victoria;
- *number and location of transactions* — regionally based estate agents execute a greater number of sales transactions per licence than metropolitan-based agents, which may be because of higher average transaction values in metropolitan areas;
- *sources of income* — the residential property sector is the basis of 80 per cent of income for estate agents in Victoria, while property sales commissions contribute more than 75 per cent of income;
- *agency size, structure and organisation* — estate agency services is a 'cottage industry', with agencies with fewer than twenty people generating more than 70 per cent of industry income;
- *market transactions* — residential property sales are the largest single source of estate agency income in Victoria; and
- *returns to estate agency services* — the prices of estate agency services have increased significantly over the past decade, reflecting Australia's property boom.

2.1 Introduction

This chapter has two elements:

- defining the market for estate agency services, including the range of services, activities and participants it involves; and
- profiling the market for estate agency services in Victoria. This is defined as the provision of services relating to properties located *within* Victoria. Participants in the market include businesses that offer estate agencies services, some of which — most notably for commercial, retail and industrial property transactions — may be located outside Victoria.

2.2 The market for estate agency services

This section defines ‘estate agency services’, and the market in which these services are traded.

What are estate agency services?

Estate agents facilitate property transactions by bringing together parties to such transactions in an effective and efficient way.

The UK Office of Fair Trading discusses the role of estate agents with respect to sales transactions in a study of the England and Wales market for estate agency services:

When successful, estate agents...become key institutions in local house [and other] sales. Estate agents make housing markets work by facilitating easy comparisons between properties, providing knowledge of relative prices in a locality and being a means through which offers to purchase can be made. They, consequently, add value by making sellers better off than they would otherwise be and mean that buyers are more likely to be satisfied with the home that they purchase and its price. Estate agents’ existence...reduces the amount of resources spent on search by buyers and sellers and makes searching far more worthwhile than in the absence of such an information network (Office of Fair Trading (UK) 2004).

Estate agency services are defined under the Australian and New Zealand Standard Industrial Classification (ANZSIC) as consisting of services involving ‘valuing, purchasing, selling (by auction or private treaty), managing or renting real estate for others’. Specifically, these services include:

- broking services;
- real estate agency services;
- real estate auctioning services;
- real estate management services;
- real estate rental agency services;
- time share apartment management services; and
- valuation services (Australian Bureau of Statistics / Statistics New Zealand 2006).

This definition specifically excludes services mainly involved in:

- title transfers or conveyancing services (which are classified as part of ‘legal services’ under ANZSIC); and
- engineering or structural property and house inspections (which are classified as part of ‘engineering design and engineering consulting services’).

In an alternative, yet largely complementary definition, IBISWorld (2006, p. 3) identifies the following activities to comprise the estate agency services industry:

- conveyancing services (other than by units of qualified legal practitioners);
- real estate agency services;
- real estate auctioning services;
- real estate body corporate management services;

- real estate broking services;
- real estate management services;
- real estate rental agency services;
- real estate title transfer service (other than by units of qualified legal practitioners);
- time share apartment managing services;
- title searching services; and
- valuing services (real estate).

These definitions illustrate the range of activities that estate agents perform. Even within one transaction, such as the sale of a residential property, several specific activities may be performed, including:

- appraisal of property;
- development of a marketing strategy;
- showing of property;
- preparation of sale documents;
- auction; and
- negotiation of sale.

For every type of real estate transaction, there are many different services, each potentially requiring its own skill set. Transactions are comprised of a number of steps that often draw on a range of skills, such as in law, marketing and finance. Indeed, agents often supplement required accreditation with additional tertiary education to deliver a more specialised range of services.

Conclusion

For the purposes of this study, 'estate agency services' are considered to comprise:

- property sales;
- property management;
- buyer advocacy;
- business broking;
- real estate advisory services; and
- specialist services that form sub-activities of any the above (e.g. auctioning).

What is a market?

At its essence, a market is the interaction of buyers and sellers, creating the possibility of exchange (Pindyk & Rubinfeld 1992, p. 11). A specific, identifiable market comprises those products and/or services that are regarded as interchangeable by the consumer, by reason of its characteristics, price and intended use.

Critical to the definition of a market is *substitutability*: the willingness and ability of consumers to substitute one product or service for another, or to change between suppliers (Hofer et al. 2007, p. 10). For all but the most tradeable products and services, markets will be particular to a certain geographic region. If consumers are unwilling or unable to substitute between products and/or services or suppliers, then the products and/or services compete in different markets.

Is there a market for estate agency services?

Whether there is a market for estate agency services can be determined by examining the nature and structure of demand and supply, and the participants engaging in transactions.

Participants involved in estate agency service transactions can be organised into two groups, each of which is subject to a range of factors that influence transactions in the market.

Supply side

The supply side of the market comprises providers of estate agency services, which include estate agents, agents' representatives and other persons working in the industry. A key determinant of supply relates to the barriers to entry to the industry, which influence the cost, ease and timeliness with which new suppliers can enter. IBISWorld classifies the barriers to entering the industry as 'low, though increasing', with regulatory and licensing arrangements (principally the time and expense for new entrants to comply with these) presenting the major consideration for prospective market entrants (IBISWorld 2006).

Demand side

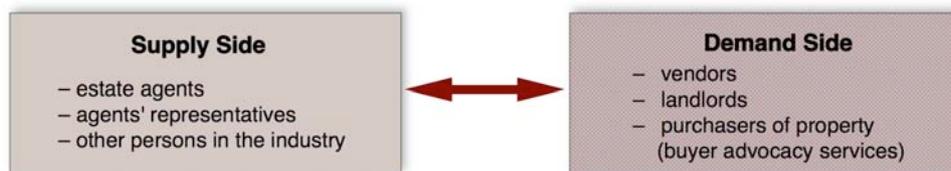
Purchasers of estate agency services include vendors (sellers of property), landlords (those renting or leasing their property), and purchasers of property (for buyer advocacy services). Determinants of demand for estate agency services include the level and value of property sales and leasing activity, levels of home ownership, and household and commercial rents. These determinants are themselves influenced by a broad range of factors, including interest rates, economic activity, taxation policy, population, demographic factors and transaction costs (IBISWorld 2006).

On the demand side, several characteristics influence the risks faced by purchasers of estate agency services. Purchasers have differing capacities to make informed decisions about the competency and probity of estate agents or about real estate, due to differences in scale, expertise, experience, access to information and frequency of transactions. Therefore, they may face different risks of financial loss and require a differing degree of regulatory protection. The extent of information asymmetry — the lack of knowledge on the part of a purchaser of the expertise or probity of a supplier — is the primary rationale for the existing legislative framework. Financial loss can occur as a result of the following:

- failure to acquire market value for a transaction;
- improper execution of contracts; and
- inappropriate conduct, such as appropriation or loss of client funds.

Figure 2.1 illustrates the principal participants in the market for estate agency services.

Figure 2.1

PRINCIPAL PARTICIPANTS IN THE MARKET FOR ESTATE AGENCY SERVICES

Residential and commercial tenants are also important in the context of the market for real estate services. Although they do not typically contract directly with estate agents for the provision of services, there is frequent interaction between them. Furthermore, the cost to an agent of managing tenants is reflected in the fees that property owners pay, and is factored into rental payments.

A 'relevant' market for estate agency services

Central to the definition of a market is the notion of a *relevant market*, which defines those goods and services that can be considered substitutes, and are therefore part of the same market. Importantly, it is purchasers of estate agency services who determine those services that constitute a market, based on their perceptions of the substitutability of alternative services. While services may appear to differ markedly, they can be considered to comprise a market if they fall within a client's 'evoked set'— the services that clients are willing to consider in order to satisfy a particular need or want (the purchase, sale or management of property, in this case).

Applying this to the context of estate agency services suggests that purchasers may be willing to consider a range of conceivable services, products and providers to meet their needs for real estate services. Additional participants are emerging as consumer behaviour and technologies develop. Alternative providers of estate agency services can substitute services for those performed by estate agents. For example, certain aspects of estate agency services could potentially be performed by other professionals, such as accountants or lawyers. Similarly, some other providers offer auxiliary services to persons wishing to sell property without engaging an estate agent — Zillow (www.zillow.com) is perhaps the most widely known of these. An Australian example, Sell Houses Fast (www.sellhousesfast.com.au), acts as an intermediary between buyers and sellers of property, largely supplanting the role of the estate agent.

Depending upon the responsiveness of client demand to an increase in the price of estate agency services (the 'price elasticity of demand'), clients may view similar services provided by alternative suppliers more favourably. Over time, the number of market entrants may increase in response to the increased price of services, although the pace of any such supply response is generally constrained by the occupational licensing arrangements in place. Similarly, vendors and landlords can execute their own transactions if they perceive the likely costs to be less than those incurred if they employed a third party, such as an estate agent.

Inherent in the definition of estate agency services is the distinction between the market for *estate agency services* and the *real estate* market. The former involves the purchase of advisory and other related services, while the latter is the purchase or sale of a physical and tangible property, such as land, housing or commercial premises. While the two markets are invariably linked and mutually reinforcing — Australia’s recent property boom has been credited with improving estate agents’ sales commissions, for example (IBISWorld 2007a, p. 2) — each market trades in discrete goods and services, albeit with many common market participants.

Competition

IBISWorld classifies the level of competition in the market for estate agency services as ‘high, and increasing’, with the market’s principal bases of competition including:

- proximity specialisation (particularly for residential services);
- marketing skills;
- quality of services;
- systems (such as in property management);
- price of services; and
- the ability of an agent to attract interest from interstate or overseas buyers.

Conclusion

There is strong evidence that there is a market for estate agency services, in terms of:

- ‘estate agency services’ can be clearly defined;
- identifiable market participants transact in estate agency services; and
- consumers have no observable willingness or ability to substitute between estate agency services and other services.

Further, as industry-specific regulatory requirements restrict the abilities of individuals and corporations to provide estate agency services, there is an identifiable supply side (or ‘industry’) for the provision of estate agency services.

2.3 The market for estate agency services in Victoria

This section considers the Victorian market for estate agency services, and describes that market with respect to the location of agents and transactions, the profile of estate agency businesses, and the relative contribution of different services to industry income.

The Victorian market for estate agency services is the market for the provision of advice and other services relating to properties located in Victoria. It is clear that some estate agents located in other jurisdictions are participants in this market, just as Victorian-based agents are able to offer their services in other geographic markets. The extent to which agents located in other jurisdictions are able to compete with ‘local’ services has important implications for competition and the efficiency of market outcomes.

The following sections describe the characteristics of the Victorian market for estate agency services.

Characteristics of the Victorian market

Number and location of agents

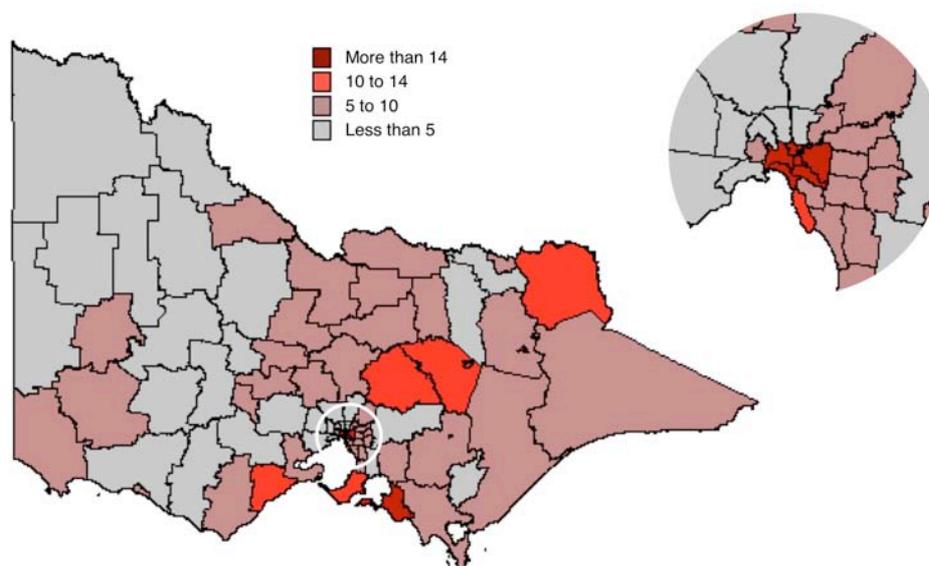
Victoria's estate agency services industry generated a total income of \$1372.3 million, in the year to June 2003 (ABS 2004).

As at 30 June 2007, there were 7767 licensed estate agents in Victoria, comprising of 5788 estate agent individuals and 1979 estate agent corporations, and 9224 agents' representatives (Business Licensing Authority 2007).

Figure 2.2 illustrates the distribution of licensed estate agent individuals across Victoria, per 10 000 people. As the distribution mapping shows, the greatest concentration of licensed agents is in the greater Melbourne area, the eastern suburbs in particular. However, there is also considerable concentration in areas close to tourist destinations, such as the Mornington Peninsula, Phillip Island and the south-west coast.

Figure 2.2

LICENSED ESTATE AGENTS PER 10 000 PEOPLE, VICTORIA



Source: CAV 2007.

Number and location of transactions

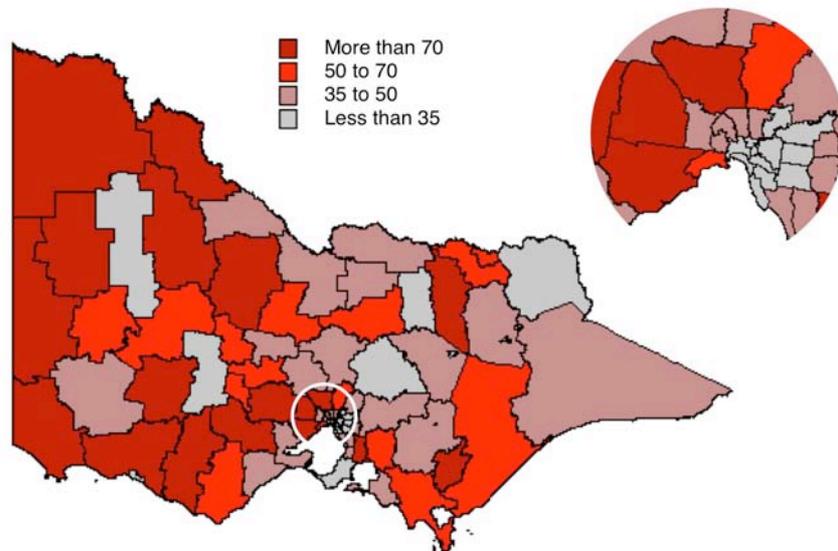
Figure 2.3 indicates the number of transactions per estate agent's licence across Victoria, showing that the average number of transactions per licence is comparatively higher outside metropolitan Melbourne. Possible explanations include:

- the higher concentration of estate agents within metropolitan Melbourne, which may be because average transaction values tend to be higher in inner city areas;

- reduced specialisation among estate agents outside greater Melbourne, due to lower concentration of estate agents outside of Melbourne; and
- a relatively high proportion of commercial transactions — which are generally of a higher average value — within Melbourne, which provides scope for greater specialisation.

Figure 2.3

AVERAGE NUMBER OF SALES TRANSACTIONS PER ESTATE AGENT'S LICENCE, VICTORIA



Sources: CAV 2007; Valuer-General Victoria 2007.

Sources of income

Table 2.1 profiles the supply of estate agency services in Victoria, in terms of the total income derived from certain activities.

Table 2.1

ESTATE AGENCY INCOME IN VICTORIA: SOURCES, PARTICIPANTS AND VALUE

| Source of income | Number of participants | Income value (\$ million) | Proportion of total income (%) |
|--|------------------------|---------------------------|--------------------------------|
| Total income from property sales commissions | 1379 | 1051.9 | 76.7 |
| Vacant land | 606 [^] | 87.7 [^] | 6.4 |
| Residential vacant land | 540 [^] | 77.7 [^] | 5.7 |
| Non-residential vacant land | 178 [*] | 10 [*] | 0.7 |
| Commissions from sales of residential properties | 1177 | 882.6 | 64.3 |
| Commissions from sales of non-residential properties | 607 [^] | 81.6 [^] | 5.9 |
| Commissions from sales of commercial, industrial and retail properties | 607 [^] | 77.3 [^] | 5.6 |
| Commissions from sales of other non-residential properties | 95 ^{**} | 4.3 ^{**} | 0.3 |
| Total income from property management commissions | 1223 | 206.5 | 15 |
| Commissions from management of residential properties | 1061 [^] | 146.5 | 10.7 |
| Commissions from management of non-residential properties | 632 [^] | 51.8 [*] | 3.8 |
| Body Corporate management fees | 215 [*] | 8.2 [*] | 0.6 |
| Total income from leasing/letting commissions/fees | 926[^] | 42.3[^] | 3.1 |
| Leasing/letting commissions/fees – residential | 802 [^] | 27.3 [^] | 2 |
| Leasing/letting commissions/fees – non-residential | 447 [^] | 15 [*] | 1.1 |
| Total income from other rent, leasing and hiring income | 193[*] | 5.6^{**} | 5.2¹ |
| Income from consulting fees | 100 [*] | 8.7 [*] | 0.6 |
| Income from property valuations | 90 [*] | 5.3 | 0.4 |
| Income from conveyancing work | 23 ^{**} | n.p. | n.p. |
| Interest income | 436 [^] | n.p. | n.p. |
| Other income | 441 [^] | 49.5 [^] | 3.6 |
| Total | 1446 | 1372.3 | 100 |

Source: ABS 2007a; refers to 2002-03 financial year.

n.p. refers to those items not available for publication.

¹ Derived figure.

[^] Estimate has a relative standard error of 10 per cent to less than 25 per cent and should be used with caution.

^{*} Estimate has a relative standard error of 25 per cent to 50 per cent and should be used with caution.

^{**} Estimate has a relative standard error greater than 50 per cent and is considered too unreliable for general use.

While these figures refer to 2002-03², a number of conclusions can be drawn regarding the relative dimensions of the Victorian market.

² Figures refer to 2002-03, although they represent the most recent ABS data available at this level of detail.

Residential property transactions were the most significant source of estate agency income, accounting for approximately 83 per cent of all industry income in Victoria. This comprised:

- vacant land sales commissions — 5.7 per cent of industry income;
- property sales commissions — 64.3 per cent of industry income;
- property management commissions — 10.7 per cent of industry income; and
- leasing/letting commissions/fees — 2 per cent of industry income.

The relative significance of residential property as a source of income for estate agents is reiterated by the findings of the *Survey of Real Estate Agencies — Characteristics of the Industry in 2007* ('the CAV/EAC survey'). The survey found that, on average, estate agencies in Victoria derive 68.9 per cent of their total agency business from residential property.

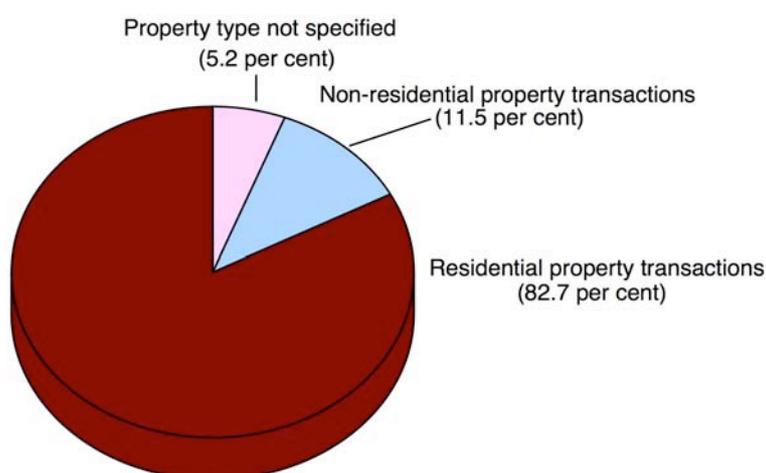
Non-residential property transactions accounted for a smaller share of industry income, at around 11.5 per cent. This comprised:

- vacant land sales commissions — 0.7 per cent of industry income;
- property sales commissions — 5.9 per cent of industry income;
- property management commissions — 3.8 per cent of industry income; and
- leasing/letting commissions/fees — 1.1 per cent of industry income.

A range of other estate agency services, which do not specify the property type to which they relate, accounts for the remaining 5.8 per cent of industry income. The composition of total estate agency services income in Victoria, by property type, is illustrated in Figure 2.4.

Figure 2.4

ESTATE AGENCY SERVICES INCOME BY PROPERTY TYPE, VICTORIA



Source: ABS 2007a.

In terms of the income contribution of specific estate agency services, property sales commissions contributed 76.7 per cent of industry income. This is significantly larger than the next leading income sources, namely: property management commissions (15 per cent of industry income); other rent, leasing and hiring income (5.2 per cent of industry income); and leasing/letting commissions/fees (3.1 per cent). The composition of total estate agency services income, by service, is illustrated in Figure 2.5.

Figure 2.5

ESTATE AGENCY SERVICES INCOME BY SERVICE, VICTORIA

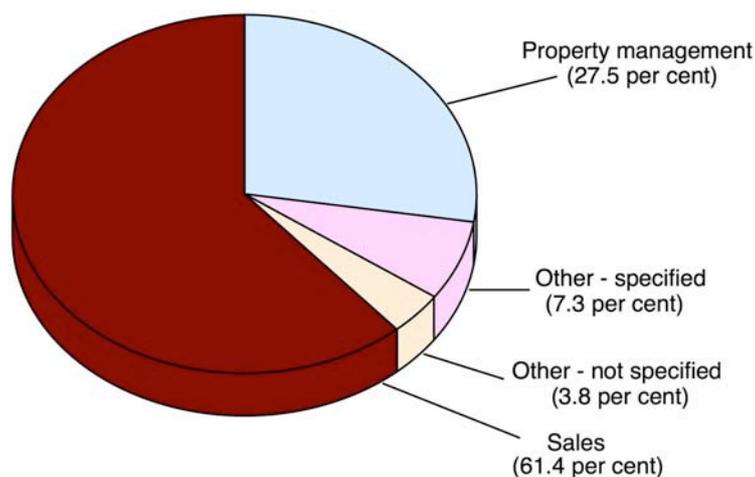


Source: ABS 2007a.

Findings of a similar order of magnitude were made in the CAV/EAC survey, as shown in Figure 2.6 and detailed in Table A.1.

Figure 2.6

SOURCE OF ESTATE AGENCY BUSINESS, VICTORIA



Source: CAV/EAC survey 2007.

Agency size, structure and organisation

Most estate agencies in Victoria are micro or small businesses³, accounting for a combined 73.1 per cent of Victorian estate agency businesses and 71 per cent of total sector income (ABS 2004). This suggests that estate agency business is very much a ‘cottage industry’, characterised by many, small estate agencies.

However, relative to the rest of Australia, the Victorian industry is relatively more consolidated: 93.7 per cent of real estate businesses in Australia are micro or small businesses, generating 71 per cent of total sector income. A complete profile of the sizes of real estate businesses in Australia is given in Table A.2.

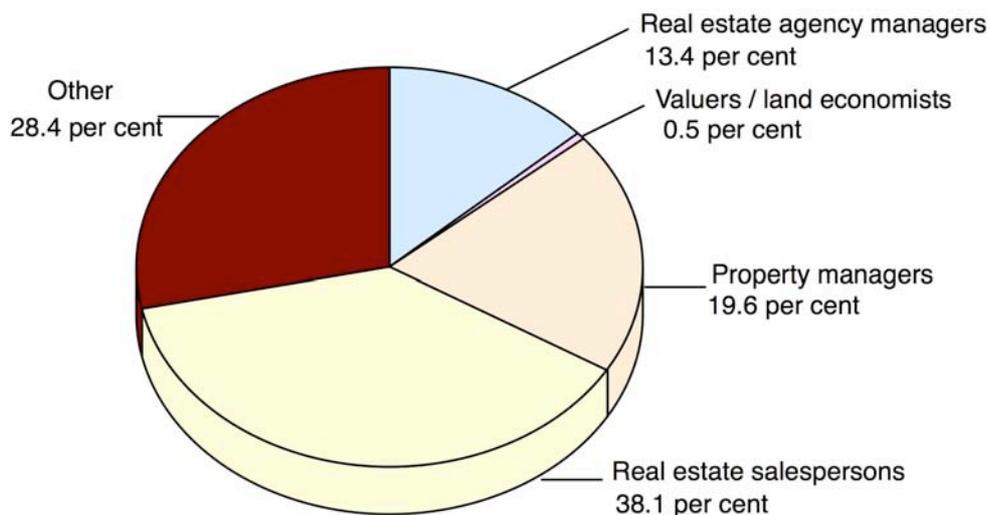
According to the CAV/EAC survey of Victorian estate agencies, only 13.9 per cent of respondents operated branch offices in addition to principal offices. Among those agencies that operated branch offices, 65.9 per cent operated only one branch office in addition to a principal office.

The CAV/EAC survey further showed that the majority of estate agencies (57.5 per cent) in Victoria have only one licensed agent, while more than 99 per cent of agencies have fewer than ten licensed agents. Most commonly, estate agencies operate with two agents’ representatives (as identified by 18.5 per cent of respondents), while 60.7 per cent of estate agencies operating with fewer than five agents’ representatives. In terms of support staff, estate agencies most commonly have one support staff member (as is the case for 39.9 per cent of respondents), while 85.3 per cent of estate agencies operate with fewer than five support staff. In terms of the total number of staff — 74.3 per cent of agencies have fewer than ten staff in total.

Figure 2.7 provides a more detailed illustration of the primary roles of those persons employed by estate agencies in Australia (see Table A.3 for complete data). This chart shows that the largest occupational group employed by estate agencies is real estate salespersons (38.1 per cent of all persons employed), which is consistent with sales being the largest source of revenue for estate agencies.

³ The ABS defines ‘micro businesses’ as those businesses that employ fewer than five people, and ‘small businesses’ as those businesses with 5–19 employees (ABS 2002).

Figure 2.7

MAIN OCCUPATION OF PERSONS EMPLOYED BY ESTATE AGENCIES, AUSTRALIA

Source: ABS 2004.

In terms of the operating structure of real estate agencies in Victoria, the CAV/EAC survey results show that corporations are the most common arrangement for estate agencies (57.2 per cent of respondents), followed by sole traders (33.4 per cent) and partnerships (9.4 per cent). Only 23.4 per cent of respondent agencies are members of a franchise group, while 7.6 per cent are members of a marketing cooperative.

Market transactions

Valuer-General Victoria data on real estate sales classifies transactions as follows:

- commercial sales;
- industrial sales;
- residential sales; and
- rural sales.

Figure A.1 to Figure A.4 in Appendix A set out the number of transactions within each category and the average value of those transactions for 2006. These figures show residential sales as being the largest single source of transactions, and highlight the variation in average transaction values across different property types (as examples, the average value of shopping centre sales in Victoria in 2006 was \$52.7 million, compared with around \$100 000 for vacant residential land).

Returns to estate agency services

Table 2.2 indicates the implied returns to estate agency services for commercial and residential transactions. These rates are calculated on the basis of the number and value of transactions (Valuer-General data) and industry income (ABS data). While it represents an estimate on the basis of an incomplete dataset, it is consistent with observations and views raised during the consultation process for this study.

Table 2.2

IMPLIED ESTATE AGENT RATES OF COMMISSION IN VICTORIA, 2006

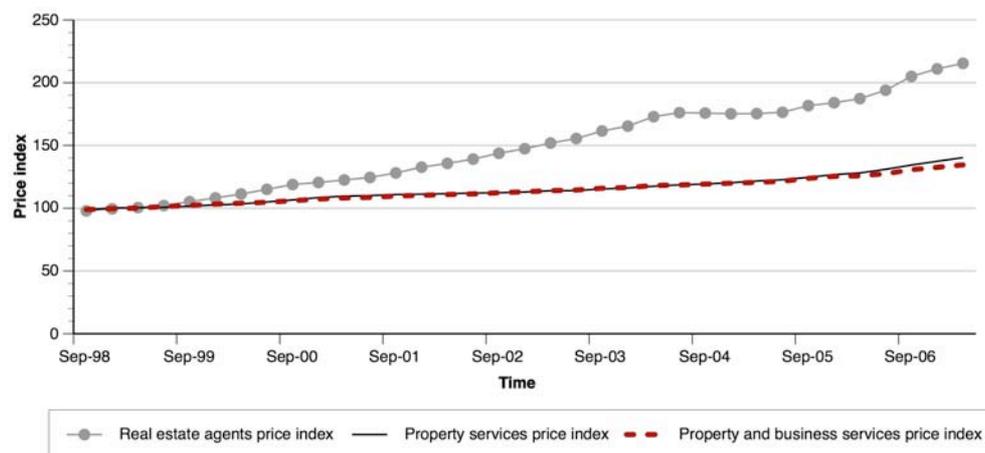
| | Residential | Commercial, industrial and rural |
|-----------------------------|---------------|----------------------------------|
| Value of commissions (\$m) | 1 101 | 102 |
| Value of transactions (\$m) | 40 474 | 10 350 |
| Implied commission rate | 2.72 per cent | 0.09 per cent |

Sources: Value of transactions based on 2006 Valuer-General Victoria data. Value of commissions is based on ABS 2007 commission/income data for the year 2002-03. Commission data has been inflated using the real estate agents producer price index to reflect 2006 values. Excludes vacant land.

Figure 2.8 demonstrates that the prices of estate agency services increased significantly over the period September 1998 to September 2006, outpacing the growth in prices for property services and for the property and business services industry sectors. The price indices are based on ANZSIC classifications and are not disaggregated according to jurisdiction. While Victoria-specific data are not available, they would likely be consistent with the national trend as trends in the price of Victorian real estate over recent years are broadly consistent with those at a national level.

Figure 2.8

PRODUCER PRICE INDICES, AUSTRALIA



Source: ABS 2007b.

In relation to the relatively significant increase in the real estate agents price index over this period, IBISWorld (2007a, p. 2) observed that:

... the major growth element has been real estate agent services... The rise in real estate agent prices coincides with the increase in house prices over the period. In short, estate agents have been in greater demand (allowing operators to push up prices). It is also important to consider that real estate agents often earn a set proportion of the ultimate house sale price; as house prices have increased so have the returns of estate agents, even though their fee percentage may not have changed.

A frequent observation of estate agency services markets is that returns are pro-cyclical. In other words, as property prices increase, so does the absolute level of agent fees, as agents tend to charge fees on a fixed percentage basis. Furthermore, there is some rigidity in fees and they do not appear to relate directly to costs. This issue is explored in more detail in the following chapters, which focus on the various segments in the market for estate agency services and the degree of effective competition within those segments.

Chapter 3

Segmentation

This chapter discusses the concept of segmentation, considers potential bases of segmentation, and builds a framework in which to determine the existence and characteristics of segmentation in the market for estate agency services in Victoria.

Key points

A segmented market consists of a number of smaller components between which there is little overlap or interaction. A segmented market would imply the market for estate agency services is comprised of a number of smaller components each based on the provision of services to consumers with similar needs, characteristics or preferences.

The approach used to identify segmentation in the market for estate agency services in Victoria is by applying the following criteria:

- *transaction characteristics*, which are those factors that distinguish different transaction types that occur within the market, and whether there are significant differences between identifiable categories of transactions;
- *purchaser characteristics*, and whether these characteristics differentiate some market participants from others; and
- *service provider characteristics*, and whether these and other characteristics differentiate some market participants from others.

In a segmented market the interactions of these elements creates a distinct set of transactions to which a clearly identifiable group of market participants with similar characteristics are a party. There is limited interaction between the parties to other transactions, with prices and levels of service in one segment having little relevance or impact on other segments.

Identifying the existence and boundaries of segmentation should consider the following questions relating to both the demand and supply sides of the market in Victoria:

- *Are there groups of purchasers of estate agency services that have specific and similar characteristics?* — Yes, residential property vendors and landlords; vendors and owners of commercial, industrial and retail property; and purchasers of business broking services exhibit specific and similar characteristics.
- *Are there groups of providers of estate agency services who have similar characteristics, and who have limited interaction with other groups?* — Yes, there are estate agencies with similar characteristics — such as training, experience and marketing — who have limited interaction with other groups.
- *Are the total number and value of transactions within a specific activity or group of activities of sufficient size for them to be considered a segment?* — Yes, the metropolitan residential; metropolitan commercial, industrial and retail; and business broking segments are of sufficient size to sustain large numbers of competitors.

The analysis finds there to be segmentation in the market for estate agency services within metropolitan Melbourne, comprised of a residential segment; a retail, commercial and industrial segment; and a business broking segment. This segmentation construct does not extend to rural and regional Victoria.

3.1 Introduction

The existence and influence of segmentation in the Victorian market for estate agency services was widely reported by industry stakeholders in submissions to the EAC's Licensing System Review. These observations supported the EAC's conclusion that the estate agency services industry is not 'one industry' — rather, it is comprised of a number of segments '... each of which could be said to require its own skills and training requirements, consumer protection requirements (or otherwise), levels of competition and therefore differing licensing and regulation considerations' (EAC 2006, p. 17).

Clearly then, understanding the nature and extent of segmentation within the market for estate agency services is crucial to informing a wide range of secondary analyses. It is also necessary to inform the development of appropriate consumer protection measures, or mechanisms that might be needed to promote efficient market outcomes within those segments.

Having considered the Victorian market for estate agency services in the previous chapter, this chapter sets out a model that is applied to identify the segments described in detail in the following chapters. **The analysis finds there to be segmentation in the market for estate agency services within metropolitan Melbourne, comprised of a residential segment; a commercial, retail and industrial segment; and a business broking segment. There is less evidence of segmentation in rural and regional Victoria, which is discussed separately.**

3.2 What is market segmentation?

What is a segmented market and how does it operate?

A segmented market consists of a number of smaller components between which there is little overlap or interaction. Segmentation has also been described as follows:

... viewing a heterogeneous market as a number of smaller homogenous markets, in response to differing preferences attributable to the desires of consumers to more precise satisfaction of their varying wants (Smith cited in Wedel & Kamakura 1999, p. 3).

Within the context of the current study, a segmented market would imply the market for estate agency services is comprised of a number of smaller components each based on the provision of services to consumers with similar needs, characteristics or preferences.

In a segmented market, businesses may choose to service the entire market and adopt different strategies for satisfying the various needs and preferences of consumers in specific segments. Alternatively, they may concentrate on delivering a subset of activities that fall within the broader market.

In the context of the market for real estate services, a (hypothetical) business could attempt to undertake all activities within the broader market, with their marketing strategy and service (such as price, or volume of advice) varying according to the needs of its respective client groups. On the other hand, a business may choose to concentrate on a limited number of activities, thereby marketing itself as a specialist in a particular area.

In effect, business behaviour can effectively reinforce any segments that may exist — businesses will continually seek to tailor their product or service to better satisfy the needs and preferences of target consumer segments, while consumers will increasingly perceive these as becoming differentiated from broader market offerings.

As the market matures, consumer expectations and business behaviour can become ingrained, and products and services transition from commodities to become highly differentiated and specialised products. Market structures in turn evolve to reflect these segmented products and participants, reinforcing the behavioural changes that caused the shift initially.

Significance of segmentation

Segmentation provides an analytical framework that is relevant for market participants, in terms of their own business and marketing strategies, and the degree of competition to which they are exposed, as well as to regulatory agencies responsible for developing effective consumer protection measures and promoting efficient market outcomes.

The *Corporations Act 2001* provides an example of the significance of market segmentation for regulatory arrangements, with specific obligations — including information disclosure provisions — for financial service providers who promote or sell products to retail, as opposed to wholesale, investors. This reflects differences in the capacity of retail and wholesale investors to effectively assess the risks associated with certain financial products, or the competence and/or probity of service providers.

3.3 How do we test if a market is segmented?

Approaches to segmentation

Previous studies of the market for estate agency services provide alternative perspectives on the existence of segmentation. While this study takes the view that there should be no pre-determined basis for identifying segmentation in the real estate services market, an overview of other approaches identifies those segmentation factors that have been identified previously and in other contexts. Those perspectives considered here are listed below and provide a starting point for analysis and propositions to test with stakeholders:

- classification systems, such as those used by the ABS and the Valuer-General Victoria;
- submissions to the Estate Agents Council Licensing System Review;
- the National Competition Policy Review of Victoria's market for estate agency services undertaken in 2000; and
- licensing arrangements in other jurisdictions.

Classification systems

The ABS and Valuer-General Victoria have constructed classification systems for the market for real estate services to support their statistical collection processes and analysis.

As included in Chapter 2, the ABS has articulated those *services* that it considers to be included within its definition of 'estate agency services' for the purposes of industrial classification. As depicted throughout the report, the Valuer-General Victoria classifies property sales transactions according to *property type*, using a structure of macro-level classifications (such as 'residential' property) and micro-level classifications (such as 'townhouses').

While each of these approaches illustrates possible bases of segmentation for the industry, neither approach captures interactions occurring between the segments. As both classification approaches are intended primarily for statistical purposes, they are necessarily discrete in their application to the industry — each service or property type should only meet the classification criteria of one category. This suggests that while such factors play a role in market segmentation, actual behaviour by market participants is likely to be more fluid.

Submissions to the Estate Agents Council

Submissions to the Estate Agents Council Licensing System Review expressed a range of views on specialisation and segmentation in the market for estate agency services. As an example, market segments were identified according to ‘types’ of agents and functions:

- residential estate agents and property managers;
- non-residential sector property managers;
- shopping centre managers;
- commercial real estate agents;
- those providing conveyancing and other services (bidders, brokers etc); and
- sale of businesses (EAC 2006).

National Competition Policy review

In the *National Competition Policy Review of Victorian Legislation relating to the regulation of Estate Agents*, study authors KPMG recommended the introduction of two levels of licence: one for residential sales, and one for non-residential, based on a segmentation of the industry comprising of five distinct functions. These functions were:

- business sales;
- commercial property sales (including industrial and agricultural property);
- commercial property management;
- residential property sales; and
- residential property management (KPMG 2000).

Licensing arrangements in other jurisdictions

Appendix D summarises the licensing requirements in place across Australian states. As this comparison shows, most jurisdictions have in place a two-tier licensing system, comparing:

- employees who act under the supervision of a licensed estate agent (similar to an agent’s representative); and
- estate agents who are entitled to own, operate and manage an estate agency business.

However, the licensing schemes for estate agents vary across jurisdictions in relation to the scope of services that licensed estate agents can perform. While Victoria, South Australia and Western Australia require general licences for estate agents, other states have several different estate agent licences in place with the specific licence required by estate agents depends on the services and activities the agent intends to offer.

New South Wales provides the most segmented licensing structure of all Australian states. A range of licences are prescribed based on a combination of type of property and function and include:

- real estate agents;
- stock and station agents;
- business agents;
- buyers agents;
- strata managing agents; and
- on-site residential property managers.

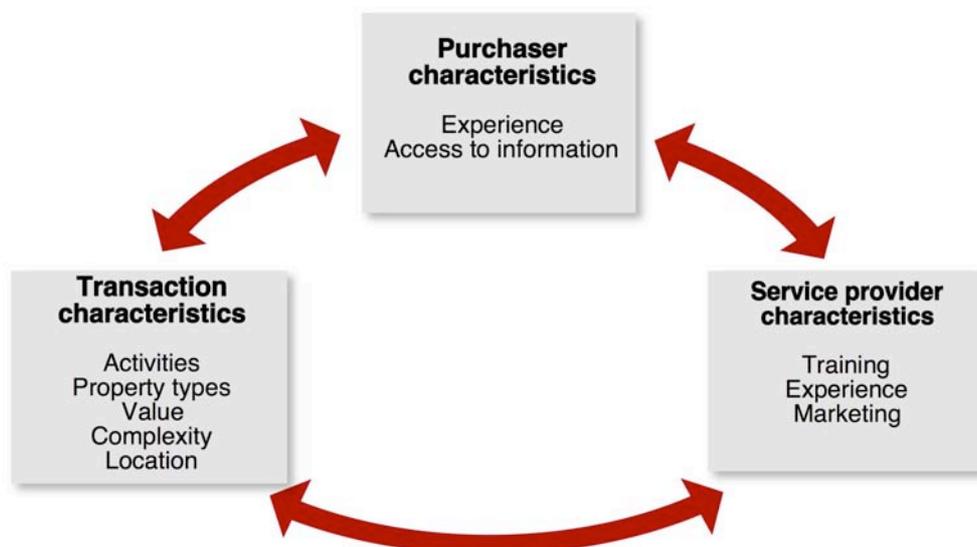
This licensing framework reflects the different skills, experience and risks associated with each range of services, and a belief that each segment is sufficiently distinct to require specialist practitioners.

Criteria used in this study to identify segmentation

Figure 3.1 sets out those criteria to be used to identify segmentation in the market for estate agency services in Victoria, which draw on some aspects of those factors put forward in the segmentation approaches reviewed. The criteria used in this study are:

- *purchaser characteristics*, such as experience in the market, and ability to access information, and whether these and other characteristics differentiate some market participants from others;
- *service provider characteristics*, such as training, experience and marketing, and whether these and other characteristics differentiate some market participants from others; and
- *transaction characteristics*, which are those factors that distinguish different transaction types that occur within the market, such as activities, property types, value and complexity, and whether there are significant differences between identifiable categories of transactions.

Figure 3.1

SEGMENTATION CRITERIA IN THE MARKET FOR ESTATE AGENCY SERVICES

In a segmented market these elements combine to create a distinct set of transactions to which a clearly identifiable group of market participants with similar characteristics are a party. These transactions all fall within the broader market but there is limited interaction between the parties to other transactions, and prices and levels of service in one segment have little relevance or impact on prices and levels of service in other segments.

Purchasers of estate agency services

Purchasers of estate agency services differ in a range of characteristics relevant to their needs, preferences and buying behaviour. Research and consultations identified the following *purchaser characteristics* as relevant to segmentation in Victoria's market for estate agency services:

- *Experience* — industry stakeholders emphasised the role of previous experience in the real estate market in influencing the needs, preferences and behaviour of purchasers of estate agency services. For example, residential vendors tend to execute transactions less frequently than other industry participants and would be expected to be less capable of making an informed choice among a range of service providers. In contrast, residential and commercial landlords are likely to be more experienced market participants, purchasing these services more frequently and over a number of years (KPMG 2000).

- *Ability to draw on various sources of information* — purchasers differ markedly in their ability and propensity to assess the market for estate agency services. Depth of experience is important but other factors are also relevant, including a willingness to consider a range of potential service providers. As examples, residential vendors tend to contact fewer agents than commercial vendors. Alternatively, vendors may access information from other sources, which might be publicly available, able to be purchased from experts or by engaging the market through a request for tender, as is often the case for commercial landlords or vendors.

Providers of estate agency services

Providers of estate agency services have a wide range of expertise, skills, training and experience. These and other characteristics present signals to the market of an estate agent's capabilities, and the services in which they might specialise.

Decisions concerning the range of services that estate agents will provide, and those segments of the market they will service and target, are intrinsically linked to business planning and strategy. However, there are a number of visible characteristics that both influence and reflect these strategic decisions. These characteristics include:

- *Training and conduct* — regulations require agents to have a minimum knowledge of the law to minimise client risk. Agents servicing particular clients frequently require specific training to better service the needs of their clients.
- *Experience* — a degree of experience is usually needed to satisfy client needs and there are various sources of industry experience. As examples, a business broking agency required all of its agents to have previously owned businesses themselves, to provide them with the knowledge and credibility needed to perform successfully in the field.
- *Marketing* — estate agencies market themselves towards particular activities and target prospective clients through a range of techniques. For residential real estate, agencies commonly convey their expertise within a local area, as evidenced by a shopfront presence in the suburb, or recent record of property sales in the area. Many franchise real estate agents will have their operating territories set out as part of their franchise agreements. Some agencies promote themselves as specialising in specific property types — such as one agency's 'retail, industrial and commercial specialists'. Other agencies emphasise quality aspects of their service, such as one residential franchise's 'the red carpet experience'.

Transaction characteristics

Box 3.1 identifies a range of transaction characteristics, which are relevant to both providers of estate agency services and their clients.

Box 3.1

TRANSACTION CHARACTERISTICS

The following transaction characteristics provide potential bases for segmenting the market for estate agency services:

- *activities* — different purchasers of estate agency services have different needs and engage estate agents to provide one or all of a range of transaction services, including property appraisal, property sales, auctioning, buyer advocacy, property management, specialist management (e.g. body corporate) and advisory services. Other clients require more detailed advice and assistance. Similarly, many agents concentrate on a distinct set of services, rather than offering all services that fall within the broader market for estate agency services;
- *property type* — real estate is commonly classified according to the purpose for which the property is, or can be, used (generally determined by zoning requirements). Commonly referred to property types include: residential, commercial, industrial, and agricultural;
- *value* — some stakeholders view transaction value as a basis for segmenting some classes of transaction services. As an example, it was suggested that different agencies engage in business broking depending on the value of the business, with segments being: sales of less than \$1 million; sales of \$1 million–\$50 million; and sales of more than \$50 million;
- *complexity* — transactions range in complexity from individual residential property transactions, through to commercial transaction advisory services, which may involve a lengthy engagement period, high transaction value, or multiple property sites; and
- *location* — both the location of the property and the real estate agent can be considerations for some transactions. Studies and anecdotal evidence suggest that vendors and landlords frequently select an agent located within close proximity of their property, reflecting the importance they place on local knowledge and physical presence. Conversely, large regional shopping centres are often sold by agents based in capital cities, due to their specialist skills and associations with institutional investors who often buy such assets.

Sources: Stakeholder consultations and responses to the ACG survey 2007.

Each of these characteristics is relevant in identifying distinct segments in the market for estate agency services.

3.4 Is Victoria's market for estate agency services segmented?

The market for estate agency services in Victoria is segmented, and as such, is characterised by restricted contact between different customers or different suppliers. The following chapters indicate there is generally little overlap between the operations of residential and commercial estate agents (or indeed, between residential and commercial purchasers of estate agency services). In other words, segmentation appears to be driven by different characteristics on both the demand and supply sides. This means estate agents have little scope to discriminate in the prices charged or levels of service offered to different segments of the market, as agents are not generally viewed as viable service providers outside their specific area of expertise.

The task then is to develop a model for determining whether it is possible to group certain transactions together and why transactions should be grouped in a particular way. In other words, to identify distinct segments in the market for estate agency services.

A model for identifying whether a segment exists and what its boundaries might be needs to consider the following questions relating to both the demand and supply sides of the market in Victoria:

- Can we identify a group of purchasers of estate agency services that have specific and similar characteristics?
- Can we identify a group of providers of estate agency services who have similar characteristics, and who have limited interaction with other groups?
- Is the total number and value of transactions within a specific activity or group of activities of sufficient size for them to be considered a segment?

These questions incorporate the relevant characteristics of property transactions, and of the various market participants.

Are there groups of purchasers of estate agency services that have specific and similar characteristics?

Yes, residential vendors and landlords, vendors and owners of commercial, retail and industrial property, and purchasers of business broking services, exhibit specific characteristics.

The most obvious difference between the various purchasers of estate agency services is the frequency with which they undertake transactions, their capacity to make an informed choice among competing service providers, and the size of those transactions. For example, owners and vendors of commercial property tend to execute higher value transactions more frequently than their residential counterparts. While some residential vendors or landlords will be better placed to make informed decisions than others, their capacity is generally lower than that of commercial vendors and landlords.

Chapter 4 considers the characteristics of residential purchasers in more detail and notes that while residential landlords typically execute transactions more frequently than residential vendors and therefore have greater experience and opportunity to change suppliers, they still bear some similarities in terms of the basis for the choice of estate agent. Consultation and analysis suggest the most significant factors are an established relationship, reputation and the proximity of an agent to a property. Furthermore, residential purchasers are often less inclined to switch between agencies compared to commercial clients. Similarly, transactions relating to residential property tend to be less complex and of a lower amount than similar transactions relating to commercial property.

On the other hand, Chapter 5 considers the characteristics of commercial purchasers and suggests that in general, the process by which estate agents are engaged is similar to that for other providers of professional services. Similarly, commercial purchasers tend to execute transactions of a higher value and greater complexity, are more willing to consider a broader range of potential service providers (including those located in other jurisdictions) and are more likely to take action such as switching agencies or taking legal action if they are dissatisfied.

These differences provide a starting point for separating purchasers into two distinct groups, namely residential and commercial (which notionally includes business broking).

Are there groups of providers of estate agency services who have similar characteristics, and who have limited interaction with other groups?

Yes, there are estate agencies with similar characteristics, and who have limited interaction with other groups.

As previously noted, segmentation arises from a situation where groups of service providers specialise in certain activities and/or transactions. It is clear this occurs among estate agencies. Many estate agencies specialise almost exclusively in residential transactions (usually both sales and property management), while others primarily execute commercial transactions.

Segmentation, on the basis of specialisation in either residential or commercial transactions, is also driven by the different skill sets required for agents to successfully compete for business in these areas. Residential purchasers expect agents to have experience in conducting transactions in the area in which their property is located and their expertise is their familiarity with a particular location or region.

On the other hand, commercial purchasers typically expect their agents to possess a broader range of skills and experience, such as tertiary qualifications in law or finance, with knowledge of a particular region often being less important. As such, there are usually significant differences in the skill sets and experience of residential and commercial agents.

Furthermore, commercial agents tend to execute more complex transactions, which are also of a greater amount than a typical residential transaction.

It is also clear that some activities within these two broad segments are more complementary than others, from a business perspective. It is true that successful residential sales agents require different skills from residential property managers (the latter need to manage actual and potential tenants and have knowledge of tenancy law). However, most residential agency *businesses* undertake both activities (with some notable exceptions). Specialisation does occur in this segment but usually on the basis of geography, rather than the activity or transaction itself. In other words, most residential agencies concentrate on transactions within a defined (and relatively small) area.

Complementary activities do exist for commercial agencies but to a lesser extent, as shown in Figure 3.2. For example, many commercial agencies execute transactions across a range of areas, including industrial, retail and other commercial premises (such as office blocks). There are, however, some activities that require a degree of specialist experience or knowledge and it is not uncommon for commercial agents to acquire additional skills if they are to execute certain transactions. A specific example of which is retail property management in shopping centres, in particular, where agents require working knowledge of the law and experience in the management of retail tenants.

Figure 3.2

PROPERTY SALES AND PROPERTY MANAGEMENT COMPLEMENTARITY

| | Property sales | Property management |
|--|----------------------------------|---------------------------------------|
| Residential property | Residential estate agents | Residential estate agents |
| Commercial, industrial, retail property | Commercial property sales agents | Commercial property management agents |

In other areas, the specificity of skills and experience is such that ‘generalist’ commercial agents would completely avoid certain activities or transactions. The most noticeable area of specialisation within the broad range of commercial transactions is the sale of businesses. Indeed, consultation and analysis as part of this study indicate that commercial estate agents typically execute very few business sales, or they focus almost entirely on such transactions. It is a commonly held view among agents, however, that business broking represents a distinct segment. Similarly there are other specific activities such as shopping centre management that require select skills and expertise.

In general, it is reasonable to conclude that there are three broad segments into which most estate agents could be distinctly classified: residential, commercial and business broking. It is also clear that competition in the market for estate agency services is influenced by this segmentation in that residential agents do not usually compete for business with commercial agents and vice versa, while commercial agents do not usually compete for business with business brokers (except in limited circumstances).

This discussion indicates that specialisation is common within the market for estate agency services, and within the notional segments that have been identified thus far. More specifically, areas of specialisation include:

- specialisation by location in the market for residential sales and property management;
- specialisation in the sale of high-value residential properties. There are some estate agencies that concentrate on such properties operate multiple locations; and
- specialisation in retail property management.

Specialisation in these areas has implications for competition among agencies. In other words, agencies cannot easily undertake such activities if they do not possess specific skills, expertise or experience, which inhibits the extent of effective competition. Furthermore, the clients of agents who specialise in these activities will differ in their need for protection against inappropriate conduct or the failure of an agent to provide an adequate level of service.

Is the total number and value of transactions within a specific activity or client group of sufficient size for them to be considered a segment?

Yes, the metropolitan residential; metropolitan commercial, retail and industrial; and business broking segments are of sufficiently large size to attract large numbers of specialist competitors.

In order for a group of transactions within a specific activity or client group to be considered a distinct segment, that group should be of sufficient size — and have the potential to generate sufficient revenue — to warrant targeting by estate agency businesses.

Furthermore, strict application of the segmentation concept — that categorises groups of transactions and market participants on a highly specialised basis — may create difficulties in assessing the extent of competition across segments, or developing a practical and workable regulatory framework.

This report takes the previous factors into account and then considers the number and size of transactions that fall under specific activities — within the context of the *total* market for estate agency services in Victoria — to reach conclusions about the existence of distinct segments.

Some residential agents located in suburban Melbourne clearly specialise in transactions within a relatively small geographic area, or even an individual suburb. Similarly, agents located in regional towns specialise in transactions (of a more diverse type) within that area. A strict interpretation of segmentation might conclude that transactions within that area, town or suburb — residential sales and property management — constitute a distinct segment.

However, this report considers the number and size of transactions in a national segment relative to the *total* Victorian market to reach conclusions about whether it should be identified as such. In other words, this report does not conclude that residential sales and property management in an individual suburb of Melbourne constitute a distinct segment, given their relatively small size. Rather, residential sales and property management in metropolitan Melbourne represents a distinct segment due to the overall size and volume of transactions.

Similarly, market outcomes (such as commission rates and returns to estate agency services) in some suburbs are likely to bear some similarities to outcomes in neighbouring and adjacent suburbs. The same cannot be said for residential versus commercial services where market outcomes and business returns differ between the notional segments.

Segmentation identified

While it is possible to identify segments at a relatively high level, the boundaries of those segments are likely to be porous — at least to some degree — and an element of judgement is necessary to identify those boundaries.

Estate agents specialise in specific activities, but there are some exceptions. There are undoubtedly some estate agents who specialise in residential sales and property management but who also execute some commercial transactions. Similarly, there are some agents — in regional and rural areas, for example — who execute a broad range of transactions.

Furthermore, there are a number of activities that fall within the commercial segment, which might reasonably be identified as distinct, or indeed as sub-segments, an example of which is retail property management.

Segmentation is also a fluid concept and subject to change in line with the ongoing development and evolution of markets, and with other factors such as technological change. There are examples of residential agencies that specialise in property management and avoid residential sales altogether (opinions put forward over the course of this study are mixed as to how sustainable this business model might be over the longer term).

Factors such as technological change have the potential to promote greater competition within and between segments. The internet provides another mechanism for acquiring information about service providers, or for agents to become aware of business opportunities. Commercial agencies in Victoria are increasingly competing with agencies from other jurisdictions and for business in other jurisdictions.

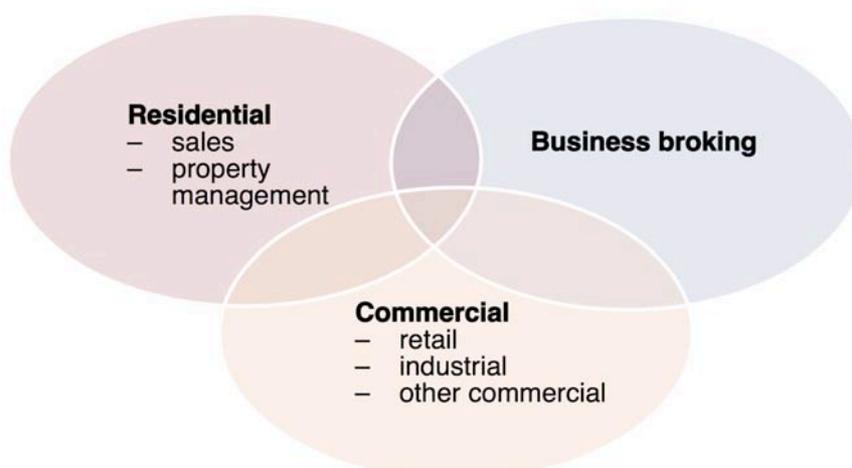
The following chapters consider the residential sales and property management, commercial sales and property management, and business broking segments in more detail, and identify how clearly the boundaries between those segments can be delineated.

3.5 Conclusion

This chapter has found there to be segmentation in the market for estate agency services within metropolitan Melbourne, comprised of a residential segment; a commercial, retail and industrial segment; and a business broking segment, with some overlap between the segments at the margins (depicted in Figure 3.3).

Figure 3.3

THE MARKET FOR ESTATE AGENCY SERVICES — METROPOLITAN MELBOURNE



This segmentation construct does not extend to regional and rural Victoria, where estate agents tend to provide a broader range of services across these segments, rather than specialising in a particular type of real estate activity.

Rather, estate agents in regional and rural Victoria typically specialise on the basis of location. As a consequence, regional estate agents usually face competition from other agents based in their town, region or district (although some commercial agents compete for services across a wide geographic area) and it is more appropriate to segment the regional and rural market according to location. This issue is considered in more detail in Chapter 6.

Chapter 4

Metropolitan residential segment

This chapter describes the characteristics of the metropolitan residential segment of the market for estate agency services in Victoria.

Key points

The provision of residential estate agency services, which includes the sale, purchase and management of residential property, is widely considered by stakeholders to be a distinct segment.

The metropolitan residential segment is the most significant segment within the market for estate agency services in Victoria, in terms of the proportion of estate agents involved in the segment — 77.2 per cent of respondents to the CAV/EAC survey engaged in residential sales activities, while 66.3 per cent of respondents engaged in residential property management activities.

Purchasers of estate agency services within the residential segment typically undertake fewer transactions than those in the retail, commercial or industrial sector. Research suggests that most residential sellers select an agent based in close proximity to their property, and generally only speak with one agent.

The relative lack of sophistication of purchasers of services in this segment is less acute for property management, where residential leases typically last for around twelve months. This provides property owners with regular opportunities to reconsider returns, fees charged, management of tenants, etc. and change agencies if unsatisfied. Further, property investment of any kind requires a degree of financial knowledge and long-term perspective, particularly given the range of alternatives investments (and the associated transaction costs). This implies a level of expertise, an ability to assess risk and reward, and to assess the relative merits of different investment strategies.

Residential estate agents compete on price, service, reputation and local presence. Proximity to a transaction and a local presence is highly valued by purchasers of services in this segment. The importance of local knowledge and experience has implications for the degree of effective competition.

4.1 Introduction

The provision of residential estate agency services, which includes the sale, purchase and management of residential dwellings, is widely considered by stakeholders to be a distinct segment.

Chapter 2 illustrated that metropolitan residential sales account for the greatest number of transactions and proportion of total estate agency income. The volume of transactions in metropolitan Melbourne has created an environment conducive to specialisation, on the basis of services performed, location and transaction size.

The remainder of this chapter considers characteristics of vendors, landlords and agents in support of the proposition that residential sales and property management can be identified as a distinct segment within the broader market in line with the segmentation approach identified in the previous chapter.

4.2 Segment characteristics

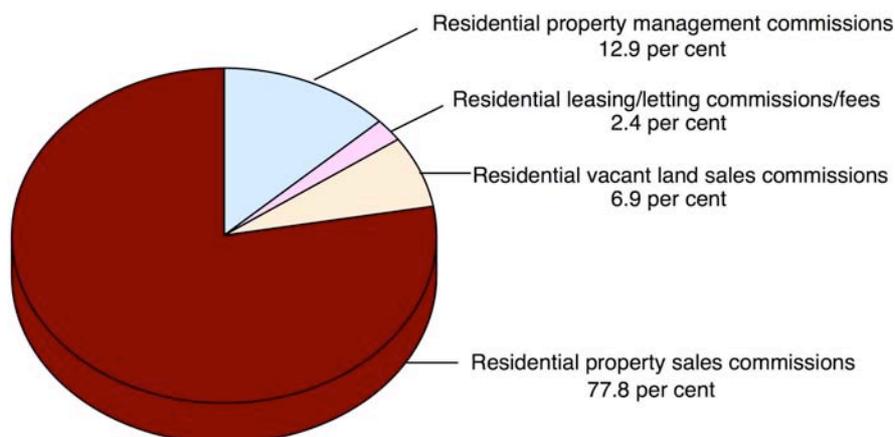
Chapter 2 identified the relative significance of residential property as a source of income for estate agencies on the basis of the CAV/EAC survey. The survey found that 70 per cent of those estate agencies engaged in residential sales derived 50 per cent or more of their total agency business from the activity, and that 63 per cent of those agencies engaged in residential property management derived 20 per cent or more of their total agency business from the activity.

In total, 77.2 per cent of respondents to the CAV/EAC survey engaged in residential sales activities, while 66.3 per cent of respondents to the survey engaged in residential property management activities. These figures demonstrate the breadth of involvement in the residential property segment of many estate agents, and of residential property sales in particular.

Figure 4.1 illustrates the relative magnitudes of sources of estate agency income within the residential segment in Victoria, highlighting the significance of residential property sales commissions as a source of income for estate agents servicing this segment.

Figure 4.1

SOURCES OF ESTATE AGENCY INCOME FROM RESIDENTIAL PROPERTY, VICTORIA

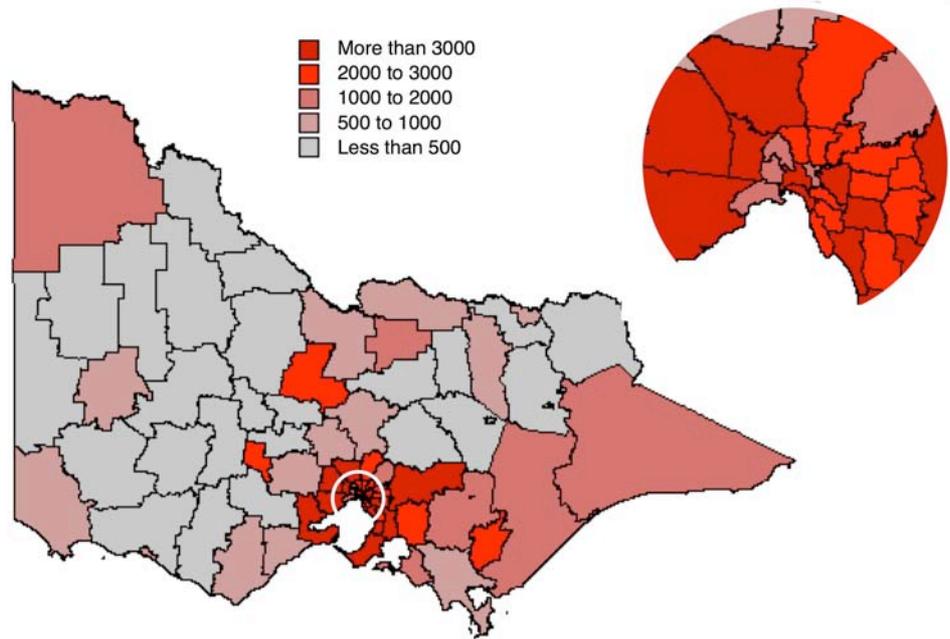


Source: Adapted from the Australian Bureau of Statistics 2007a.

The number and distribution of residential sales in Victoria in 2006 is depicted in Figure 4.2 and Figure 4.3 illustrate the types of transaction the Valuer-General Victoria categorises as residential and the number and average value of transactions in such properties.

Figure 4.2

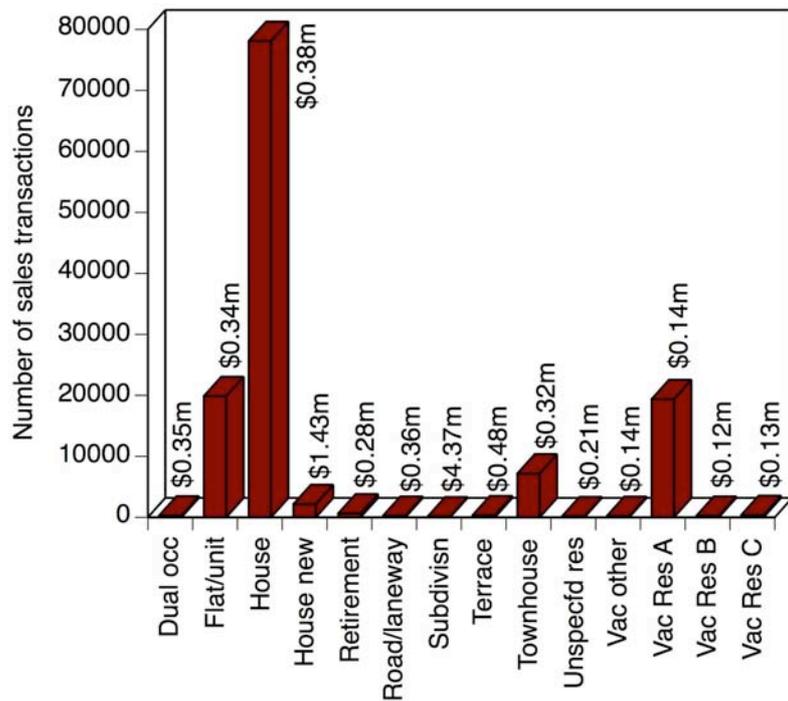
RESIDENTIAL PROPERTY SALES IN VICTORIA, 2006



Source: Valuer-General Victoria 2007.

Figure 4.3

RESIDENTIAL PROPERTY SALES IN VICTORIA BY NUMBER AND AVERAGE VALUE, 2006



Source: Valuer-General Victoria 2007.

There is no comparable information with respect to property management transactions.

4.3 Purchasers of estate agency services

This section focuses on purchasers of residential estate agency services. The key issue to address is what they take into account when entering into these transactions.

Residential sales

Purchasers of estate agency services within the residential segment typically undertake fewer transactions than those in the retail, commercial or industrial segment. Anecdotal evidence suggests vendors execute a sale every seven years, on average, which implies the information asymmetry is more acute (and hence, there is greater need for protection through regulatory measures).

The Australian Housing and Urban Research Institute (AHURI) conducted a survey of vendors of residential property for the EAC and Office of Fair Trading and Business Affairs in 1997. The context for the survey is different from that for this review, as the Victorian Government had recently deregulated the fees and commissions estate agents were able to charge for their services. Even so, consultation over the course of this study suggests many of its findings and conclusions remain relevant.

The survey's key findings are summarised in Box 4.1.

While there have not been any recent studies in Victoria exploring similar issues, a study of the estate agency services market in England and Wales by the UK Office of Fair Trading found that 90 per cent of sellers choose an agent located within five miles of their property and generally spoke to no more than one agent.

Discussions with industry participants over the course of this review offered diverging views with respect to residential vendors:

- vendors tend to use the internet as a filtering device when they are looking to engage an estate agent and most vendors would invite proposals from between three and six agencies when they are selling their house. However, an owner of a large number of residential estate agencies businesses estimated around 30 per cent of people selling a property will only invite one agent to bid for the work, while most will only invite between two and three;
- an estate agency's market share in the area is a criteria commonly used by prospective purchasers of estate agency services;
- price is an important, but not definitive, factor for purchasers when selecting a real estate agent in the residential segment — rather, it is one of several considerations. More important is the willingness of the purchaser to trust the agent; and
- word-of-mouth, an established brand and referrals from family and friends were also identified as important factors.

Box 4.1

SURVEY OF RESIDENTIAL VENDORS — KEY FINDINGS**Property sales**

Approximately 60 per cent of vendors sold by private sale and the other 40 per cent by auction. Auctions are most common in the inner- and middle-ring Melbourne suburbs.

Selecting an agent

Most respondents reported that the professionalism of the sales staff and reputation of the agency were important factors in selecting an agent. Reputation was cited as the most important factor by 20 per cent of respondents, while 18 per cent cited the selling price quoted by the agent.

Forty per cent of vendors approached one agent, while 35 per cent approached at least three. Agents with the lowest commission were selected by 13.5 per cent of vendors.

Knowledge of vendor rights

Approximately 60 per cent of vendors were aware they could negotiate commissions with agents, while 43 per cent were aware of advertising rebates.

Awareness of vendor rights was relatively high among people in professional and managerial positions, along with male vendors and those in the workforce. Vendors selling by auction also appear to be more aware of the possibility of negotiating than those selling by private sale. According to vendors, about 30 per cent of estate agents informed them of the right to negotiate commissions.

Knowledge of dispute resolution

Between 20–25 per cent of vendors were aware of the dispute resolution mechanisms available to them. Those who did generally learned either from past experience with selling a property or through the media.

Negotiating with agents

Approximately 44 per cent of vendors attempted to negotiate commissions with agents. They were more likely to be professionals, young, or born overseas. Vendors selling by auction and those with higher priced dwellings were also more likely to negotiate with an agent. Nearly 60 per cent of vendors who attempted to negotiate found their agent 'willing' and negotiating appeared to successfully reduce the commission fee. Vendors most commonly set the fee by agreeing to a specified percentage of the sale price, while 'negotiators' displayed a higher propensity to use a sliding percentage method to agree fees.

Source: AHURI, in conjunction with Centre for Urban and Social Research, Swinburne University 1997.

The findings of the Allen Consulting Group survey of estate agents in relation to this issue are summarised in Box 4.2.

Box 4.2

DEMAND-SIDE CONSIDERATIONS WHEN APPOINTING AN ESTATE AGENCY

Purchaser considerations when appointing an estate agency include:

- the service offered by an estate agency;
- the skills, knowledge and experience of estate agency staff;
- the price of estate agency services;
- the purchaser's awareness of an agency's brand and image;
- an agency's profile and reputation;
- perceptions of an agent's integrity, morals and ethics;
- the estimated selling price of the purchaser's property quoted by an agent;
- an agency's location;
- an agent's marketing ability and sales strategy for the property;
- the quality of an agent's communication and responsiveness;
- the ability of the vendor to deal directly with senior/principal agents;
- any past dealings with the estate agency;
- whether the vendor has a personal relationship with the agent, especially in regional areas;
- the availability and presentation of an estate agency's web-based services;
- the estate agency's community profile, particularly in regional areas;
- an agent's attention to detail; and
- an agent's ability to sell their property on an 'off-market basis'.

Source: ACG survey of estate agents 2007.

It is likely there have been some changes in this area in recent years. A number of industry representatives observed that residential property owners were becoming better informed and expecting more from agents in terms of the information provided and advice about returns. As such, expectations of service levels were becoming more aligned with the type of services providers by other professional advisers in relation to different asset classes (such as stockbrokers).

Media attention on property values has increased significantly in recent years. Forums such as newspaper articles, television programs, etc. provide vendors with information about possible sale values.

There is also an increasing market for the provision of property information, which is being facilitated by technology (the internet, in particular). Some information is available free-of-charge or can be purchased, through agents and other services. Such information typically includes extensive data on recent sale prices, the number of transactions in certain suburbs, and the characteristics of properties.

Specific examples include:

- Property Data Online, which provides the most current information available by combining Valuer-General data with sales reported by Property Data Online members;
- Australian Property Monitors, which provides real estate market information to the industry and consumers; and
- websites such as *realestate.com.au*, which provides a suite of data and information to buyers and sellers of real estate at various levels of detail. It provides a free suburb profile — which includes demographic details, such as household income, median prices over a five-year period, and information about the suburb — that can also be upgraded at a fee of \$49.95 to include details of all sales within that postcode over the previous twelve months.

Residential property management

The relative lack of sophistication is less acute for property management, where residential leases typically last for around twelve months. This provides property owners with regular opportunities to reconsider returns, fees charged, management of tenants, etc. and change agencies if unsatisfied.

Further, property investment of any kind requires a degree of financial knowledge and long-term perspective, particularly given the range of alternative investments (and the associated transaction costs). This implies a level of expertise, an ability to assess risk and reward, and to assess the relative merits of different investment strategies.

The findings of the Allen Consulting Group survey of estate agents on the factors that residential landlords take into account when selecting an estate agent to manage their property is summarised in Box 4.3.

Box 4.3

WHAT LANDLORDS WANT FROM ESTATE AGENTS

Those factors that landlords consider when selecting an agent to manage their property include:

- care of their interests;
- careful selection of tenants;
- accurate bookkeeping;
- precise communications;
- guidance to avoid legislative pitfalls; and
- sound systems in place at the estate agent.

Source: ACG survey of estate agents.

An obvious point of difference between residential vendors and residential landlords in terms of the skills and expertise required of estate agents is the ability to negotiate with prospective tenants and manage existing tenants. This includes familiarity with the *Residential Tenancies Act 1997*.

The NCP review of the Estate Agents Act analysed the residential segment and reached different conclusions with respect to residential sales and residential property management. It concluded the latter bore similarities to commercial property management and noted:

Given the long-term investment nature of residential and commercial rental property, most landlords are repeat purchasers of property management services. Therefore, they develop experience in assessing the services of property managers. In addition, most landlords are familiar with the work of property managers, because much of it is similar to the work people do in managing their own homes (e.g. organising maintenance) ... It is also fairly easy for a landlord to assess the services provided by an agent. For example, if an agent fails to secure a tenant, then the landlord can review the marketing and price of rent placed on the property. (KPMG 2000, p. 54)

Despite this, consultation over the course of this review found that residential landlords frequently engaged an agent with whom they have had recent or previous experience. That is, if an agent executes a sale, provided some advice in relation to a purchase, or was involved in the sale by the previous owner, they will often be involved in management of the property.

An established relationship is important, as is the case with most areas of the estate agency services market. A purchaser who is familiar with an agent (through a previous transaction, word-of-mouth, or advertising), would often approach that agent to execute other transactions or provide advice. Another industry participant stated that most purchasers will place a premium on an existing relationship with the agent — they are paying for ‘comfort’.

Further, one industry representative noted that property investors very rarely change property managers unless there is a significant reason to do so⁴. This behaviour is influenced by the associated transaction costs, including the necessary effort associated with changing agents. Landlords rarely change managing agents — the agent would ‘need to do something very badly to lose a client’.

Finally, landlords tend to choose managing agents that are located relatively close to their rental property. The importance of an agent’s location is considered in more detail below.

Other market participants

Chapter 2 identified a number of other individuals and entities who are not direct participants in the market for estate agency services — in that they do not purchase services directly from agents — but are nevertheless important. They are afforded considerable protection, through the Residential Tenancies Act, for example, are other measures related to the sale of property (prohibitions on under-quoting or dummy bidding, for example).

A key function of residential agents is to manage actual and prospective tenants, and a landlord’s view of the quality of service will be driven by the manner in which this occurs.

⁴ It should be noted that a significant proportion of those landlords transfer between estate agents when estate agencies sell rent rolls.

Similarly, actual or potential buyers of property will derive some indication of the expertise, conduct and probity of any estate agent who is involved in the marketing and sale of a particular property. This in turn, is likely to influence any future decision to purchase estate agency services (for property management and/or subsequent sale). The evidence suggests the majority of residential purchasers consider an agent who has previous experience with managing the sale or rent of a particular property.

Therefore, the services that estate agents indirectly provide to these ‘other market participants’ are potentially an important determinant of any decision they might make at some future point as a purchaser of estate agency services.

4.4 Providers of residential estate agency services

Chapter 2 detailed the average size of estate agencies, supporting the views expressed by a number of industry participants who described the residential real estate agency segment as a ‘cottage industry’, characterised by a large number of small estate agencies.

Residential agents typically derive the majority of their income from commissions on residential sales or from property management fees. There is a (very) limited degree of crossover by residential estate agents into the commercial sector, although they may execute relatively small commercial transactions, such as selling the local milk bar in the region they service. This is more common in less densely populated areas.

Agents typically rely on a combination of the basic education and experience required as part of their licensing obligations under the *Estate Agents Act 1980*, in addition to the practical expertise and experience derived from concentrating on sales and property management in a particular area. In many cases, this type of expertise is not generally supplemented with significant additional formal education and training, as is typically the case for commercial agents but rather, through practical experience. Other sources of training are available to estate agents, such as those delivered by the REIV.

The prevalence of franchises in the residential segment indicates the importance, from a vendor or landlord’s perspective, of an established brand name and reputation. Individual franchises gain in the marketing of properties as part of heavily advertised brands, from network and scale benefits and training facilities. In other words, they are able to differentiate their service from other agents, who would tend to emphasise their knowledge of a particular area.

Respondents to the ACG survey identified a broad range of knowledge and skills that are required to provide estate agency services within a residential property context. These included:

- *interpersonal skills* — many agents emphasised that estate agency services are essentially a ‘relationship business’, requiring skills in communication, sales, organisation, negotiation, and dispute resolution. Compassion and empathy are also highly valued qualities;
- *local knowledge* — residential estate agents must have an in-depth knowledge of the area and its amenities, local demographics, and market conditions (such as sales prices, vacancy rates and average rents);

- *segment knowledge* — residential estate agents must have a deep understanding of the requirements of property buyers and investors; and
- *technical skills* — a thorough knowledge of relevant legislation (such as the Estate Agents Act, Residential Tenancies Act, *Sale of Land Act 1962*, *Subdivision Act 1988*, *Fair Trading Act 1999*) and legal processes (such as VCAT processes), accounting and numeracy skills, computer literacy, and due diligence processes.

In addition to the above, residential agents need to possess the specialist skills required to perform certain services, such as a knowledge of development and building approvals processes for the sale of residential land. Stakeholders suggested that there were different skill sets required for property managers to those for salespeople, as shown in Table 4.1.

Table 4.1

SPECIALIST SKILL REQUIREMENTS — RESIDENTIAL PROPERTY

| Property managers | Property salespeople |
|---|---|
| <ul style="list-style-type: none"> • Knowledge of the Estate Agents Act and the Residential Tenancies Act • Knowledge of VCAT procedures • Customer service skills • Residential Tenancies Bond Authority (RTBA) procedures • Negotiation skills • Experience handling client funds | <ul style="list-style-type: none"> • Knowledge of the Sale of Land Act and the Estate Agents Act • Knowledge of appraisal procedures • Sales skills • Negotiation skills • Customer service skills • General industry knowledge |

This implies a degree of specialisation within estate agencies, such as through separate property sales and management divisions within agencies, however complementarities between the two ensure that they remain part of the same segment.

Importance of geography

Local knowledge and proximity to a property are nominated as two of the most important characteristics for sellers of estate agency services. As such, residential agents tend to concentrate on sales and management of properties that are located within a relatively short distance from their office. This is most notably in the CBD and across metropolitan Melbourne and is apparent in the practices of some larger estate agencies.

Estate agency franchisees are generally allocated ‘territories’, which are defined geographic areas for which they have the exclusive rights within the franchise (that is, franchisees are not permitted to deal within the territories of others).

Agents in residential property rarely work outside ‘their’ territory. Franchise offices refer work between franchise offices where they are approached by prospective clients outside their territory. In this sense, there is a strong element of geographic segmentation, which is likely to inhibit effective competition between residential agents. This only tends to break down in specific circumstances, such as agents who offer a boutique service or cater to a particular client group (for example, high value residential sales).

Buyer advocacy

Buyer advocacy represents a very small element of the market for estate agency services in terms of the revenue it generates and the proportion of agents that provide the service. Some agents expressed concerns about perceptions of conflict of interest among potential and actual clients and suggested that the activity added little value. It is likely there are few specialist buyers advocates and that many agents might provide advice to existing clients (such as landlords), as an adjunct to other services and in order to maintain a relationship with a valued client.

4.5 Competition

Despite legislative and regulatory requirements, the formal barriers to entry to the market for estate agency services are considered to be low (IBISWorld 2007). However, the importance of local knowledge and experience has implications for the degree of effective competition.

Residential estate agents compete on price, service, reputation and local presence. Estate agents’ fees and commissions are set out in myriad arrangements, such as percentage of sale price, fixed fees, or a fixed fee plus a percentage. Typical commissions are between 2–3 per cent for residential sales, although some agents are able to earn an additional amount under certain circumstances (as a form of performance incentive, such as if a sale price exceeds a certain amount). Property management fees tend to be a proportion of rental income.

The importance of location suggests the geographic distribution of agents provides an indication of the extent of competition for residential estate agency services. Figure 2.2 illustrated the concentration of agents, implying that there are typically between 5–10 agents able to provide such services (the relatively high number of licensees in the metropolitan area can be explained by the likely inclusion of commercial agents for whom location and proximity to a property is less important than for residential agents).

Consultation over the course of this review revealed differences in views on the number of competitors that residential agencies face. One view suggested that there were typically two to three dominant residential agencies in a given area, with a handful of other agents competing for any remaining business. In contrast, for most commercial listings, there will be at least five agencies that come to purchasers’ minds to perform the transaction. It was proposed that residential estate agents were able to attract higher fees for their services than commercial agents, due to a ‘less competitive environment’.

The ACG survey of estate agencies also provided views on the number of competing agents in the residential sector:

- agents identified between 5–50 competitors in their local area in the CBD and inner suburbs;
- agents identified between 5–30 competitors in their local area in suburban areas and regional centres; and
- agents identified fewer than five competitors in regional centres and small regional towns.

Outcomes

Recently, clients are increasingly setting fixed percentage plus incentive fees, which are intended to more closely align the interests and incentives of an agent with those of the vendor. As an example, an agent may receive a fixed commission of 1.5 per cent of sale price up to the vendor's reserve price, and 10 per cent commission for any amount over the reserve price.

Furthermore, a number of agents consulted over the course of this study stated their clients were becoming more astute and more demanding. Since deregulation of the market and the ability of agents to set their own fees, which occurred in 1995, estate agents can be more responsive to purchasers — however agents need to consistently demonstrate their value, and frequent and experienced purchasers of estate agency services are confident negotiating more favourable commissions.

Despite this, commissions are generally a fixed percentage of a property's sale price, which implies competitive pressures are relatively limited. Chapter 2 suggested that returns to estate agency services were pro-cyclical (having a positive relationship with property values), with limited direct relationship to cost. In other words, agents are able to earn a higher amount as sale prices increase without necessarily having to incur a commensurate increase in operating costs.

The importance of an agency's location and its expertise in a specific area, from a vendor or landlord's perspective, means the number of transactions 'available' to an agency is effectively reduced. In other words, certain areas cannot support a large number of agents who differentiate their services on the basis of their knowledge of a specific area.

Therefore, the residential segment in Victoria exhibits similar characteristics to estate agency services market outcomes elsewhere, a particular example of which is England and Wales. The UK Office of Fair Trading concluded:

Levels of concentration ... are unlikely to support single firm dominance or general collusion. But we do recognise that market supply is not wholly fragmented and that these are best characterised as 'moderately concentrated' markets [on the basis of HHI, for example]. Moreover, although we have sufficient evidence on entry and exit over time to be confident that it is perfectly possible for agents to enter a local market and achieve a strong market position given time, we also believe that short term 'hit and run' entry is generally not feasible. (NERA study for UK Office of Fair Trading, Appendix D, p. 7)

In the Victorian context, there is typically a lagged supply response to high returns from residential estate agency service activities. Licensing requirements contribute to this but other factors are likely to be equally, if not more significant. Not only is it unclear how long those positive returns will last — given uncertainty about the length of a property boom, for example — it also takes some time to become established and recognised as an expert with a certain area, for the reasons outlined previously. This task is likely to be easier for an agent that is part of an established larger agency with reputation (in the case of franchises, for example) — and this resonates with clients.

There is little objective data in relation to returns to residential property management and few stakeholders consulted as part of this review expressed specific views. However, earlier findings about the perceived reluctance of property owners to shift between service providers implies returns to property management are similar to returns to residential sales.

4.6 Conclusions

The provision of services relating to residential sales and residential property management exhibits characteristics of a distinct segment that incorporates both activities. There are some differences between the ‘typical’ vendor and the ‘typical’ landlord, most notably in terms of the frequency with which they undertake transactions, although landlords generally take account of the same factors as vendors (and buyers).

Furthermore, any information asymmetry is less acute for property management, as investors and landlords are more sophisticated and have more frequent opportunities to reassess and change suppliers. This led KPMG to conclude that residential sales and residential property management were distinct segments.

However, on the supply side, the two activities are complementary, certainly from a whole-of-business perspective (although staff within an individual residential agency often specialise in one of property management or sales). There is a complementary relationship between residential property sales and residential property management. This is because sales are more volatile than property management (which is often thought of as an agent’s ‘bread and butter’), and sales and property management build relationships with clients that can be used to sell other services in the future.

Despite this, there is a limited degree of specialisation within the residential segment, beyond geographic segmentation. While specialisation within a region has been discussed, there are some ‘boutique’ agencies in Melbourne that tend to dominate ‘high end’ residential property sales, rather than multi-office agencies. This illustrates the importance of the amount of a transaction in any analysis of segmentation as the price paid for high-value residential properties can exceed prices paid for some commercial properties.

Furthermore, some agencies specialise in the following:

- land sub-division;
- appraisals;
- student accommodation;

- retiree and assisted living accommodation; and
- off-the-plan investor sales, where developers sell property directly to financial planners, who then earn commissions for on-selling property to investors.

While the above are all areas of specialisation, the scale of activity is relatively small within the context of the *total* market for estate agency services. Furthermore, the differences between agents that execute these transactions and agents that focus on sales and property management — in terms of specialist knowledge and training — are likely to be immaterial and many residential agents would be able to compete with the ‘incumbents’ at least to some degree.

The boundaries between these ‘sub-segments’ are not obvious or clearly defined and while there might be some lag in a supply response to higher commissions and fees, it would occur over time if that increase were sufficiently high. This may change in the future.

A relatively recent development is for some estate agencies to focus on one or the other type of transaction on a large scale, separate from the other. This business model represents a likely change in the residential segment, which suggests segmentation could be observed at a less aggregated level (in line with the findings and conclusions of the NCP Review).

There are complementary business links between residential property sales and management, which are well known. However, links between estate agency services and financial products and services are an emerging opportunity. As an example, Suncorp Metway owns L.J. Hooker, in recognition of the potential to cross-sell other products to clients on the rent roll. The ability of service providers to leverage other services — estate agency and other — is common across all segments and is also observed in other industries. This reflects the importance of trusting and ongoing relationship between agent and customer.

Finally, technological developments are likely to continue to impact on the residential segment. Industry participants noted that purchasers were increasingly using websites to assess the relative skills and expertise, which has the potential to reduce transactions costs and ultimately, supplant the role of the estate agent. This is a likely development across all segments of the estate agency services market in the years to come.

Chapter 5

Metropolitan commercial, retail and industrial segment

This chapter describes the characteristics of the metropolitan commercial, retail and industrial segment of the market for estate agency services in Victoria.

Key points

The provision of ‘commercial’ estate agency services exhibits the characteristics of a distinct segment.

Commercial purchasers tend to have a greater capacity than those in the residential sector to make informed decisions about the competence and probity of estate agents.

The most notable distinction between commercial and residential vendors and landlords is that the former are generally involved in a greater number of commercial transactions, and therefore, are able to draw on a greater volume and type of information about the adequacy of service providers. At the same time, the size of commercial property transactions creates a more litigious environment so purchasers of estate agency services frequently support the advice provided by estate agents with advice from other experts (such as legal, financial or accounting).

Purchasers of commercial estate agency services were described as being ‘very demanding and footloose’. When listing a property, purchasers often interview around four or five different agencies, and even where a purchaser uses a particular estate agency (such as their property manager), they will generally still undertake a tendering process, giving their current agency an opportunity to match the preferred tender. As a result, property sales and property management are not as complementary as in the residential segment, meaning that agents involved in a commercial purchase or sale have a reduced chance of then also being involved in any property management transactions.

A ‘commercial agent’ will execute transactions across a range of commercial sectors (including commercial, retail and industrial). Agents working within this segment require specialist skills to successfully compete for business — most large commercial agencies only recruit staff who have tertiary qualifications in business and provide specialist on-the-job training.

Commercial agents do not typically execute residential sales or residential property management. There is, however, some overlap between residential and commercial transactions, with some (primarily) residential agents dealing in small transactions involving retail property, particularly in less densely populated areas. Similarly, commercial estate agents do not typically sell businesses, an activity which itself is considered a distinct segment. Commercial estate agents generally undertake transactions with a wider range of values than residential agents (for example, from \$0.5 million–\$200 million).

5.1 Introduction

The provision of ‘commercial’ estate agency services differs considerably from the residential segment — from both purchaser and provider perspectives — and exhibits the characteristics of a distinct segment. That is, a ‘commercial agent’ will execute transactions across a range of commercial sectors (including commercial, retail and industrial).

Commercial purchasers tend to have a greater capacity to make informed decisions about the competence and probity of estate agents. As the NCP Review noted, a business decision to engage an estate agent is similar to the decision to engage a legal or financial advisor, an accountant or an IT system. Further:

Given the relative size of the investment and the risk associated with purchasing commercial property, it is likely that commercial property owners have a certain level of commercial competence themselves and are able to determine where to buy professional services and how to assess the quality of that service (KPMG 2000, pp. 59–60).

Agents working within this segment require specialist skills to successfully compete for business — most large commercial agencies only recruit staff who have tertiary qualifications in business and provide specialist on-the-job training. This contrasts with the residential segment, in which a key requirement is local knowledge.

Commercial agents do not typically execute residential sales or residential property management. There is, however, some overlap between residential and commercial transactions, with some (primarily) residential agents dealing in small transactions involving retail property, particularly in less densely populated areas. However, if a residential estate agent were to attempt to deal in larger commercial, industrial, office or retail transactions, purchasers would generally begin to question the agent's credentials in dealing transactions of this size and nature. Similarly, commercial estate agents do not typically sell businesses, an activity which itself is considered a distinct segment.

The remainder of this chapter considers the characteristics of commercial transactions, and of the various parties to those transactions. In particular, it considers the rationale for including transactions of different types — industrial and retail, for example — in a single market segment.

5.2 Segment characteristics

The 'commercial' segment captures a broad range of non-residential property classes. The most frequent commercial and industrial property sales according to the Valuer-General Victoria categories relate to the following property types:

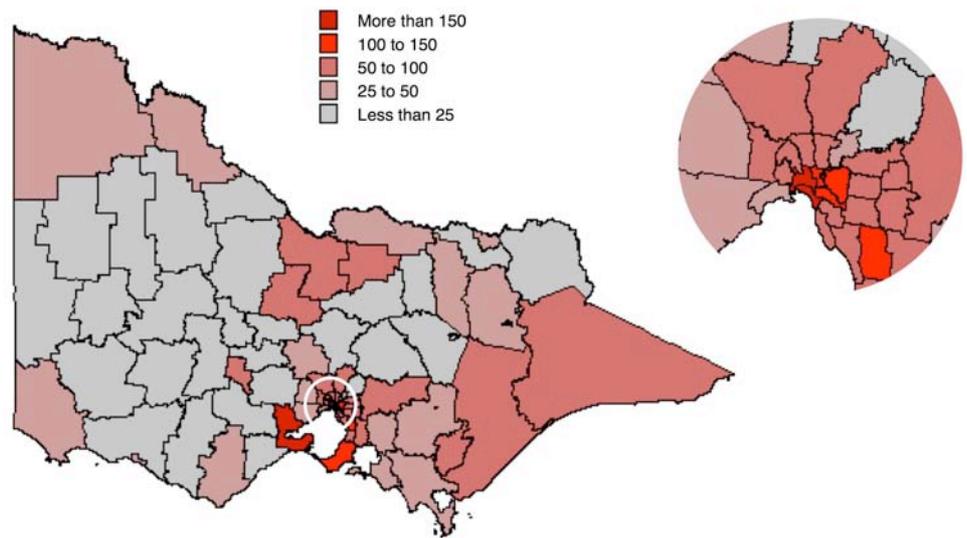
- offices and office buildings;
- shops;
- stores and showrooms;
- surgeries;
- factories;
- warehouses; and
- vacant land zoned for commercial purposes.

The Valuer-General Victoria also includes property management, however no official data are collected for these transactions. Chapter 3 identified the proportion of income derive from commercial transactions. Commercial estate agents generally undertake transactions with a wider range of values than residential agents (for example, from \$0.5 million–\$200 million).

Figure 5.1 and Figure 5.2 depict the number and distribution of commercial and industrial sales across Victoria during the 2006 calendar year. These maps indicate that the greatest number of such transactions occur in or close to metropolitan Melbourne.

Figure 5.1

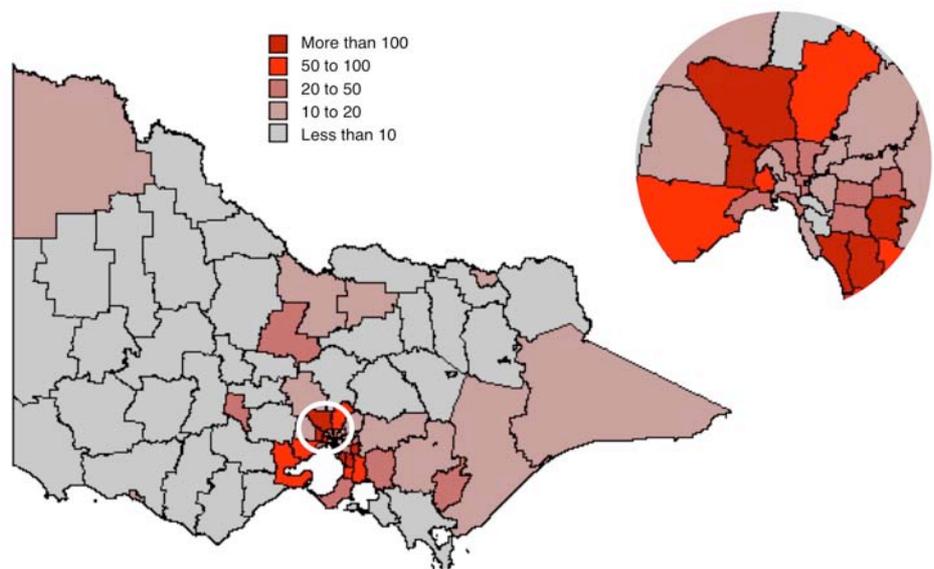
COMMERCIAL PROPERTY SALES IN VICTORIA, 2006



Source: Valuer-General Victoria 2007.

Figure 5.2

INDUSTRIAL PROPERTY SALES IN VICTORIA, 2006



Source: Valuer-General Victoria 2007.

More detailed data concerning the frequency and value of commercial and industrial sales transactions are included in Appendix A. This data illustrates the relatively low frequency of sales transactions for many specific types of commercial and industrial property (such as caravan parks and oil depots), as well as the relatively higher average sales values of many classes of commercial and industrial property (such as hotels).

5.3 Purchasers of commercial estate agency services

The most notable distinction between commercial and residential vendors and landlords is that the former are generally involved in a greater number of commercial transactions, and therefore are able to draw on a greater volume and type of information about the adequacy of service providers. At the same time, the size of commercial property transactions creates a more litigious environment, so purchasers of estate agency services frequently support the advice provided by estate agents with advice from other experts (such as legal, financial or accounting).

Purchasers of commercial estate agency services were described as being more sophisticated and experienced than residential purchasers, and as ‘very demanding and footloose⁵’. When listing a property, purchasers often interview around four or five different agencies, and even where a purchaser uses a particular estate agency (such as their property manager), they will generally still undertake a tendering process, giving their current agency an opportunity to match the preferred tender.

While ongoing relationships are important, purchasers of commercial estate agency services are more willing (and able) to consider alternative providers. Therefore, property sales and property management are not as complementary as in the residential segment, meaning that agents involved in a commercial purchase or sale have a reduced chance of then also being involved in any property management transactions. Purchasers are viewed as astute and will go wherever they believe they can get the best service.

In practice, there is a wide range of purchasers of commercial estate agency services, where property transactions are an inherent element of business — property investment — or where they are incidental to other activities, such as a retail business that changes location infrequently.

Large commercial property

Owners of shopping centres are at one end of the spectrum. These purchasers of estate agency services — entities such as Westfield and AMP — typically deal in high value transactions. The average value of shopping centres sold in Victoria in 2006 was \$52.7 million (Valuer-General Victoria 2007).

⁵ That is, purchasers of real estate services who are not tied to a particular service provider but will move from one provider to another for each transaction based on price and service.

The Shopping Centre Council of Australia contends that these purchasers do not want or need the protections provided by estate agent legislation; rather, it is a regulatory burden. Large firms, sometimes multi-nationals or listed companies, whose business it is to invest in and operate shopping centres that contain numerous and diverse tenants, are involved with large numbers of transactions — leases, in particular — that are frequently re-negotiated. As a result, they will be able to draw on their own business expertise and other expert advice (such as legal and financial advice), which is available either in-house or externally.

Furthermore, the Shopping Centre Council saw little need for such entities to use licensed estate agents for property management but merit in utilising an agent to execute a sale (there may be some instances where a vendor has less experience, e.g. inheritance, part-owner).

The NCP Review undertaken in Victoria in 2000 observed that the licensing requirements for commercial property agents may be impeding activity within the industry, and that a number of benefits would result from reducing the regulation that applies to commercial agents. Within the area of commercial sales, there are limited instances of market failure (such as reduced information asymmetries due to commercially sophisticated vendors) requiring government intervention in the market. Consequently, KPMG recommended a less restrictive form of licensing for agents selling commercial property and businesses (KPMG 2000, pp. 60–64).

Small business

At other end of spectrum are small businesses, such as a stand-alone retail premises, cafés, restaurants, and others. Transactions in property are incidental to their core business activities and they therefore, bear some similarities to residential purchasers (or indeed, may have less experience with property transactions than an investor in residential property). Stakeholders suggested that small businesses generally do not shop around for professional services, and tend to ask their accountants as a first option. The Office of Small Business (OSB) has established referral relationships with accounting bodies to ensure that small businesses are directed to appropriate sources of advice.

Furthermore, the value of transactions to which small businesses are a party are relatively low, particularly in comparison to other commercial transactions. In some cases, a sale price might actually be lower than many residential transactions. For example, average sale prices for selected properties that might fall within the commercial category are as follows:

- food sites — \$0.3 million;
- licensed grocer — \$0.6 million;
- motel — \$0.89 million;
- shop / dwelling — \$0.52 million;
- surgery — \$0.55 million; and
- theatre — \$0.47 million (Valuer-General Victoria 2007).

Some landlords may themselves be small businesses. These landlords may engage an estate agent to manage their property for the protection and expertise a professional managing agent can provide. Similarly, there is a lack of information relating to rents for small businesses, as there is less turnover and transaction visibility in retail property than in residential property (where there are newspaper ads for property in almost every suburb every week). In New South Wales, there is a register of rents, which does not exist in Victoria (where there is a register of leases, but not rents).

The Office of Small Business (OSB) and the Small Business Commissioner provide various advisory services and other forms of support to potential purchasers of estate agency services. These are described in Box 5.1.

Box 5.1

SOURCES OF INFORMATION — SMALL BUSINESS

A range of services are available to assist small business in relation to property matters. These include:

- *referrals to professional services* — the OSB maintains a register of professional services to which it refers small businesses, conditional upon the professional providing the first hour of service free;
- *information* — the OSB provides publications advising small businesses on signing retail leases, selecting business locations etc.;
- *small business mentoring* — the OSB subsidises a small business mentoring service;
- *seminars* — facilitated by the OSB and delivered by professionals on a range of topics relevant to small businesses;
- *mediation* — The Office of the Small Business Commissioner ('the Commissioner') mediates disputes that involve small business, which may then proceed to VCAT if mediation is unsuccessful; and
- *valuation* — the Commissioner may also appoint a specialist valuer to make an assessment in disputes involving rents. This overcomes a lack of information, and information asymmetry between the tenant and landlord. In these instances, the assessment made by the specialist valuer is binding on the tenant and landlord.

The following factors were identified in responses to the ACG survey of estate agents as being important to purchasers when selecting an estate agent to handle a commercial transaction:

- agent skills and expertise;
- educational qualifications;
- integrity and reputation;
- commissions and fees;
- market presence and exposure;
- local presence;
- level of service;
- presentation and professionalism;
- level of speciality in specific area;

- agent ability of the agent to conduct a detailed feasibility analysis;
- retail property management experience and track record of achievement;
- past experience with the agency;
- independence;
- confidentiality; and
- for complex transactions, an agent's ability to provide technical advice.

5.4 Providers of estate agency services

Commercial estate agency services typically involve the execution of property transactions and any accompanying negotiations with parties to the transaction. However, commercial agents also provide a broader range of services, which depend on the needs of the client. Commercial agencies may provide information as a core part of their core business, which may relate to current opportunities, the market for property, economic factors, or market participants (i.e. introducing potential parties to a transaction).

Commercial estate agents tend to specialise less by location in comparison to residential agencies, and larger agencies provide a much greater range of services (although they will have in-house experts across a range of different types of transactions).

In general, more specific skills (such as specific experience or additional education and training) are required to be successful in commercial property. This might be supported by specialist resources (financial, legal), which might be available in-house or purchased (the joint provision of service), for more complicated or specialised transactions.

Smaller commercial agencies are still able to operate across different industries but may have to employ specific advisers to supplement their own knowledge and experience. Commercial agents generally seek specialist professional advice as required, such as financial and legal advice (the latter reflecting the more litigious nature of the commercial estate agency services segment).

In some cases, an agent may refer work to other agents if they do not have the expertise to execute a transaction. This way, they are able to retain the client for the work they can perform, and ensure that the client receives favourable service and terms elsewhere. Commercial agencies sometimes refer some transactions to other agencies when they do not have the expertise to undertake the transaction themselves, or may conduct a tender and interview process on behalf of the client.

Additional training and specific expertise, beyond that provided through obtaining estate agent qualifications, were viewed as essential to successfully competing in the commercial segment, which may be available through external courses or in-house training. A number of commercial agents considered additional in-house training, specific experience and tertiary qualifications — such as law, accounting, or real estate degrees — to be of particular importance for commercial agents. Some commercial agents had recruited some former residential agents, some of whom had successfully adapted to the commercial sector, while others had not.

The NCP Review noted that commercial property agencies would ensure agents were appropriately trained in relevant aspects of their business, irrespective of whether specific licensing requirements existed. It is clear this observation still holds. Furthermore:

It could even be argued that if the current restrictions of the Act no longer applied and real estate businesses enjoyed lower cost structures, then agents may be better positioned to provide employees with alternative training that is better suited to their specific needs (KPMG 2000, p. 64).

Location of agent and proximity to a property

Commercial agents frequently operate across regions and state borders, certainly to a far greater extent than residential agents. That is, factors other than a commercial agent's location and proximity to a property are important, most notably, their experience and expertise with particular commercial activities. Consequently, commercial agents in Victoria compete with agents in other jurisdictions for Victorian and for interstate business.

Do sub-segments exist?

While commercial agents can generally operate relatively fluidly across different commercial property types, such as industrial and office premises, there are some areas that require a degree of specialist knowledge and/or focus.

For example, the sale or management of retail premises often requires specific knowledge of location, prospective business, the mix of other retail premises in a shopping centre, or a need for face-to-face interaction with tenants, and familiarity with legislation such as the *Retail Leases Act 2003*. This implies that geography might assume relatively greater importance for commercial agents engaged in retail transactions and there may be a difference between retail property *management*, and property *purchases and sales*. Furthermore, purchases and sales can conceivably involve residential property (e.g. if a shopping centre was expanding and needed to purchase neighbouring properties).

Consultations also indicated there are some activities that even larger commercial agents generally avoid, which implies that specific skills and expertise are required, which cannot be easily obtained. Particular examples include:

- *Shopping centre management* — shopping centre managers are essentially running businesses, and as such, tend to have business degrees, rather than real estate qualifications. Some commercial agents have made a conscious decision not to become involved in shopping centre management, particularly due to the specific issues (including the litigious operating environment) involved in managing smaller retail tenants. Agents that are involved with shopping centre management frequently supplement lease negotiations and dealing with tenants with facilities management.
- *Hospitality sector* — transactions within this area typically involve the sale or purchase of a business, in addition to any property. Transactions in this area requires more specialised knowledge of specific licensing and planning frameworks and very few commercial businesses, even those that undertake a wide range of commercial estate agency services would have a specialist area for hotel broking.

- *Business broking* — the sale of businesses is commonly viewed as a distinct segment and requires a unique combination of real estate, legal and financial expertise. Specific issues include the assessment of appropriate valuation techniques, treatment of goodwill, and identification of, and negotiations with, a range of potential buyers. The differences and the scale of operations are deemed so significant as to warrant classification as a distinct segment (see Chapter 7).

5.5 Nature and extent of competition

The commercial segment is generally viewed as being highly competitive, which is driven in part by the willingness of purchasers to shop around, irrespective of whether they have an established relationship with an agency. Furthermore, the ability of agents to apply their experience and expertise to a range of different activities and across a range of locations further enhances competition. This means that a simple analysis of the distribution of agents across Victoria provides little indication of the degree of effective competition within certain areas. Some predominantly residential agents may transact at the lower end of the commercial segment.

The degree of effective competition is illustrated in the process by which commercial estate agents are typically engaged. It is common for a number of agencies to be invited to respond to a request for tender, followed by a detailed selection process. The number and type of competitors that an agency faces will depend on the specific transaction involved, including its value and any unique characteristics. It is clear, however, that commercial agencies are able to execute a diverse range of transactions and will take steps to ensure that have the necessary skills to compete effectively, including procuring specialist services.

Commercial agencies are also exposed to competition from accounting firms, financial advisers and investment banks, which have been involved in various aspects of commercial property for many years. Entities of this kind are able to provide competition across all commercial segments and for all transactions, regardless of size.

Potential obstacles to competition are the costs generated by differences in legislative requirements and the need for agents to satisfy different obligations. This implies that a transaction must be sufficiently high to compensate for any costs that an interstate agent might incur (including the engagement of local agents).

5.6 Conclusions

The key points of difference between the residential and commercial segments of the Victorian market for estate agency services, and the basis for classifying them as distinct segments, can be summarised as follows:

- the capability of the purchaser, irrespective of the frequency or size of transactions. The NCP Review concluded the purchase of estate agency services was similar to the purchase of other professional services and this conclusion remains valid. Therefore, the degree of information asymmetry — and need for protection through regulation — is reduced;
- there is some overlap in terms of estate agent activity but this is limited to specific transactions of specific sizes, i.e. lower value retail;

- the location of an agent is less important for commercial than for the residential segment, where it remains one of the most important factors that residential vendors and landlords taken into account. Indeed, many commercial agents operate across jurisdictions. While some local presence and knowledge is important for agents in regional areas, specialist knowledge is essential (e.g. managing a shopping centre in Geelong requires specialist shopping centre expertise). Purchasers in regional areas will often specifically seek out specialist, rather than local, agents to perform certain property transactions.

Chapter 3 noted that identification of boundaries relies on judgement. While absolute size is significant, it is not clear that differences are great, or that these sub-segments are of sufficient size, within the context of the total market to be considered as distinct segments.

While there are some specific areas of specialisation and areas where unique skills and experience are necessary — some retail transactions, for example — the scale of activity in terms of total income and the significance of the differences are not so great as to represent different segments and any difference is likely to be subtle. In other words, the broad base of commercial skills and experience necessary to compete for any type of commercial estate agency service is likely to provide many agents with the capability to compete for a large range of commercial transactions. While a supply response to observed increases in returns to a specific activity might be inhibited to some degree, it is still likely to occur within a relatively short timeframe.

The provision of commercial estate agency services, which includes commercial, industrial and retail property management and sales transactions, is a distinct segment. And, that the segment has a geographical boundary (the metropolitan region), and that while there are areas of specialisation such as retail property management, they do not constitute separate segments.

Chapter 6

Regional and rural estate agency services

This chapter describes the characteristics of estate agency services in regional and rural areas of Victoria. It concludes that regional and rural markets do not constitute a specific segment, although estate agency services in these areas do have a range of characteristics specific to these areas.

Key points

Compared with the metropolitan market, estate agency services in rural and regional areas are characterised by relatively fewer property transactions, a slightly different mix of estate agency services (for example, there tends to be less residential property management, and buyer advocate work in regional areas), and some property classes particular to these areas (such as the sale of hobby farms and vineyards).

Similar to metropolitan areas, the success of an estate agent in regional Victoria is dependent upon a knowledge of the local area, a good reputation, strong relationships and good service.

Estate agents in rural and regional areas generally offer the full range of estate agency services, rather than specialising in particular property transactions. This is driven by smaller market sizes and lower population densities compared with the metropolitan market. It is out of economic necessity that estate agents in regional areas cater to multiple segments of the market and they must adopt a 'general practitioner' approach to estate agency services in regional areas. An ability to service all sectors of the market provides a mechanism for smoothing revenue during seasonal or cyclical variation within specific sectors of regional markets.

However, there are some exceptions to this. In Victoria's major regional centres, estate agencies specialise in specific property transactions to a certain degree. In mid-size country towns and service centres, large companies such as Elders and Landmark compete, providing a range of services (such as banking and insurance) in addition to real estate. For certain complex or high-value property transactions (for example, the sale of a shopping centre in a regional town), city-based agencies are engaged to handle the transaction due to their specialist expertise and access to national and international networks of prospective buyers.

Estate agents in rural and regional areas tend to compete within defined geographic areas. This demonstrates the importance of local knowledge but also reflects the greater distances between viable population bases. While rural and regional markets for estate agency services share a number of similar characteristics, there are many markets, rather than one homogenous 'rural and regional segment'.

Rural and regional markets are found not to constitute a distinct segment because of the role of proximity and local knowledge as the primary determinant of competition for all but the most specialised transactions (such as regionally based shopping centres and significant farming businesses). While there is a degree of specialisation by agents in regional centres, the boundaries of these sectors are by no means pronounced, and there is little evidence of competition between agents located in separate regional centres (unless branch offices of the same agency are located in each). There is therefore no basis upon which to develop a specific policy response in relation to consumer protection.

6.1 Introduction

The vast majority of income in Victoria's market for estate agency services is generated within metropolitan Melbourne, which is where the majority of transactions occur, and the majority of estate agents are located. Chapter 5 noted that proximity is an important factor to take account of when considering segmentation, as it is apparent there is a degree of segmentation on this basis, most notably in the residential segment.

Chapter 4 and Chapter 5 also found that the overlap between the residential and commercial segments increased as distances from Melbourne increased. That is, as distances from Melbourne increase, residential agents are increasingly viewed as potential competitors for some commercial transactions and the boundaries between segments become porous.

This chapter considers whether this notion of segmentation extends to regional and rural areas of Victoria, whether purchasers have unique characteristics or access to different sources of information, and whether agents specialise in certain activities to the same extent as those in metropolitan Melbourne.

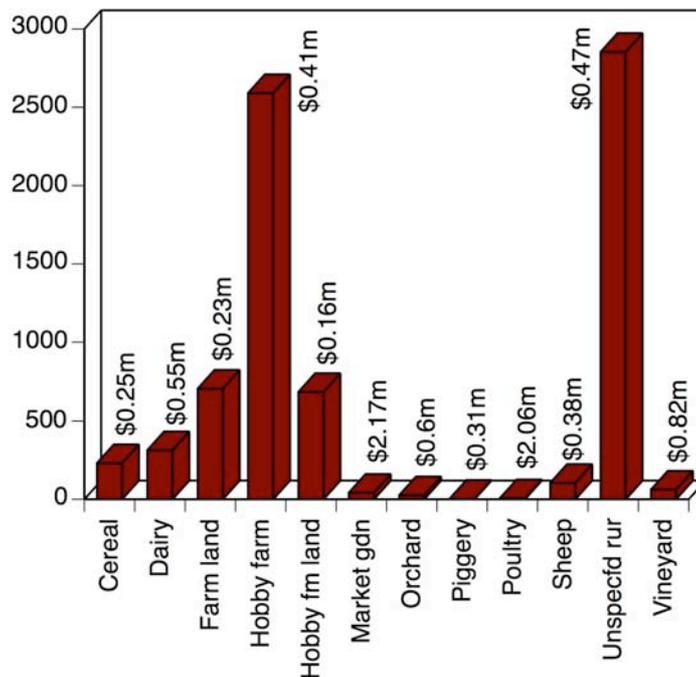
It is apparent that the market dynamics in regional and rural areas differ from those in metropolitan Melbourne. Most importantly, the relatively low number and value of such transactions has important implications for the ability of estate agents to specialise in certain activities. At the same time, local knowledge and reputation are equally, if not more important than for residential estate agency services in Melbourne.

6.2 Characteristics

Estate agency services delivered in regional and rural Victoria are similar to those delivered within metropolitan Melbourne (such as residential sales and property management), however agents in these areas also conduct a range of more specific transactions of types of rural property. Figure 6.1 depicts the number and average value of the various categories of rural property transactions, as defined by the Valuer-General.

Figure 6.1

FREQUENCY AND VALUE OF RURAL PROPERTY SALES IN VICTORIA, 2006

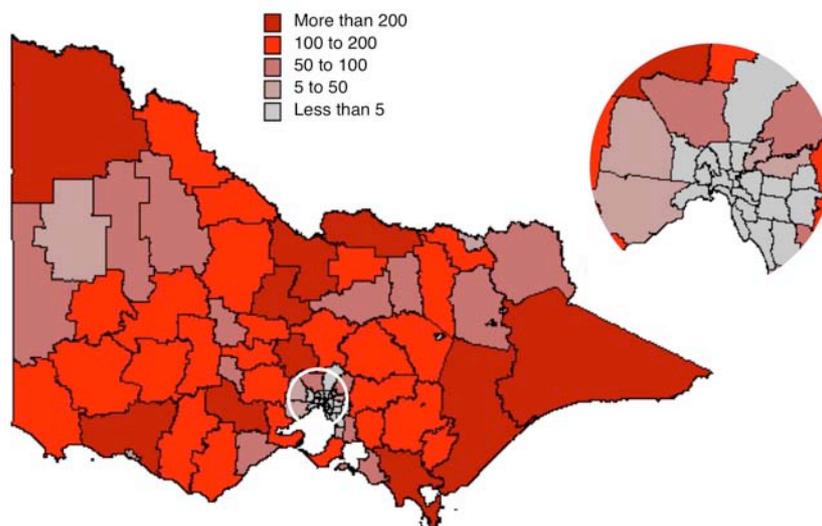


Source: Valuer-General Victoria 2007.

Figure 6.2 depicts the distribution of rural property sales in Victoria during 2006, which, as would be expected, tend to occur more frequently in regional areas.

Figure 6.2

DISTRIBUTION OF RURAL PROPERTY SALES IN VICTORIA, 2006



Source: Valuer-General Victoria 2007.

6.3 Purchasers of estate agency services

The relatively low number of property transactions in regional and rural areas has important implications for the market for estate agency services. For instance, there is a considerable diversity across the purchasers of estate agency services in regional and rural areas, which include:

- residential and commercial vendors;
- residential and commercial landlords (although the extent of property investment is relatively smaller than in metropolitan regions);
- farm-owners; and
- providers of other agricultural services.

Purchasers of estate agency services in regional areas will generally draw on the same sources of information as Melbourne-based purchasers, most notably: previous experiences, expertise, skills and qualifications, and the advice of other advisers. However, comparisons with the residential and commercial segments in metropolitan areas are not straightforward, as there is likely to be greater diversity in the needs of purchasers, their expertise and experience and the particular advice they require. For example, farm-owners operate businesses and therefore are experienced in making decisions about competing service providers in other areas of their business. On the other hand, owners of residential properties and landlords are similar to those in metropolitan areas.

The following factors are identified by stakeholders as determining the success of estate agents in regional areas:

- *knowledge of the local area*, such as climate and land usage. Parties to property transactions will expect and rely upon an agent's local knowledge of factors such as rainfall, land use, success of crops, etc. Agents need to know the suitability of the land for a variety of uses;
- *reputation*, within the community. As with many services, reputations in country areas are 'earned slowly and lost quickly'. Strong incentive exists for agents to actively avoid any real or perceived conflicts of interest for this reason;
- *relationships*, are particularly important in regional and rural areas; and
- *service*, most agents seek to differentiate their business on the quality of their service.

Many of these factors are common to other areas of the estate agency services market, although specific knowledge of farming techniques, topography and possible land uses assume a greater importance for certain transactions in regional areas.

6.4 Providers of estate agency services

Estate agents in regional and rural areas generally offer the full range of estate agency services, rather than specialising in particular property transactions. In these regions, the distinctions between residential property, commercial property and business sales are not as readily apparent as in metropolitan Melbourne.

The lack of specialisation by rural and regional estate agencies is driven by smaller market sizes and lower population densities compared with the metropolitan market. It is out of economic necessity that estate agents in regional areas cater to multiple segments of the market and they must adopt a 'general practitioner' approach to estate agency services in regional areas. As observed by some regionally based estate agents in their responses to the ACG survey:

In a country area, you can't afford to specialise.

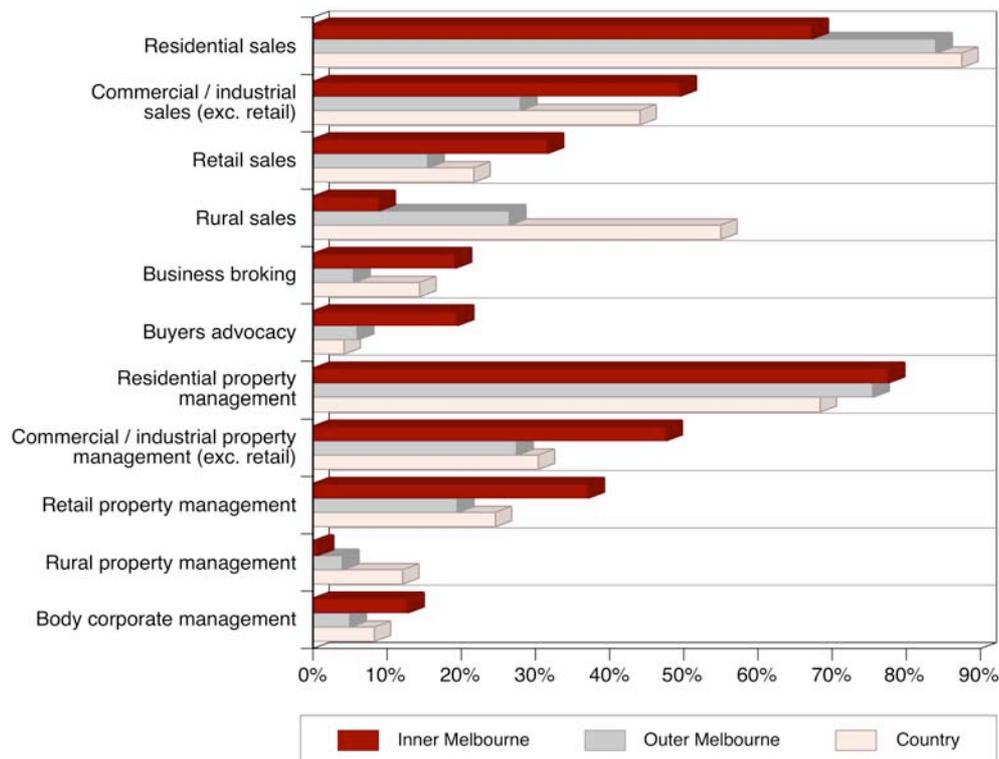
There is little scope in my region to 'boutique'.

Stakeholders consistently expressed that estate agents in rural and regional areas need to be 'all things to all people'. An ability to service all sectors of the market provides a mechanism for smoothing revenue during seasonal or cyclical variation within specific sectors of regional markets.

Figure 6.3 shows mixed evidence from the CAV/EAC survey to support these comments. The findings show that while a greater proportion of country agents engage in residential sales and rural sales than those in Melbourne, this country agents do not always engage in a broader range of services than those in Melbourne (for example, commercial/industrial sales, retail sales and buyers advocacy).

Figure 6.3

PROPORTION OF ESTATE AGENTS PROVIDING SERVICES BY REGION OF VICTORIA, 2007



Note: Figures refer to the proportion of estate agencies responding to the EAC/CAV survey that derive income from each service.
 Source: CAV/EAC survey 2007.

However, there are some exceptions to this. In Victoria’s major regional centres — namely Geelong, Ballarat, Bendigo, Warrnambool, Shepparton, and Wangaratta — estate agencies specialise in specific property transactions to a certain degree, which provides scope for some of the major estate agency brands (e.g. Barry Plant, LJ Hooker, Ray White etc.) to develop a presence in these markets. Several stakeholders observed that these larger agency brands sometimes recruit locally established estate agents, who have strong local knowledge, reputations and client bases. This reflects the importance of geographic factors, similar to the residential market in Melbourne. Furthermore, they supplement entry into a region with a well-known and advertised brand name, in-house training, standard procedures and practices.

For certain complex or high-value property transactions (for example, the sale of a shopping centre in a regional town), city-based agencies are engaged to handle the transaction due to their specialist expertise and access to national and international networks of prospective buyers.

Similarly, large companies such as Elders and Landmark generally compete in mid-size country towns (e.g. Horsham, Warracknabeal), and typically establish their presence around existing stock and station agents.

As an example, Elders has a network of 43 offices in Victoria, and 350 offices nationally, which are a mixture of company-owned and franchise businesses. It undertakes extensive in-house training but also frequently recruits staff who have lived in the region they service, where they have established relationships and reputations.

Elders operates primarily in regional areas, though has recently launched its commercial property business in Melbourne. Elders' business lines include:

- real estate;
- insurance;
- livestock;
- rural banking, home loans and wealth management;
- wool trading;
- water trading; and
- telecommunications (through its partnership with Optus in Opel).

Landmark operates using a similar model to Elders, as a public company (as a subsidiary of AWB), with a national network of branches and franchises, providing a broad range of services to rural and regional Australia.

As with other areas of the estate agency services market, there is great potential to leverage the range of products and services due to importance of trust and prevalence of ongoing relationships. A common example in rural areas is the purchase, exchange or sale of livestock and other agricultural products, where large market participants, such as Elders and Landmark, are able to offer a greater range of services than many other estate agents.

Property appraisal represents another potential area of specialisation. For example, appraisal contracts with banks, or local and state governments, can conflict agents out of potential work in many circumstances. As mentioned, this reflects the importance of an agent's reputation within an area (and the importance of avoiding any perception of a conflict of interest). There are however, synergies between the appraisal and estate agency businesses, and the livestock and estate agency businesses.

On the whole, local knowledge is particularly important for estate agents in regional and rural areas, for residential and commercial transactions, but also for those transactions specific to these locations. This has important implications for competition between agents within those regions. For example, agents would not typically be able to effectively compete for business unless they can draw on specific knowledge or unless they are able to draw on the resources and backing provided by an established brand. As a result, it is difficult for agents from one region to work in neighbouring areas because they do not have a recognised presence, reputation or relationships. A recognised, national estate agency brand is one way of easing the entry of an estate agent into new regional areas. Even large commercial agents transacting in regional locations sometimes act as the principal agent on a transaction, and appoint a local partner to undertake certain activities (such as property inspections)

6.5 Competition

A commonly held view is that estate agents in regional and rural areas tend to compete within defined geographic areas (i.e. a degree of geographic segmentation exists for many transactions). This demonstrates the importance of local knowledge but also reflects the greater distances between viable population bases (and the travel costs that agents would incur). While regional and rural markets for estate agency services share a number of similar characteristics, there are many markets, rather than one homogenous 'regional and rural segment'.

Regional markets for estate agency services may be slower to respond to changes, with implications for prices and other outcomes. In particular, it is difficult for estate agents to establish themselves in a new area unless they are able to draw on an established brand, supported by an extensive network, in-house training, and business systems. Furthermore, the prevalence of leveraging or the provision of multiple services by a single entity would also undermine competition and the willingness of purchasers to consider alternatives.

Despite this, it is clear that areas with relatively low population densities provide less scope for agents to provide a low level of service. It was noted earlier that reputations in country areas are 'earned slowly and lost quickly'.

The previous chapter noted that proximity is less of a factor for commercial estate agency transactions and commercial agents are frequently involved in transactions that are a considerable distance from their office. For example, large commercial agents advised they frequently execute transactions in some regional areas, such as shopping centre management. Regionally based purchasers may prefer to engage a city-based agent to benefit from their specialist expertise in a certain area or their external perspective (they may be viewed as being more able to keep transaction details confidential than a local agent).

However, there will be instances and transactions where it is not efficient for a Melbourne-based agent to perform small-scale transactions in regional areas, which ultimately reduces the extent of effective competition for such transactions.

Despite this, it appears that purchasers are becoming increasingly demanding of estate agents, largely due to better availability of information. This is common across all areas of the Victorian estate agency services market. For example, the internet has changed the way that buyers purchase property, with buyers first perusing agents' listings on the internet before approaching agents directly. This was identified as a preferred technique of purchasers who do not reside in a particular area and are seeking to purchase a holiday home or to relocate to a region.

6.6 Conclusions

This chapter highlights the differences between estate agency services in metropolitan Melbourne, and in regional and rural Victoria. It concludes that while the regional and rural sector is an important component of the Victorian market for estate agency services, it does not constitute a distinct segment of the market based on the criteria adopted in this study. In contrast, it comprises a series of smaller geographic 'markets'.

Chapter 3 defines a market segment as comprising a distinct set of transactions that are delivered to a clearly identifiable group of market participants. This leads to the identification of segments in the Melbourne metropolitan area, based on property type and the existence of common characteristics within particular groups of purchasers of estate agency services. However, applying the definition to the rural and regional sector demonstrates that, on balance, the sector does not make up a distinct segment of the Victorian market for estate agency services.

The specialisation and groupings of agents and purchasers of estate agency services that create segmentation in the metropolitan area are less evident or absent in the rural and regional sector. The sector is characterised by diversified and discrete markets clustered around larger population bases, and the diversity and geographic separation of markets means the notion of segmentation effectively breaks down beyond metropolitan Melbourne.

Specialisation by estate agents is a key indicator of segmentation in the model used in this study. The volume of demand in metropolitan Melbourne makes specialisation viable for agents. In regional and rural markets, however, there is less specialisation as lower population densities limit the opportunities for agents to target particular properties, transactions or client groups. Therefore, businesses must diversify if their operations are to remain viable.

Consequently, regional and rural agents generally deal with a wider range of properties — residential, commercial and rural — and offer a full range of services and transactions to a diverse mix of property clients (sellers/buyers and landlords/tenants). While there is a degree of specialisation in larger regional centres, the boundaries are fluid and there is dubious value in distinguishing such activities from a policy perspective.

Furthermore, purchasers of estate agency services (commonly vendors and landlords) in regional and rural markets do not have similar and common characteristics. Agents are generally engaged by a wide range of vendors and landlords, each with particular expertise and experience and differing needs, not merely in terms of the types of property they own, but also with respect to the services, advice and support they need. Regional and rural agents also deal with a variety of property purchasers and tenants who similarly, have differing needs and preferences and thereby influence activities and services provided by agents.

The nature of competition further erodes the existence of a separate regional and rural segment. Competition in regional and rural markets is influenced by proximity and local knowledge for all but the most specialised transactions (such as regionally based shopping centres and significant farming businesses). Due to the larger distances between rural and regional markets, estate agents tend to compete within certain geographical areas; there is little evidence of competition between agents located in separate regional markets (unless branch offices of the same agency are located in each). For example, an agent in Wodonga is unlikely to compete with an agent in Warrnambool.

Therefore, prices and services in one market tend to have less impact on other regional markets as a result of limited (or no) effective competition between agents in different geographic markets. In other words, purchasers of estate agency services are less able to substitute the services of an agent in one geographic market for those of an agent in another market, unless the markets are adjacent.

Nevertheless, the regional and rural sector contributes substantially to the total demand for and supply of estate agency services in Victoria. In 2006, almost 32 per cent of all property sales originated in country Victoria, accounting for around 21 per cent of total sales revenue (in excess of \$11.6 billion).

Chapter 7

Business broking segment

This chapter describes the characteristics of the business broking segment of the market for estate agency services in Victoria.

Key points

Purchasers of business broking services generally have a degree of commercial sophistication, and are therefore capable of selecting an agent to handle the sale of their business, just as they would engage any other professional service provider.

Business broking is viewed as being a distinct and specialist segment. Business brokers rarely perform other types of estate agency services, and estate agents seldom offer business broking alongside other estate agency services, except in regional areas.

According to the findings of the CAV/EAC survey, 12.8 per cent of respondents undertook business broking as part of their business. For those agencies engaging in business broking:

- more than half derived less than ten per cent of their income from business broking;
- 26.1 per cent derived 11–90 per cent of their income from business broking; and
- 21.8 per cent derived 91–100 per cent of their income from business broking.

The data suggests that there is a higher concentration of specialist business brokers in Melbourne, while business broking becomes a non-specialist activity, undertaken as one of several activities that estate agents engage in, in outer Melbourne and country areas.

Business broking requires agents to have specific skills and experience, different to those of an estate agent dealing primarily in other forms of property. The nature of the service implies a need for knowledge of finance and accounting, experience in the management of a business, and relevant legislation.

Specialisation within the business broking segment is typically based on transaction value. Stakeholders suggest the existence of three distinct sub-segments:

- transactions of less than \$1 million, which are generally handled by property agents who offer a range of other services;
- transactions of \$1million – \$50 million, which are viable for a range of different service providers; and
- transactions of more than \$100 million, which generally involve investment banks.

The degree of effective competition is linked to the value of a transaction. For instance, there are likely to be fewer competitors for lower value transactions, and this is a sub-segment in which a broker's local presence carries more weight. Transactions of around \$1 million were viewed as the point at which business broking could reasonably be considered a 'truly national market'.

7.1 Introduction

Business broking involves commercial transactions, implying that purchasers of such services have a degree of commercial sophistication and are capable of making an informed choice. However, businesses will — as is the case for commercial property sales and property management — differ in their capacity to make informed decisions about services offered by competing estate agencies.

Participants in the real estate industry tend to view business broking as a distinct and specialist segment. Business brokers rarely offer other types of estate agency services, and estate agents seldom offer business broking alongside other estate agency services. As discussed in the previous chapter however, estate agents practising in regional Victoria tend to offer a broader range of services than agents in metropolitan Melbourne, with agents in regional Victoria often offering business broking as one of several services.

7.2 Segment characteristics

Specific activities that estate agents perform as part of business broking services include:

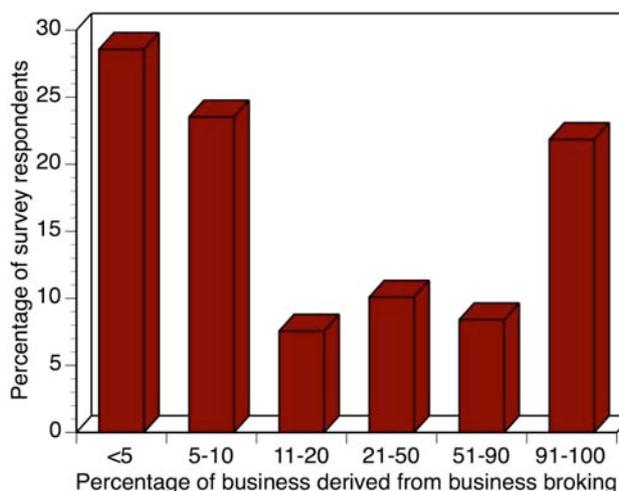
- developing marketing strategies;
- identifying and targeting potential buyers;
- preparing documents describing the business for sale;
- negotiating with potential buyers; and
- facilitating contracts of sale.

The sale of a business is not always combined with the sale of property. However, there are some specific classes of property where this is the norm, such as hotels and other licensed premises.

Figure 7.1 depicts the involvement of estate agencies in business broking as a proportion of total agency business, as found in the CAV/EAC survey. Only 12.8 per cent of respondents undertook some form of business broking as part of their activities. Of those agents that engage in some level of business broking, the graph's bimodal distribution of the graph suggests that estate agents generally either undertake very few business broking transactions (more than half of all real estate agencies that offer business broking services derive less than ten per cent of their income from such activity), or they are business broking specialists (21.8 per cent of respondents derived 91–100 per cent of their income from business broking). Only 26.1 per cent of those responding agencies that engaged in some level of business broking derived 11–90 per cent of their income from business broking.

Figure 7.1

ESTATE AGENCY BUSINESS DERIVED FROM BUSINESS BROKING, VICTORIA



Note: Percentage of agency business is based upon transaction volumes. Figures refer only to those estate agencies that engage in business broking, which constitutes around 12.8 per cent of all survey respondents.

Source: CAV/EAC survey 2007.

Table 7.1 illustrates the average number of business broking sales per month, by estate agent location, which is depicted in Figure 7.2.

Table 7.1

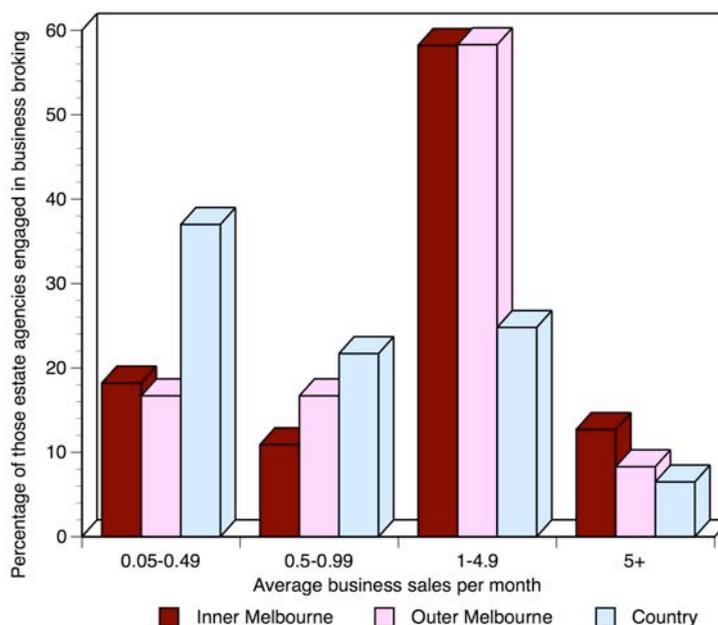
AVERAGE BUSINESS SALES PER MONTH, VICTORIA

| Region | Average business sales per month | | | | Total |
|-----------------|----------------------------------|-----------------------|-----------------------|----------------------|------------------------------------|
| | 0.05–0.49 | 0.5–0.99 | 1–4.9 | 5+ | |
| Inner Melbourne | 10 (18.2 per cent) | 6 (10.9 per cent) | 32 (58.2 per cent) | 7 (12.7 per cent) | 55 (100 per cent) |
| Outer Melbourne | 2 (16.7 per cent) | 2 (16.7 per cent) | 7 (58.3 per cent) | 1 (8.3 per cent) | 12 (100 per cent) |
| Country | 17 (37 per cent) | 10 (21.7 per cent) | 16 (34.8 per cent) | 3 (6.5 per cent) | 46 (100 per cent) |
| Total | 29 | 19 | 55 | 11 | 113 |

Note: Percentages in parentheses refer to proportion of regional total. Figures refer only to those estate agencies that engage in business broking, which constitute around 12.6 per cent of all estate agent respondents.

Source: CAV/EAC survey 2007.

Figure 7.2

AVERAGE BUSINESS SALES PER MONTH

Source: CAV/EAC Survey 2007.

This data shows that, for those estate agencies that offer business broking services, their average number of business sales decreases as the agency's distance from the CBD increases. This suggests a higher concentration of specialist business brokers in Melbourne, while business broking becomes a non-specialist activity, undertaken as one of several activities that estate agents engage in, in outer Melbourne and country areas. This hypothesis is consistent with the previous chapter, which found that regional and rural agents tend to provide a broader range of services, which are likely to include the sale of businesses (such as farms).

7.3 Purchasers of business broking services

As with commercial property sales and property management, the characteristics of a purchaser of business broking services will be influenced by the value and sophistication of the business being sold. Small businesses will tend to be involved in fewer transactions and therefore, are less able to draw on experience and other professional services. Such entities have been described as 'business builders and operators, not business leaders'.

The contrast is a larger company that is frequently involved in mergers and acquisitions, and is a party to transactions of a higher value. As noted in the NCP Review, such transactions could involve transfer of stock or shares, valuation of goodwill and negotiations over ongoing employment arrangements. Parties to transactions of this kind are likely to exhibit many of the characteristics identified in Chapter 5, as described by the Shopping Centre Council.

The NCP Review also noted:

... we contend that small business operators are required to purchase a number of important services, such as financial advice, legal services, accounting, marketing, business planning and computing services. Small business owners can demonstrate the same commercial competence in selecting these services as with selecting a real estate agent (KPMG 2000, p. 70).

Despite this, entities such as the OSB and Small Business Commissioner provide specific information, advice and advocacy to certain purchasers. An example is the OSB publication, *Valuing a Small Business: The Essentials*, which includes advice on:

- establishing the price of a business;
- valuation methods, including the treatment of goodwill;
- franchise arrangements, including codes of conduct; and
- contractual outlets for purchasers.

ACG survey

Those factors that were identified as important for purchasers of business broking services in responses to the ACG survey included:

- professionalism — agents should have business broking as their core business;
- good reputation — business brokers should have a reputation for honesty, integrity and an ability to achieve results;
- understanding of relevant industries — business brokers need to have a clear understanding of the industries of the businesses they sell, including knowledge of key performance ratios and business improvement possibilities;
- presentation — the professional appearance of a business broker's agents, offices and communications;
- national footprint — a business broker's ability to draw on resources across the country, and reach prospective buyers across the country; and
- unbiased reach — business brokers are perceived to provide unbiased advice, partly because they are not generally remunerated on a per diem basis, as are accountants and solicitors.

7.4 Providers of business broking services

While the characteristics of the purchasers of business broking services are similar to those of commercial vendors and landlords, business broking requires estate agents to have specific skills and experience. The nature of the service implies a need for knowledge of finance and accounting, so tertiary qualifications in these areas are common, as is direct experience in the management of a business.

Similarly, business brokers generally need a slightly different skills set to that of an estate agent dealing primarily in residential property. As examples, respondents to the ACG survey suggested that business brokers should possess:

- a knowledge of specific legislation pertaining to the sale of businesses;
- an understanding of basic accounting; and
- skills in appraising business values.

Such is the specialist nature of the skills required for business broking that a respondent to the ACG survey noted that while their agency had previously engaged in business broking, they no longer offered these services due to the highly specialised skills required.

Specialisation within the business broking segment

Specialisation within the business broking segment is typically based on transaction value. Stakeholders suggest the existence of three distinct sub-segments.

- Transactions of less than \$1 million — typically involving the sale of businesses such as corner shops, hotels, caravan parks, and post offices. There are likely to be many brokers in this sub-segment, most of which are property agents who execute other transactions.
- Transactions of \$1million – \$50 million — transactions of this value are viable for a range of different service providers. Purchasers would generally expect an agent to be able to identify potential buyers in all jurisdictions.
- Transactions of more than \$100 million — such transactions are less frequent and involve entities such as large investment banks, rather than specialist business brokers with real estate accreditation.

There is limited specialisation on the basis of geography but transactions would need to be of specific size to warrant bidding by a ‘non-local’. This is consistent with previous chapter where local agents would be well-placed to undertake transactions, despite not specialising in that area.

7.5 Competition

The degree of effective competition is linked to the value of a transaction. For instance, there are likely to be fewer competitors for lower value transactions, and this will be a sub-segment in which a broker’s local presence carries more weight.

As transaction value increases, so too will the number of potential competitors to handle the transaction, i.e. the catchment area for likely bidders for service will expand (into other jurisdictions). Transactions of around \$1 million were viewed as the point at which business broking could reasonably be considered a ‘truly national market’.

However, the extent of competition will not hinge on a single dollar figure and will frequently depend on the complexity of the transaction, including required knowledge of a specific licensing framework (such as hospitality and leisure sectors). In reality, the boundaries of transaction value sub-segments will be porous and therefore should not be thought of as distinct segments in themselves.

At the same time, business brokers will face competition from the accounting profession who execute the sale of businesses as part of the normal course of their operations. Therefore, agents seeking to concentrate on business broking will need to acquire relevant skills and specific experience in this area.

7.6 Conclusions

There is a consensus of views that business broking represents a segment in the market for agency estate services. Analysis of this segment indicates that purchasers of business broking services display similar characteristics to purchasers of commercial property sales or management services, although transactions will be executed less frequently, meaning purchasers have less direct experience on which to base a decision. That is, business broking has more in common with commercial property sales than property management, where contracts are negotiated and reviewed more frequently.

Proximity remains an important consideration, particularly for smaller transactions, but the extent of effective competition is ultimately determined by the value of the transaction. Higher value transactions tend to be contested on a national basis by specialist business brokers or investment firms, while lower value transactions are more likely performed by non-specialist estate agents that operate in close proximity to the business.

Chapter 8

Findings and conclusions

8.1 Key findings

The Victorian estate agency services market exhibits the characteristics of a segmented market. This is apparent in the clear distinction between residential, commercial (comprising commercial, retail and industrial), and business broking segments within metropolitan Melbourne, albeit with some porous boundaries. However, this segmentation construct does not extend to rural and regional Victoria, where estate agents tend to be non-specialist in the services they offer, beyond servicing an identifiable geographic region (noting that there may be some degree of specialisation in large regional centres).

The approach used to identify market segments is through an analysis of the characteristics of providers and purchasers of estate agency services and the characteristics of transactions. In Victoria, the interaction of these elements creates a distinct set of transactions to which clearly identifiable groups of participants with similar characteristics are a party. There is limited interaction between segments, with prices and service levels in one segment having little relevance or impact on other segments.

The different expectations, needs and behaviours of purchasers in each segment, and how estate agents respond to these differences, creates the effective boundaries between the segments. Businesses will continually seek to tailor their product or service to better satisfy the needs and preferences of target consumer segments, while consumers will increasingly perceive these as becoming differentiated from broader market offerings. As the market matures, market structures evolve to reflect these segmented products and participants, reinforcing the behavioural changes that caused the shift initially.

For example, residential vendors and landlords place high value on the proximity of an agent to their property and evidence of an agent's success in executing trades within the area. This requires little formal training over and above the requirements of the Estate Agents Act but instead encourages agents to specialise within a specific area, with little scope or need to expand into other areas.

On the other hand, commercial vendors and landlords expect agents to possess specific skills and expertise, many of which require additional training. As a result, commercial agents must respond to those expectations and demonstrate their competence, usually through experience.

The differences between the expectations and requirements are such that there is limited overlap between the segments. In other words, residential agents typically focus on residential sales and property management; commercial agents focus on commercial sales and property management.

However, segmentation is also strongly related to the location in which a transaction occurs. This is most apparent in regional and rural areas, where the boundaries between the segments dissolve, and agents offer a broader range of estate agency services. This approach is a response to the market environment, as specialisation in all but the largest regional centres would be unlikely to generate sufficient revenue to sustain an estate agency. Once again, agencies' activities are influenced by the characteristics of their clients, and they adopt an appropriate business strategy, i.e. they demonstrate experience and expertise specific to a region, rather than familiarity with specific transactions or activities.

8.2 Implications of market segmentation

Segmentation has important implications for market outcomes, and in particular, the degree of effective competition within a market (and as a result, pricing and service outcomes). For example, distinct segments imply there is limited interaction between the various market participants that operate within those segments.

This is apparent in the market for estate agency services where agents who facilitate sales of residential properties or residential property management — particularly those located within the Melbourne metropolitan area — tend to have little experience with the execution of commercial real estate transactions. As such, purchasers of 'commercial' estate agency services would not typically consider these agents to be viable alternatives. Similarly, commercial real estate agents generally do not execute residential property transactions, and purchasers of residential property services would not recognise such agents as having the necessary expertise.

In contrast, in markets where there is no clear basis for segmentation, participants are able to freely move across all areas and provide services to all parties seeking to execute transactions. Therefore, it is not possible to assess the extent of market concentration or the degree of effective competition by simply identifying the total number of sellers of goods and services and any legislative or regulatory barriers to entry. In the case of the latter, these barriers are considered to be low (IBISWorld 2007).

Rather, it is necessary to identify whether segmentation exists, what the specific characteristics of those segments are, and how clearly delineated the boundaries of segments might be. Similarly, barriers to entry for specific segments do not necessarily relate to those that apply for the broader market, an example being the licensing requirements for all Victorian real estate agents. While all agents must comply with the education, training and experience requirements, and consumer protection measures of the Estate Agents Act, these requirements ensure agents are familiar with legislative obligations and do not necessarily provide agents with all the skills or expertise necessary to successfully compete to provide the entire range of services that comprise the market.

Indeed, the role of training requirements is to ensure that licensed agents can satisfy the imperatives of the legislation, these relating to notions of consumer protection, basic competences, and legislative understanding. Requiring prospective agents to undertake additional vocational training — beyond that required meeting legislative requirements — would impose an unnecessary burden and supplanting the roles of other training providers and on-the-job experience.

While this report recognises that specialisation exists and has significant implications for purchasers of estate agency services as well as for estate agents, it also recognises that segmentation is a concept that should provide some practical insights for policy development. Regulation is typically developed in response to specific issues but also has regard to the nature and extent of the problem it is intended to address, and any costs it might generate (in terms of compliance or administrative burdens, for example).

KPMG concluded it was necessary to continue underwriting minimum standards of competence for residential sales, because vendors of residential property may not be able to differentiate between agents on the basis of quality and may not be aware of financially significant risks from choosing a poor agent, such as the risk of a sale being aborted due to faulty documentation. In contrast, a general estate agents licence would not require agents to be subject to the same competency standards (KPMG 2000; CAV / Tunstall Consulting 2006).

Regulatory implications

The concept of segmentation is important from a policy and regulatory perspective. For example, a segmented market might require a different response to the exercise of market power — such as the promotion of greater competition for certain activities — than a market where all service providers are able to undertake all activities. Furthermore, the nature and extent of market failure might differ across segments, an example of which is the degree of information asymmetry between buyers and sellers. Owners of residential properties typically execute transactions less frequently than owners of commercial property, and are in many instances less able to make an informed decision about competing service providers. This implies that a different regulatory response could be considered.

This analysis has found that while segmentation exists, it is the result of the characteristics of market participants, rather than a direct product of the regulatory framework. In other words, licensing requirements provide for a base level of competence and professional conduct that *all* agents must demonstrate, irrespective of the estate agency services they provide. However, business success depends on the ability of agents to demonstrate expertise in other areas, either knowledge of a particular location or activity, as noted in the previous section.

Therefore, regulation is important as it provides a degree of protection to many purchasers of estate agency services. However, agents would still need to acquire certain skills and experience in the absence of current licensing requirements in order to differentiate themselves from other suppliers and to meet the needs of prospective clients. As such, licensing requirements create some barriers to entry in the market for estate agency services, particularly for other service providers who possess valued skills as part of their other activities. However, the extent of effective competition is also driven — to a greater extent — by other factors. As an example, residential agents cannot compete for the majority of commercial transactions, even though residential and commercial agents are subject to the same legislative requirements. Similarly, residential agents operating in certain locations cannot easily relocate to other locations, even though potential customers will be aware they have satisfied legislative requirements and are obliged to conduct their business in a particular manner.

*Appendix A***Supplementary material**

Table A.1 sets out the sources of estate agency business in Victoria, as found by the CAV/EAC survey.

Table A.1

SOURCE OF ESTATE AGENCY BUSINESS, VICTORIA

| Activity | Average proportion of estate agency business |
|--|--|
| Sales | 61.4 per cent |
| Residential sales | 47.3 per cent |
| Retirement village unit sales | 0.7 per cent |
| Commercial / industrial sales (excluding retail) | 5.9 per cent |
| Retail sales | 2.1 per cent |
| Rural sales | 5.4 per cent |
| Property management | 27.5 per cent |
| Residential property management | 20.9 per cent |
| Commercial / industrial property management (excluding retail) | 3.8 per cent |
| Retail property management | 2.6 per cent |
| Rural property management | 0.2 per cent |
| Other – specified | 7.3 per cent |
| Business broking | 4.6 per cent |
| Buyers advocacy | 1.7 per cent |
| Government – local, state, national & semi government | 0.1 per cent |
| Body corporate management | 0.9 per cent |
| Other – not specified | 3.8 per cent |
| Other – not specified | 3.8 per cent |
| Sub-total | 3.8 per cent |
| Total | 100 per cent |

Source: CAV/EAC Survey 2007.

Table A.2 sets out data concerning the size of real estate businesses in Australia, in terms of the proportion of total sector income, their average operating profit margin and average income per person employed. This data is drawn from the ABS (2004), and refers to the period 2002-03.

Table A.2

SIZE OF REAL ESTATE BUSINESSES, AUSTRALIA

| Business size | Proportion of businesses | Proportion of total sector income | Average operating profit margin | Average income per person employed |
|---------------------|---------------------------|-----------------------------------|---------------------------------|------------------------------------|
| 0–4 persons | 39 per cent [^] | 11.4 per cent [^] | 14.4 per cent ^{1^} | \$95 000 [^] |
| 5–9 persons | 34.1 per cent | 25.7 per cent | 10.2 per cent [^] | \$93 500 |
| 10–19 persons | 20.6 per cent | 33.9 per cent | 11.4 per cent [^] | \$106 500 |
| 20–49 persons | 5.8 per cent [^] | 17.9 per cent [^] | 11.7 per cent [^] | \$98 700 [^] |
| 50–99 persons | 0.4 per cent [^] | 3.4 per cent [^] | 11.1 per cent | \$103 600 [^] |
| 100 or more persons | 0.2 per cent [^] | 7.7 per cent | 6.3 per cent | \$111 800 |

Source: ABS 2004.

Note: the profit margin for businesses with 0–4 persons employed in particular may be affected by the drawings of sole proprietors and partners, which are excluded from business expenses and profit calculations.

Table A.3 sets out the main occupation of those persons employed by real estate businesses in Australia, including a description of the primary duties normally associated with each occupation.

Table A.3

MAIN OCCUPATION OF PERSONS EMPLOYED BY REAL ESTATE BUSINESSES, AUSTRALIA

| Occupation and primary duties | Proportion of persons employed |
|---|---------------------------------------|
| Real estate agency managers | 13.4 |
| • Primary duties include coordinating the activities of agency salespersons in selling and leasing real estate. | |
| Real estate salespersons | 38.1 |
| Residential properties | 33.2 |
| • Primary duties include arranging the sale and lease of residential properties and assisting buyers to buy suitable properties. | |
| Commercial properties | 4.9 [^] |
| • Primary duties include arranging the sale and lease of residential properties and assisting buyers to find suitable properties. | |
| Property managers | 19.6 |
| Residential properties | 14.9 |
| • Primary duties include supervising the leasing of residential rental properties on behalf of owners | |
| Commercial properties | 4.7 |
| • Primary duties include supervising the leasing of commercial rental properties on behalf of owners. | |
| Valuers / land economists | 0.5 [^] |
| • For valuers, primary duties include: assessing the value of land, property, commercial equipment and merchandise. | |
| • For land economists, primary duties include: providing advice on the administration, commercial and operational use of land and property. | |
| Other | 28.4 |

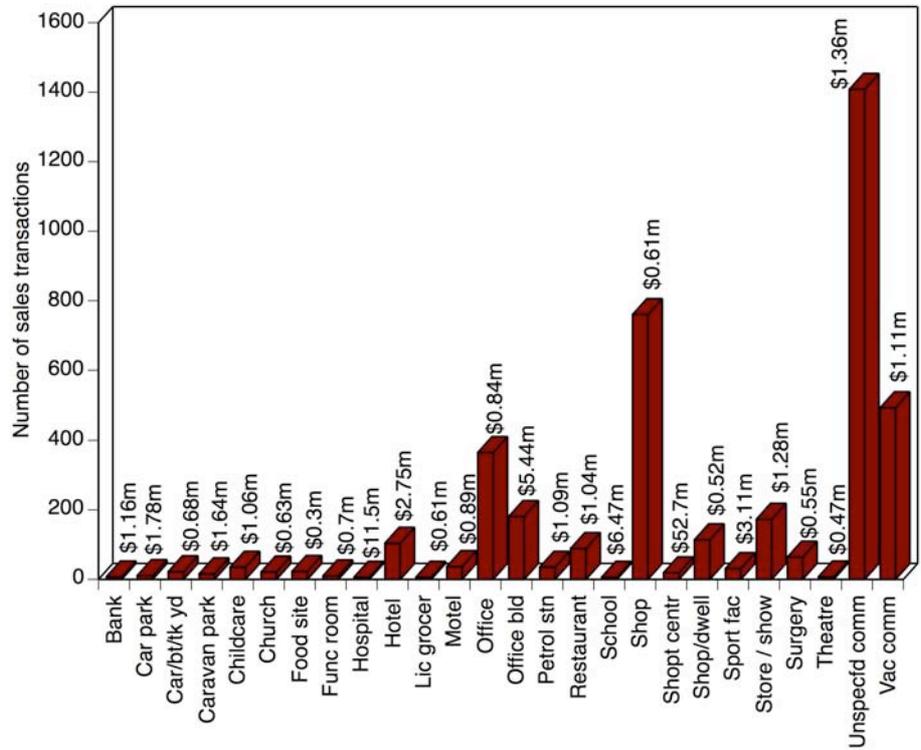
Source: ABS 2004.

[^] Estimate has a relative standard error of 10 per cent to less than 25 per cent and should be used with caution.

Figure A.1, Figure A.2, Figure A.3 and Figure A.4 depict the number and average value of each class of commercial, industrial, residential and rural sales transaction, as defined by the Valuer-General Victoria.

Figure A.1

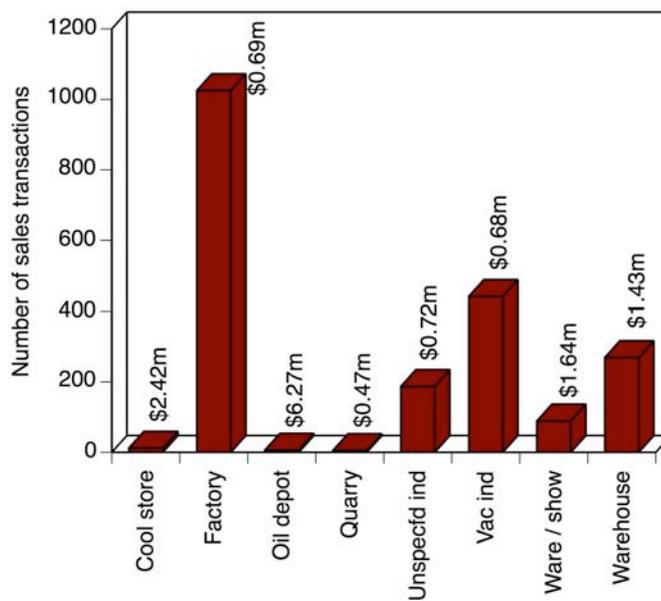
COMMERCIAL PROPERTY SALES IN VICTORIA, 2006



Source: Valuer-General Victoria 2007.

Figure A.2

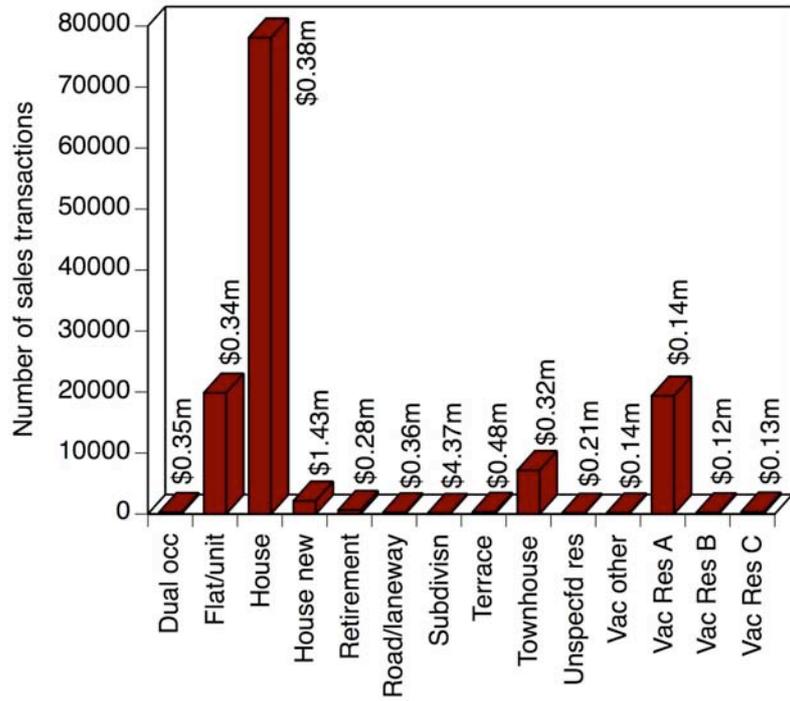
INDUSTRIAL PROPERTY SALES IN VICTORIA, 2006



Source: Valuer-General Victoria 2007.

Figure A.3

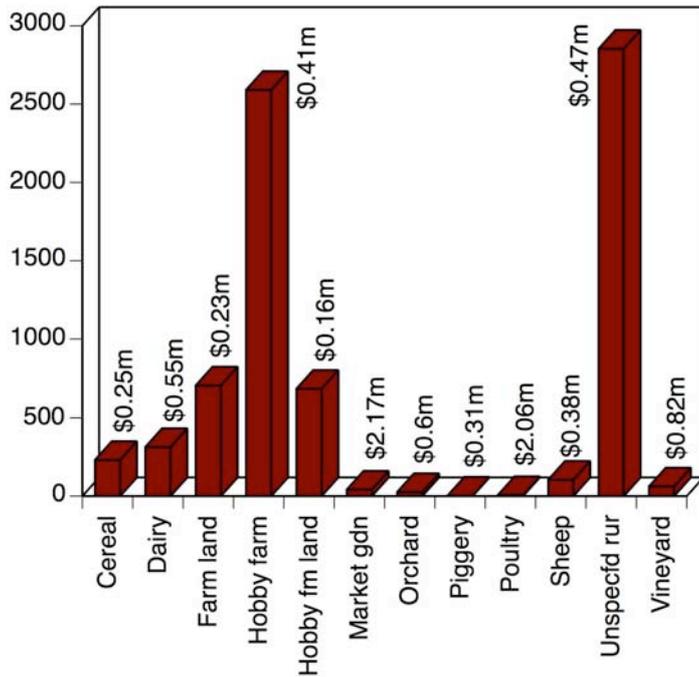
RESIDENTIAL PROPERTY SALES IN VICTORIA, 2006



Source: Valuer-General Victoria 2007.

Figure A.4

RURAL SALES IN VICTORIA, 2006



Source: Valuer-General Victoria 2007.

Appendix B

Licensing requirements under Estate Agents Act 1980

Licensing

Estate agents must be licensed in Victoria. The primary objective of licensing is to protect consumers from the two types of problems: poor information about agent competence, and the risk of financial loss.

The licensing regime for estate agents and employment of agents' representatives is set out in Part 3 of the *Estate Agents Act 1980*. Section 12 of the Act requires a person or corporation that acts as an estate agent or claims to be an estate agent to be licensed. Under Section 14, licences are restricted to those who address specific requirements.

To minimise the risk of fraud, licensing conditions prohibit certain persons from obtaining a licence. These include an insolvent under administration and persons recently convicted of certain offences.

In terms of this study, however, the more relevant licensing criteria relate to the training and experience requirements. These seek to ensure a minimal level of agent experience and training and thus alleviate instances of agent incompetence.

In this respect, applicants must satisfy two broad conditions in order to be eligible for a licence:

- they must currently or have recently held an estate agent's licence in Victoria, another Australian jurisdiction, New Zealand or other overseas country (and be able to demonstrate adequate knowledge of Victoria estate agency law); or
- they must have passed prescribed training courses and have been employed as an agent's representative during the previous three years for a period equivalent to one year full-time.

Corporations are not eligible to hold an estate agent's licence unless there is a licensed estate agent acting in 'effective control' of the estate agent operations of the corporation.

Applicants new to the industry must, therefore, meet experience and training requirements. Training requirements are discussed below.

Training requirements

Pre-licensing has been mandatory since the 1980s. The *Certificate IV in Property (Real Estate Agency Practice)*, which comprises 17 national competency standards (at least 8 of which are tested through written examinations) is the training currently prescribed under the *Estate Agents (Education) Regulations 2004*.

To be eligible for employment as an agent's representative — a precursor to obtaining a licence — a person must have completed the *Course in Property (Agents' Representatives)*.

The Certificate IV may be provided by any Registered Training Organisation (RTOs). There is a high degree of competition among the many RTOs offering the course, which include some universities, TAFEs, the REIV and other training providers.

Appendix C

Stakeholder consultation

Table C.1 sets out those stakeholders consulted to inform this study.

Table C.1

STAKEHOLDERS CONSULTED

| Organisation | Representative |
|---|---|
| Industry consultation | |
| Australian Livestock & Property Agents' Association | Val Hilton Executive Officer — Southern Region |
| Barry Plant | Mike McCarthy Director and Chief Executive Officer |
| BDH Solutions | Ross Hedditch Director |
| Colonial First State Property Management | Chris Lobb Company Secretary |
| Killen Thomas | David Marks Director, Officer in Effective Control Deputy Chair, Estate Agents Council |
| Elders | Shane McIntyre Real Estate Manager — Victoria and Riverina |
| Fitzroys | Michael Donavon Director, Officer in Effective Control |
| Jones Lang LaSalle | James Kaufman National Director |
| Law Institute of Victoria | Michael Brett Young Chief Executive Officer |
| LMB Linke | Graeme Linke Director |
| Real Estate Institute of Victoria | Enzo Raimondo Chief Executive Officer Peter Lowenstern Corporate Solicitor Ben Vivikanandan Manager Policy and Communication |
| Shopping Centre Council of Australia | Milton Cockburn Executive Director Katy Jackett Deputy Director Max Cameron Legal Adviser |
| The Westfield Group | Paul Duree Corporate Solicitor |
| Consumer consultation | |
| Office of Small Business | Craig Roberts Manager – Small Business Policy |
| Office of the Small Business Commissioner | Fiona Lawson Project Officer |
| Tenants Union of Victoria | Mark O'Brien Chief Executive Officer |

Appendix D

Interjurisdictional comparison

D.1 Interjurisdictional licensing arrangements

Table D.1 sets out a high-level comparison of the licensing arrangements in place in other jurisdictions for persons providing estate agency services.

Table D.1

ESTATE AGENT LICENSING ARRANGEMENTS IN OTHER AUSTRALIAN JURISDICTIONS

| Criteria | New South Wales | Queensland | Western Australia | South Australia | Tasmania |
|--------------------------------|--|---|---|---|---|
| Administering authority | The Office of Fair Trading | The Office of Fair Trading | The Real Estate and Business Agents Supervisory Board | The Office of Consumer and Business Affairs | The Property Agents Board |
| Legislation | <i>Property, Stock and Business Agents Act 2002</i> | <i>Property Agents and Motor Dealers Act 2000</i> | <i>Real Estate and Business Agents Act 1978</i> | <i>Land Agents Act 1994</i> | <i>Property Agents and Land Transactions Act 2005</i> |
| Licensing structure | <p>Specialist licences required for specific areas of practice:</p> <ul style="list-style-type: none"> • real estate agent; • stock and station agent; • business agent; • buyers agent; • strata managing agent; and • on-site residential property manager. <p>Additional accreditation is required for auctioneers; valuers are required to register separately.</p> <p>Other persons working as employees of licensees must have certificates of registration:</p> <ul style="list-style-type: none"> • real estate salesperson; • stock and station salesperson; • business salesperson; • registered strata manager or community manager; and • on-site residential property manager. | <p>Specialist licences required for specific areas of practice:</p> <ul style="list-style-type: none"> • real estate agent; • shopping centre management; • property developers (only those involved in residential property sales); and • resident letting. <p>Real estate salespeople are required to hold a registration certificate to work as an employee of a licensed real estate agent.</p> | <p>Estate agents must hold a real estate and business agent's licence, or be registered as a sales representative working under the supervision of a licensed real estate and business agent.</p> | <p>Land agents (persons involved in the sale of land or businesses) are required to be registered, while land sales agents are negatively licensed.</p> | <p>Specialist registration required for specific areas of practice:</p> <ul style="list-style-type: none"> • real estate agent; • property manager; and • general auctioneer. <p>Persons intending to become property consultants or assistant property managers are required to advertise of their intention to enter the industry, and be listed on the register of employed persons held by their employer.</p> |

Sources: The Business Licensing Authority 2007; Office of Fair Trading 2007; Office of Fair Trading 2007; The Real Estate and Business Agents Supervisory Board 2007; Office of Consumer and Business Affairs 2007; The Business Licence Information Service 2007.

Appendix E

Consultation Papers

This appendix reproduces the Issues Papers provided to industry and consumer stakeholders as part of the consultation for this process. The attachments referred to in each paper are the same and hence, have only be reproduced once.

E.1 Issues Paper — industry consultation

The following is a reproduction of the Issues Paper for industry stakeholders.

Introduction

The Allen Consulting Group (ACG) has been engaged to research and report on segmentation in the Victorian real estate agency services market on behalf of the Estate Agents Council. The specific terms of reference are included in Attachment 1.

We have been requested to provide a snapshot of the real estate agency services market and in particular, to identify and describe any segments within the broader market, including their characteristics. We have also been asked to consult with industry and consumer stakeholders and draw on a diverse range of views and perspectives on the Victorian market for real estate agency services.

This paper will form the basis of our consultation with key industry participants. It identifies a range of issues that are relevant to understanding how the industry is structured and the causal factors for that structure. While we have identified some relevant issues and specific questions, we would also encourage you to identify and raise any matters relevant to the terms of reference.

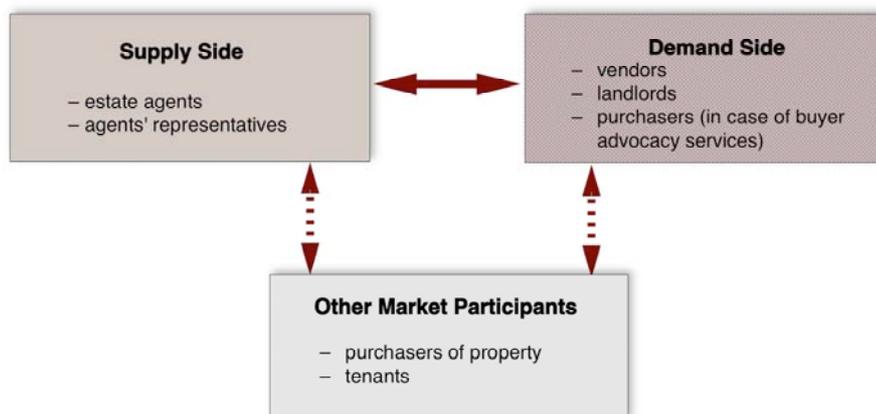
Your organisation

The Council has identified your organisation as having valuable knowledge of the estate agency industry that will assist with our research. Some background on your organisation will enable us to better understand your views and to guide our discussions so we may make the most effective use of the time you have made available.

Market for real estate agency services

The following diagram illustrates the broader market for real estate agency services in terms of the market participants. The primary relationship is between ‘suppliers’ (estate agencies) who provide services to ‘purchasers’ (vendors, landlords and buyers, in the case of buyer advocacy services) in exchange for payment. Other market participants include buyers of real estate and tenants, who interact primarily with estate agencies.

Examples of specific activities or services that fall within the market for real estate agency services are included in Attachment 2.

MARKET FOR REAL ESTATE SERVICES

A segment is a sub-section of the broader market, where the characteristics of the market participants are distinct — to some extent — from those in other segments. The characteristics of suppliers, purchasers and other participants can be the basis for identifying the boundaries of segments, particularly if they differ in easily identifiable ways. For example, participants in the market for residential real estate agency services may differ from commercial market participants according to the specific activities they undertake or the frequency with which they engage in transactions.

Participants in clearly defined segments would tend to have little interaction with those in other segments; this is a key factor to consider when assessing the extent of competition in the broader market for real estate services. In practice, however, the boundaries between segments may be difficult to identify precisely, or may blur or overlap. Our task is to determine whether distinct segments exist and if so, to identify their defining characteristics.

An earlier study of the Victorian estate agency market in 2000 identified segments based on activities. However, the market is likely to have evolved since then and other factors may be involved in segmentation in the current market.

Suppliers of real estate agency services***Characteristics***

In the case of suppliers, a reasonable basis for identifying segments might be the different skills or experience that agencies require to undertake certain activities. Other important factors may be agencies' location and their capacity to provide services beyond their immediate vicinity, an agency's size or the value of a transaction. On the demand side, the size, type, skills and needs of purchasers and other market participants may be relevant factors.

We are interested in your responses to the following questions:

Can the Victorian market for real estate agency services be easily divided or segmented and what are the segments?

What is your basis for segmenting the market? For example, how relevant are factors such as location, nature and size of transactions, type of property, activities, and services provided by agencies?

What are the specific activities or services that fall within each segment?

What is the nature and complexity of transactions in each segment?

Do agencies require substantially different capabilities — such as skills or experience — to operate in each segment?

Do agencies need to be of a particular size to operate in particular segments?

How significant is an agency's location and does this differ according to the segment in which they operate?

How has the Victorian real estate agency market evolved in recent years? For example, can agencies undertake a broader range of activities than in the past and has this affected the way the industry is segmented?

Competition

If the requirements to perform activities and provide services are substantially different between segments, agencies may be less able to expand their operations into other activities or move between segments, without engaging additional resources, undertaking additional training or acquiring specific knowledge. It may be that agencies who concentrate on a specific activity — or group of activities — or location are not able to effectively compete with agencies who concentrate on other activities. This has important implications for identifying the boundaries of segments, and for assessing the degree of competition within and across segments.

Therefore, we are interested in your responses to the following questions:

How easily can agencies operate across segments or move between segments?

On what basis do agencies compete with each other within each segment? Price or non-price factors, for example?

Do fee structures differ substantially across or within segments?

What has been the impact of technology and web-based internet services on competition? Does this impact differ across segments?

Have any recent changes to the regulatory framework for the real estate market impacted on competition? If so, how and has this differed across segments?

Characteristics of purchasers of real estate services

Equally important in identifying specific segments of the real estate market are the specific characteristics of the 'demand side' or purchasers of real estate services — namely, vendors and landlords — and how agencies respond to their needs.

For example, purchasers may differ according to their ability to assess the quality and probity of a range of different real estate agencies; this may be due to the frequency with which they engage their services, their previous experiences, or their ability to draw on a range of information.

Therefore, we are interested in your views on the following:

How do purchasers differ across and within segments? For example, how relevant are factors such as location, type, knowledge, size, previous experience with agencies, level of service required, nature and size of transaction, and any special needs?

How important is the frequency with which purchasers of real estate services interact with agencies and how does it differ across and within segments?

What are the major risks facing purchasers of real estate services and how do they differ across and within the various segments?

Other market participants

Other stakeholders, such as tenants and buyers of property, do not generally purchase services directly from real estate agents. They do, however, frequently interact with the primary market participants. This means they can potentially impact on the way agencies structure their operations and the services that agencies provide to the demand side of the market (such as the provision of advice to landlords on the management of tenants, for example).

Therefore, we are interested in your responses to the following questions:

How do the 'other participants' (such as tenants and buyers of property) impact on the market for real estate agency services and the segments within that market?

What are the characteristics of these participants?

What are the major risks these participants face?

E.2 Issues Paper — consumer consultation

The following is a reproduction of the Issues Paper provided to consumer stakeholders.

Introduction

The Allen Consulting Group (ACG) has been engaged to research and report on segmentation in the Victorian real estate agency services market on behalf of the Estate Agents Council. The specific terms of reference are included in Attachment 1.

We have been requested to provide a snapshot of the real estate agency services market and in particular, to identify and describe any segments within the broader market, including their characteristics. We have also been asked to consult with industry and consumer stakeholders and draw on a diverse range of views and perspectives on the Victorian market for real estate agency services.

This paper will form the basis of our consultation with key stakeholders. It identifies a range of issues that are relevant to understanding how the real estate services market is structured and the causal factors for that structure. While we have identified some relevant issues and specific questions, we would also encourage you to identify and raise any matters relevant to the terms of reference.

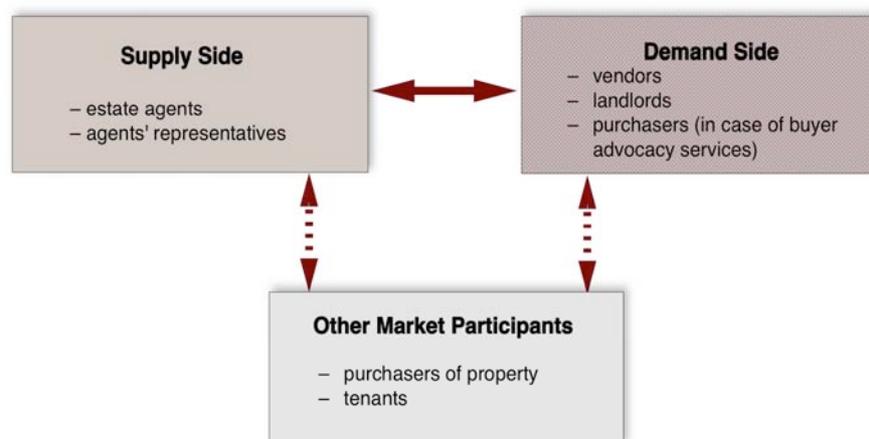
Your organisation

The Council has identified your organisation as having valuable knowledge of the estate agency industry and in particular, about consumers and their dealings with estate agencies that will assist with our research. Some background on your organisation will enable us to better understand your views and to guide our discussions so we may make the most effective use of the time you have made available.

Market for real estate agency services

The following diagram illustrates the broader market for real estate agency services in terms of the market participants. The primary relationship is between ‘suppliers’ of real estate services (estate agencies) who provide goods or services to ‘purchasers’ (vendors, landlords and purchasers, in the case of buyer advocacy services) in exchange for payment. Other market participants include buyers of real estate and tenants, who interact primarily with estate agencies.

Examples of specific activities or services that fall within the market for real estate agency services are included in Attachment 2.

MARKET FOR REAL ESTATE SERVICES

A segment is a sub-section of the broader market, where the characteristics of the market participants are distinct — to some extent — from those in other segments. The characteristics of suppliers, purchasers and other participants can be the basis for identifying the boundaries of segments, particularly if they differ in easily identifiable ways. For example, participants in the market for residential real estate agency services may differ from commercial market participants according to the specific activities they undertake or the frequency with which they engage in transactions.

Participants in clearly defined segments would tend to have little interaction with those in other segments; this is a key factor to consider when assessing the extent of competition in the broader market for real estate services. In practice, however, the boundaries between segments may be difficult to identify precisely, or may blur or overlap. Our task is to determine whether distinct segments exist and to identify their defining characteristics.

An earlier study of the Victorian estate agency market in 2000 identified segments based on activities. However, the market is likely to have evolved since then and other factors may be involved in segmentation in the current market.

Characteristics of purchasers of real estate services

An important step in identifying specific segments of the real estate market is to identify the specific characteristics of the 'demand side' or purchasers of real estate services — namely, vendors and landlords — and how agencies respond to their needs.

For example, purchasers may differ according to their ability to assess the quality and probity of a range of different real estate agencies; this may be due to the frequency with which they engage their services, their previous experiences, or their ability to draw on a range of information. As a result, the nature of the service that respective purchasers of real estate services require can differ substantially.

Therefore, we are interested in your views on the following:

Can the Victorian market for real estate agency services be easily divided or segmented and what are the segments?

What is your basis for segmenting the market? For example, how relevant are factors such as location, nature and size of transactions, type of property, activities, and services provided by agencies?

What are the specific activities or services that estate agencies undertake or provide within each segment?

What is the nature and complexity of transactions in each segment?

How do purchasers differ across and within segments? For example, how relevant are factors such as location, type, knowledge, size, previous experience with agencies, level of service required, nature and size of transaction, and any special needs?

What factors or information do purchasers of real estate services take into account when selecting a real estate agency?

How important is the frequency with which purchasers of real estate services interact with agencies and how does it differ across and within segments?

What are the major risks facing purchasers of real estate services and how do they differ across and within the various segments?

How has the Victorian real estate agency market evolved in recent years? For example, do real estate agencies undertake a broader range of activities than in the past and has this affected the way the industry is segmented?

Other market participants

Other stakeholders, such as tenants and buyers of property, do not generally purchase services directly from real estate agents. They do, however, frequently interact with the primary market participants. This means they can potentially impact on the way agencies structure their operations and the services that agencies provide to buyers and landlords (such as the provision of advice on the management of tenants, for example).

Therefore, we are interested in your responses to the following questions:

How do the 'other participants' (such as tenants and buyers of property) impact on the market for real estate agency services and the segments within that market?

What are the characteristics of these participants?

What are the major risks these participants face?

Do estate agencies provide specific services to other parties involved in real estate transactions?

Suppliers of real estate agency services

Characteristics

In the case of suppliers, a reasonable basis for identifying segments might be the different skills or experience that agencies require to undertake certain activities. Other important factors may be agencies' location and their capacity to provide services beyond their immediate vicinity, an agency's size or the value of a transaction. On the demand side, the size, type, skills and needs of purchasers and other market participants may be relevant factors.

We are interested in your responses to the following questions:

Do real estate agencies require substantially different capabilities — such as skills or experience — to operate in each segment?

Do agencies need to be of a particular size to operate in particular segments?

How significant is an agency's location and does this differ according to the segment in which they operate?

Does the nature of an estate agency's services differ according to the profile of the buyer?

Competition

If the requirements to perform activities and provide services are substantially different between segments, agencies may be less able to expand their operations into other activities or move between segments, without engaging additional resources, undertaking additional training or acquiring specific knowledge. It may be that agencies who concentrate on a specific activity — or group of activities — or location are not able to effectively compete with agencies who concentrate on other activities. This has important implications for identifying the boundaries of segments, and for assessing the degree of competition within and across segments.

Therefore, we are interested in your responses to the following questions:

On what basis do agencies compete with each other within each segment? Price or non-price factors, for example?

Do fee structures differ substantially across or within segments?

Has the provision of web-based services by estate agencies affected the ways estate agencies compete to attract vendors and landlords? Does this differ across segments?

What impact, if any, has the provision of web-based services by estate agencies had on other participants (buyers and tenants? For example in terms of their reliance on contract with estate agencies and the strategies agents use to attract buyers and tenants to properties. Does this differ across segments?

Attachment 1

Real Estate Agency Market Segmentation Study — Terms of Reference

- Define the market for the provision of real estate services in Victoria taking into consideration demand and supply characteristics.
- Identify and examine the nature and extent of segmentation in the estate agency service market and, where applicable, reference arrangements in other states.
- Describe the industry participants and functions characteristics of each market segment including the individuals and type of businesses.
- Describe the transactions characteristic of each market segment in terms of the size (in dollar terms), number, nature and complexity of transactions.
- Describe the consumer characteristic of each market segment including the likely harms arising for those consumers and the consumer protections available.
- Assess the nature and extent of competition within each market segment including the impact on competition of changes in regulation affecting estate agency during the last 5 years.
- Identify the issues and implications of the market segmentation arrangements as a factor to be considered in reviewing industry licensing arrangements.

Attachment 2

Market for real estate agency services

The following are examples of activities and services that fall within the broader market for real estate services:

- residential sales of houses, units, apartments;
- buyer advocacy;
- commercial sales, ranging from small through to large retail premises and leisure activities, such as hotels and clubs;
- industrial sales;
- rural sales;
- residential property management;
- commercial property management, ranging from small through to large retail premises and leisure activities, such as hotels and clubs;
- industrial property management;
- rural property management;
- business broking; and
- body corporate management.

Appendix F

Abbreviations

ACG — the Allen Consulting Group

AHURI — The Australian Housing and Urban Research Institute

BLA — The Business Licensing Authority

CAV — Consumer Affairs Victoria

EAC — the Estate Agents Council

OSB — the Office of Small Business

REIV — the Real Estate Institute of Victoria

Appendix G

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