

In the Matter of **Part 4 of the Real Estate Agents Act 2008**

And

In the Matter of **Complaint No: CA2767647**

In the Matter of **John McKenzie**
Licence Number: 10014002

Decision of Complaints Assessment Committee

Dated this 14th day of January 2011

Complaints Assessment Committee:

10034

Chairperson: Paul Morten

Deputy Chairperson: Denise Bovaird

Panel Member: Rob Crozier

Complaints Assessment Committee

Decision finding unsatisfactory conduct

The Complaint

Mr C (the complainant) bought a commercial property in Wellington (property) in late December 2009.

The property was sold by mortgagee sale. John McKenzie (the agent) was a sales agent for Capital Commercial Limited (which trades as Bayleys), the licensee company which conducted the sale of the property on behalf of the mortgagee, Company C.

The complainant was provided with certain written information about the property by the agency.

A letter dated 5 November 2009 described certain key attributes of the property. The attributes included a statement that net income was "approximately \$131,474"; that this sale presented an added value opportunity; that there was "773 m² vacant floor"; that the property was nestled on two titles; and that there were six car parks.

An information memorandum was provided to the complainant. It contained greater detail about the property. It finished with a disclaimer that the memorandum had been prepared "solely to assist interested parties in deciding whether to express their interest" in the property, and "then make their own valuation of the Land and Buildings."

The disclaimer made it clear that the memorandum did not purport to contain all the information a prospective purchaser might require. All interested parties needed to conduct their own investigation and analysis and verification of data contained in the memorandum.

Among other things, the information memorandum stated that the property had five tenants and one vacancy. Two tenants were said to have recently renewed their leases. The building had a total gross rental of \$176,580 per year, "with upside".

There was said to be "770 m² vacant floor-potential to convert to residential". "With four long-term tenants and the second floor completely vacant there is a fantastic opportunity to add value whilst enjoying a steady income". The information memorandum stated that "the second storey of 773 m² is currently vacant and requires redevelopment."

The information memorandum stated that a conversion of the second floor to residential rooms could provide an excellent source of income and value add to the property with students in close proximity providing a bountiful supply of prospective tenants.

The information memorandum included an income summary, stating that gross income was \$172,690, with net outgoings of \$41,216.

A table set out gross operating expenses, of \$51,747. Less recoverables, net operating expenses were said to be \$41,216. The Committee notes that the operating expenses did not include any estimate for insurance or maintenance, which the complainant says in fact cost \$25,800.

In fact, the top floor was not vacant. 40 m² was leased to Company A. Company A's two-year lease commenced on 1 November 2005. It had 2 rights of renewal, each for 2 years. The lease expires on 31 October 2011.

The lease was varied in January 2006 to include the 40 m² on the second floor, which was apparently used as storage space. Company A therefore had the potential right to use that space until 2011.

The gross rental was not \$176,000, as stated. The complainant says that it was \$160,448.

Bayleys estimated the encroachment licence fee to be \$3000 a year. The complainant says that there was no encroachment licence, and it transpires the encroachment fee is \$6420.

Bayleys said the building Warrant of Fitness cost \$515 per year. There was no warrant of fitness issued. When issued, the complainant says it cost \$596.

The complainant says that the operating expenses were not as described by Bayleys. Once insurance, maintenance, proper encroachment licence fees, and lift costs are included (the latter \$2800 not \$535), the complainant states that the net operating expenses were \$73,000, not \$41,000.

The thrust of the complaint is that the agent and Bayleys were obliged to provide accurate information to prospective purchasers. They did not. The complainant says he has suffered financial loss as a result.

Material Facts

From correspondence from the agent and the complainant that has been received following the Committee's decision to enquire into the complaint, the Committee has been able to identify the areas of dispute between the two parties.

The agent states that the complainant went through the building on several occasions, and was aware that Company A had a storage unit on the second floor. He refers to the lease documents, and the letter regarding the lease of the storage unit.

Contrary to the allegation by the complainant, there was an encroachment licence, but the licence was not transferable. Any purchaser would have to apply for a new licence. The City Council refused to provide information about the encroachment licence fee to the mortgagee: they would only provide that information to the building owner. The agent states that the complainant was aware of the need for a parking encroachment licence, since he had spoken to the Council about that.

As to the operating expenses schedule, the mortgagee was only able to provide such documents as were available to it.

As to the building warrant of fitness, the agent says that that was a matter that the mortgagee was supposed to have attended to by the date of settlement.

As to the estimated income, the agent states that the complainant's figures are very misleading. After the complainant received the initial information and various brochures, there was a six-week period before the contract was signed in late December 2009. During the course of that six-week period, the parties had allowed for operating expenses closer to \$60,000 (to include \$10,000 insurance costs), plus a buffer (presumably for unexpected costs), giving a potential net rental of between \$110,000 and \$115,000. Once rental renewals had been finalised, and taking into account that the complainant did not intend to sign up the dairy tenant, the net rental income estimate was reduced to \$100,000.

The agent states that the complainant used these figures to reduce the purchase price from \$1.7 million down to \$1.6 million.

In a letter dated 21 May 2010, the managing director of Bayleys (the MD) states that documentation relating to Company A's lease of the 40 m² storage space was part of the due diligence package provided to Mr C before he bought the property.

The MD states that the assessment of the encroachment licence fee was derived from a Company B valuation provided to Bayleys by the mortgagee. The Committee notes that that it is a document apparently prepared in June 2007.

The MD states that Bayleys does not accept the complainant's claim of financial loss. Outgoings were only estimates. Leases were still being finalised. The buyer was aware that he needed to make his own assessment of critical outgoing charges, such as lifts and building maintenance.

The complainant replied on 20 July 2010. He accepts that he asked the agent what was the locked room on the second floor. He accepted that he received a copy of the January 2009 "variation letter" in relation to the Company A lease. He states he was not told that Company A leased that area on the second floor.

As to the encroachment fee, the complainant says he was not aware that the encroachment licence fee dated back to a historic licence granted in July 2006. He considers the agent ought to have updated the encroachment fee, and provided the correct fee.

The complainant accepts that the building warrant of fitness issue was resolved before settlement.

The complainant says that the information memorandum stated that gross rental from signage was \$5400 year. He claims that only after purchase of the building did he find out that income from the Billboard depended on ability to sell the billboard space, with the property owner deriving only a 40% net share of the income. In fact, income for the period 1 September 2008 to 31 August 2009 from the billboard was only \$1497.49.

The complainant denies that there was any discussion about the lift being on an "as is basis". The figure of \$535 per year for the lift was misleading. A service contract for the lift is \$2800 per year.

The complainant reiterated the point of this claim. Bayleys was a reputable real estate agency, which compiled its information memorandum based on outdated figures from a Company B valuation prepared in June 2007. No hard work was done to substantiate those figures, or to remove or update out-of-date expenses.

The agent has replied to this further information. He says that the complainant knew about the lease to Company A for storage on the second floor. He repeats that he was unable to ascertain the actual encroachment licence fee. He states that the complainant was provided with a copy of the billboard lease. He says the complainant was aware of missing operating expense costs. He says everybody was aware that the lift was not working and was "as is".

The agent makes the point that the complainant is a seasoned property owner who owns numerous properties, both commercial and residential, well able to conduct his own due diligence.

The agent vigorously denies any suggestion that there was any intention to mislead, and repeats the point that it is extremely difficult to obtain accurate information from an owner, when a mortgagee sale is being conducted.

Finally, on 1 December 2010, the complainant has provided a final reply to the Authority.

He denies that he was told that the 40 m² of storage space on the second floor was subject to a lease. He reiterates previous comments about the inaccurate operating expenses provided in the information memorandum.

Relevant Provisions

Although the information memorandum was provided to the complainant before the Real Estate Agents Act 2008 (the 2008 Act) was in place, the Committee considers that this is a matter that it is required to assess under the provisions of the 2008 Act. The information contained in the memorandum constitutes a continuing representation to the complainant and other prospective purchasers. The complainant did not buy the property until the end of December 2009. The 2008 act came into force on 17 November 2009.

Section 72 of the Act provides as follows:

72 Unsatisfactory conduct

For the purposes of this Act, a licensee is guilty of unsatisfactory conduct if the licensee carries out real estate agency work that-

- (a) falls short of the standard that a reasonable member of the public is entitled to expect from a reasonably competent licensee; or
- (b) contravenes a provision of this Act or of any regulations or rules made under this Act; or
- (c) is incompetent or negligent; or
- (d) would reasonably be regarded by agents of good standing as being unacceptable.

Relevant rules contained in the Real Estate Agents Act (Professional Conduct and Client Care) Rules 2009 (the Rules) are as follows:

- 5.1 A licensee must exercise skill, care, competence, and diligence at all times when carrying out real estate agency work.
- 6.3 A licensee must not engage in any conduct likely to bring the industry into disrepute.
- 6.4 A licensee must not mislead a customer or client, nor provide false information, nor withhold information that should by law or fairness be provided to a customer or client.

Discussion

The Committee starts by setting out the stated purpose of the 2008 Act.

3 Purpose of Act

- (1) The purpose of this Act is to promote and protect the interests of consumers in respect of transactions that relate to real estate and to promote public confidence in the performance of real estate agency work.
- (2) The Act achieves its purpose by—
 - (a) regulating agents, branch managers, and salespersons:
 - (b) raising industry standards:
 - (c) providing accountability through a disciplinary process that is independent, transparent, and effective.

The focus of the Committee is therefore not limited to what impact any breach of the Rules or Act might have just on the complainant. It is the interests of consumers in general, rather than just the complainant, that form the proper focus of the legislation, and this disciplinary proceeding.

It is clear that the information memorandum provides information to all prospective purchasers—not just to the complainant—that is inaccurate or incorrect.

It is self-evident that the second floor was not vacant. 40 m² of space on the second floor was entitled to be leased until December 2011.

The agency knew there was a lease of 40 m² of that floor space. The agency knew that there was a likelihood that the property would be bought by someone interested in redeveloping it, to obtain a better rental return. In fact, the information memorandum specifically touted the ability of a purchaser to add value, and referred to the "fantastic opportunity to add value" by reason of the fact that the second floor was vacant.

In fact, development of the second floor was entirely dependent on a purchaser successfully negotiating with Company A on an agreed basis for the surrender of its lease of the 40 m² area. Any tenant in that situation would hang out for a good price. Bayleys must have been aware of that.

Yet the information memorandum did not alert a prospective purchaser to this difficulty. On its own, that was misleading, and in the Committee's view, a clear breach of Rule 6.4.

In addition, income details contained in the information memorandum were not correct, not the least because various leases were up for renewal.

Estimated income derived from the billboard was wrong.

The estimated encroachment licence fee was based on a licence fee that was hopelessly out of date.

Information about the lift operating costs was not correct. In fact, consumers needed to be aware that the lift was in an "as is" condition.

The Committee does not consider that there is any evidence that the agency, or the agent, intended to mislead the complainant or other consumers. But on the face of it, the information contained in the information memorandum was capable of misleading consumers, and was false.

The Committee accepts the difficulties the agency faced in obtaining information from the mortgagee. It also notes the terms of the disclaimer contained in the information memorandum, particularly where the disclaimer records that data contained in the information memorandum needed to be independently verified.

The agent now finds himself in the difficult position of trying to establish that the complainant knew about a number of matters which are now contained in his complaint.

The Committee makes two points. First, it is not sympathetic to the position the agent finds himself in. Had the information about the so-called vacant second floor been correct, and had the income and expense details been clearly signposted as estimates which the mortgagee had been unable to verify, then the agent would not be caught in this "he says, she says" situation. Second, even if the agent was able to establish that the complainant knew about all the inaccuracies in the information memorandum by the time he submitted his offer for the property, the fact remains that the information memorandum was out there with other prospective purchasers, who ran the risk of being similarly misled.

Some information has been provided by the agent suggesting that the complainant has a bit of a track record. The Committee declines to take into account such information, which it considers irrelevant to the substance of the complaint.

The Committee considers that the agent had an obligation to identify, in the clearest terms, in the

information memorandum that the second floor was not vacant, and that income and operating expense information was potentially suspect. He failed to do so. Unfortunately, he must take responsibility for that.

Such conduct, in the Committee's view, is also conduct which is liable to bring the industry into disrepute.

In the circumstances, the Committee considers that the conduct by the agent falls short of the standard a reasonable member of the public is entitled to expect from a reasonably competent licensee (a breach of section 72(a) of the 2008 Act); contravenes rules made under the Act (a breach of section 72(b)); and would reasonably be regarded by agents of good standard as being unacceptable (a breach of section 72(d)).

Decision

After conducting an inquiry into the complaint, pursuant to section 89(1) of the Real Estate Agents Act 2008, the Committee held a hearing with regard to that complaint. In accordance with section 90(1) of the Act, the Committee conducted the hearing on the papers, and pursuant to section 90(2) the Committee's determination was made on the basis of the written material before it.

The Committee has determined under section 89(2)(b) of the REAA 2008 that it has been proved, on the balance of probabilities, that John McKenzie has engaged in unsatisfactory conduct.

Orders

The Committee will conduct a separate hearing on the papers to decide what orders, if any, should be made under s 93 of the Act.

Section 93 provides:

93 Power of Committee to make orders

- (1) If a Committee makes a determination under section 89(2)(b), the Committee may do 1 or more of the following:
 - (a) make an order censuring or reprimanding the licensee:
 - (b) order that all or some of the terms of an agreed settlement between the licensee and the complainant are to have effect, by consent, as all or part of a final determination of the complaint:
 - (c) order that the licensee apologise to the complainant:
 - (d) order that the licensee undergo training or education:
 - (e) order the licensee to reduce, cancel, or refund fees charged for work where that work is the subject of the complaint:
 - (f) order the licensee—
 - (i) to rectify, at his or her or its own expense, any error or omission; or
 - (ii) where it is not practicable to rectify the error or omission, to take steps to provide, at his or her or its own expense, relief, in whole or in part, from the consequences of the error or omission:
 - (g) order the licensee to pay to the Authority a fine not exceeding \$10,000 in the case of an individual or \$20,000 in the case of a company:
 - (h) order the licensee, or the agent for whom the person complained about works, to make his or her business available for inspection or take advice in relation to management from persons specified in the order:
 - (i) order the licensee to pay the complainant any costs or expenses incurred in respect of the inquiry, investigation, or hearing by the Committee.
- (2) An order under this section may be made on and subject to any terms and conditions that the Committee thinks fit.

The Committee requires the investigator authorised to assist the Committee with its inquiry to obtain a record of any previous disciplinary decision in respect of John McKenzie under either the Real Estate Agents Act 1976 or the Real Estate Agents Act 2008, if any such decision exists, and provide it to the Committee and the agent and the complainant.

The agent and the complainant may file submissions on what orders, if any should be made. The complainant may file submissions by 24 January 2011. If further time is needed by reason of the Christmas vacation period, an application for an extension of time should be made by letter. These submissions, if any, will then be provided to the agent, with a timeframe for filing final submissions.

Publication

One of the Committee's functions pursuant to section 78(h) of the Act is to publish its decisions.

Publication gives effect the purpose of the Real Estate Agents Act of ensuring that the disciplinary process remains transparent, independent and effective. The Committee also regards publication of this decision as desirable for the purposes of setting standards and that it is in the public interest that the decision be published.

The Committee directs publication of its decision, but omitting the names and identifying details of the complainant (including the address of the property), and any third parties in the publication of its decision.

Right of Appeal

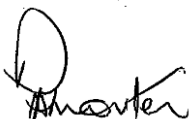
A person affected by a determination of a Complaints Assessment Committee may appeal by way of written notice to the Disciplinary Tribunal against a determination of the Committee and must do so within 20 working days from the date of the determination.

[The Committee has yet to finally determine this complaint because the parties are being given an opportunity to make submissions on orders before the Committee determines what orders should be made, if any.

The Committee considers that the 20 working day appeal period does not commence until it has finally determined this complaint by deciding what orders should be made, if any.

Appeal is by way of written notice to the Tribunal. Further information on lodging an appeal is available by referring to the **Guide to Lodging an Appeal** at www.justice.govt.nz/tribunals.

Signed



Paul Morten
Chairperson
Complaints Assessment Committee
Real Estate Agents Authority
Date: 14 January 2011