Australian Price Indexes for Real Estate Agents' Fees

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Summary

The real estate industry in Australia is heavily localised, deregulated in most states, and has been experiencing relatively strong growth. Fees are, in general, based on a percentage of the sales or rental price. The index covers commercial sales, commercial property management, residential sales, and residential property management activities. The compilation is relatively complex, involving a matched sample methodology for the residential survey, the use of the CPI *Established house price index* series, and real estate data from a major private commercial property organisation. The index is published at the aggregated real estate agents level.

1. Introduction

The Australian Bureau of Statistics (ABS) is undertaking a long-term development program to progressively extend the scope of the producer price indexes into the services sector of the economy.

On 18 April 2000, the ABS launched a new quarterly publication, **Producer Price Indexes for Selected Service Industries, Australia**. This publication presented quarterly price index numbers for most industries (at the four digit class level of the Australian and New Zealand Standard Industrial Classification - ANZSIC) within the Transport and storage, and Property and business services sectors, from September quarter 1998 to March quarter 2000.

An experimental Real Estate Services price index has been compiled on a quarterly basis since the June quarter 1995, and backcast to 1989-90.

2. Classification/ types of activities

Services provided by real estate agents fall into the ANZSIC class 7720, which consists of units engaged in the primary activities of valuing, purchasing, selling (by auction or private treaty), managing or renting real estate for others. Units mainly engaged in providing a real estate transfer service performed by qualified legal practitioners are included in Class 7841 Legal Services.

The Australian real estate industry is divided into two main sectors: residential property and commercial/ industrial property. Each of these sectors can be broken down into two main components: property sales and property management. The real estate index is therefore composed of the four activities:

- sale of residential property
- sale of commercial property
- management of leased residential property
- management of leased commercial property.

These four activities account for 82% of agents' income (1998-99 statistics). Total income from property sales commissions is 58% and income from property management commissions 24% of real estate agents' income.

3. Business model

Structure of the real estate industry

The bulk of agents' incomes is from the sale of residential property, followed by residential property management. Between June 1998 and June 1999, income from property sales commissions was the main income stream of businesses in all size ranges except for those which employed 100 or more people, who derived the bulk of their income from property management commissions. Businesses are concentrated in the four states of NSW, Victoria, Queensland, and Western Australia. Between June 1996 and June 1999 there was a 6% decrease in the number of private sector businesses in the real estate services industry.

The real estate industry is heavily localised and dominated by small businesses. 1998-1999 statistics show that 96% of businesses employ less than 20 people, and 47% of businesses employ less than 5 people, indicating that the majority of work is in the local area. This can be explained by the fact that buyers are generally only looking in particular locations, so an agent is likely to concentrate their activities in one area to increase the chance of obtaining a sale. Smaller agents appear to be involved almost exclusively in residential property sales in their local area, while commercial property sales appear to be the domain of the larger businesses.

Real estate agents may form franchise or marketing groups. 46% of real estate agency businesses had franchise or marketing group/ cooperative affiliation at the end of June 1999. All members of a franchise agreement trade under the franchiser's name or banner. Members of a marketing group are independent businesses which trade under individual names or trading banners but adopt a common marketing policy.

Activities excluded from the real estate price index include valuations, time share apartments management, title searching, and conveyancing work. Conveyancing was opened up to competition from non-legal businesses after deregulation, leading to a marked decrease in the price that purchasers and vendors were charged for conveyancing. Conveyancing services are difficult to price as no two contracts between the conveyancer and the client are the same, and fees are highly subject to change driven by market forces.

Description of services priced

Most agents' fees in Australia have been deregulated. The non-residential sector has been deregulated for some time, while deregulation of the residential sector began a number of years ago, following the 1992 Prices Surveillance Authority's (PSA) inquiry into real estate agents' fees. To date, all states and territories have been deregulated with the exception of Queensland, which is due for deregulation in the near future. Prior to this inquiry, agents' fees were regulated by a set of scaled fees which determined what agents could charge. Today fees set by regulation are the *maximum* fees, and agents are free to negotiate lower fees than those scheduled.

Fees are determined by the individual business proprietor or franchiser. Costs included in the agent's fee include advertising, marketing, agents' time and expertise and an allowance for agents' overheads such as phone, premises, office expenses etc. Costs excluded are government stamp duty and bank fees.

4. Sample design

Data is collected on a state-by-state basis, with the index published at the national level. Data is mostly collected from capital cities as these account for the bulk of real estate activity.

The residential real estate index is compiled using a matched sample methodology, which involves comparing changes in fees for specific house prices, usually supplied by the respondent to the nearest $1000. This compilation only reflects agents' commissions (a percentage of the sales / rental value paid to the agent by the vendor). To account for fee changes due to changes in house prices, the CPI *Established house price index* series is used to adjust the index.

The ABS has utilised data compiled by a major private commercial property management organisation to represent commercial sales and property management services. The data is based on dollar yields obtainable in the market. This organisation collects data from their own clients as well as clients from other agents, and claim to have 95% coverage of the markets that they maintain a series for. Their sample comprises all buildings above a threshold floorspace, which varies from city to city. Data is produced quarterly.

5. Industry pricing and record-keeping practices

Under deregulation, agents' fees are based on a percentage of the sale or rental price and then generally a discount is negotiated between the agent and the vendor (seller). Fees are guided by a set of scale fees. Agents' fees tend to change in proportion to the value of the building, with owners paying agents higher fees when building values increase, and negotiating lower fees when building values decrease. Fees paid by the vendor are sometimes split between a number of agencies in a conjunctional sale.

For commercial sales, agents' fees depend on the contract between the vendor and the agent. For very expensive buildings there is an upper limit on the value vendors are prepared to pay agents.

With residential rental property, an additional initial fee - a letting fee - is charged for finding a tenant for a residence, which is usually about one weeks' rent. With commercial leasing, concessions such as rent-free periods or improvements made to the building are frequently offered, especially as incentives in a depressed market.

Factors affecting price change

The property value is a primary factor in the determination of price movements. Real estate agents can receive a rise in fees from an increase in their commission rate, or from a rise in the sales / rental value of the real estate.

Discounting is widespread among real estate agents. In commercial property transactions there also exists a range of common conditions - e.g. free fitout, rent-free periods, reduced initial rentals - that affect price movements.

The agent's time and expertise, office and other resource expenses, are included in the fees and contribute to price movements.

6. Publication structure and relationship to the CPC

The real estate index is published at the *real estate* agents level, which is both a three-digit and a four-digit class under the ANZSIC classification. The three-digit ANZSIC 772 and the four-digit ANZSIC 7720 are both equivalent to the three-digit CPC 722. Activities under ANZSIC 7720 relate to the four-digit CPC classes. The CPC defines activities to a finer level than does ANZSIC, which does not break down real estate agents beyond 7720. The following table shows how the classifications relate to each other.

ANZSIC	CPC
772 Real Estate Agents	**722 Real estate services on a fee or contract basis**
7720 Real Estate Agents	
Sales	7222 Buildings and associated land sales
Commercial	72221 Residential
Residential	72222 Non-residential
Property management	7221 Property management
Commercial	72211 Residential
Residential	72212 Non-residential

7. Pricing methodology and specifications

Data for representative sale prices, and the agent's commission for the sale and rental of the property, are collected, with advertising services excluded.

- Residential sales:

A sample of six representative house sales prices, and the corresponding total agents' fees, are collected from each respondent for each month. The total fees are the prices paid by the vendor and not the fee per agent. The six prices reported are selected at the respondent's discretion, and properties sold for investment or finance purposes are not differentiated on the collection form.

The sales prices are used to match observations between quarters, and so the movement in real estate agents' fees for a house of a particular price is recorded. For each house price, an average agent fee is obtained for each quarter. The changes in fees are measured as percentage changes in these average prices, which are weighted to obtain the overall percentage change in fees for each state. To also reflect the movement in house prices in the real estate index, this data is used in conjunction with the CPI *Established house price index* series. Changes in agents' fees are combined with changes in the CPI house index to derive real estate index numbers for residential sales for each state.

- Residential property management:

A survey is conducted to obtain the standard fees agents charge (as a percentage) for property management. Property management includes rental collection and property maintenance (eg, arranging property inspections or house repairs). Most of the fee charged is for rental collection. Some respondents have provided separate figures for these two components, while some have only given the charge for rental collection. Where the fee is decomposed, an average of the two prices is taken. For instance, if the figures are 5% for rental collection and 2% for property maintenance, they are averaged to give 6% for property management. Some respondents have supplied a range of percentages according to furnished and unfurnished properties, and other conditions, for which an average is also taken.

The letting fee is not measured directly since rent prices should reflect changes in the letting fee. Agents can earn more revenue from letting fees if there is a high turnover of tenants in the residence; however, the number of times a house is let has no relevance to the level of the transaction price being measured.

The index is compiled in a similar way to residential sales, using CPI data for *Privately owned dwelling rents.* The percentage change in the fees (as dollar amounts) is combined with the percentage changes in the CPI rent index, to derive the real estate index numbers for residential property management for each state.

For both the residential sales and residential property management indexes, a national index is calculated by weighting together the state index numbers. The two indexes are then aggregated to produce the Australian residential real estate index.

- Commercial sales:

A major private commercial property organisation produces *Capital Value Indicators* for the CBD office markets, which show the average capital value per square metre of net lettable area. These figures are used as proxies for the sale price. Although they do not reflect discounting in the market, they do track broad movements in agents' fees which are based on a percentage of the sales price. Actual data on expenditure on capital improvement and upgrading since completion, have been incorporated where known. The data is provided for a set basket of properties, although in practice buildings which are undergoing significant changes are removed from the basket and reintroduced once the changes are completed.

- Commercial property management:

Rent figures are also produced by this private company for the CBD office market. The rent figures are divided into two rent series: gross rents and effective rents. The gross rent series is based on the market rental achievable for a lease of 1000 square metres. The effective rent series takes into account the value of concessions like rent-free periods or improvements made to the building, which are incentives sometimes offered in a depressed market. Incentives are converted to a present value based on prevailing market investment yields and amortised over the life of the lease, assumed to be 100 years. These amortised values of incentives are deducted from the gross rent in the calculation of the effective rental.

The effective rent series is a more accurate representation of the true current market rental, and is the one used by the ABS as an index for property management and leasing transactions. There is not always a linear relationship between rents and fees, as companies occasionally charge minimal property management fees to get the leasing rights to a building, though the relationship generally holds.

State indexes are derived and weighted together to produce Australia level indexes for both commercial sales and commercial property management. These two indexes are then aggregated to give the Australian commercial real estate index. This is then combined with the Australian residential real estate index to give the overall real estate index for Australia. The commercial real estate index structure is different to the residential real estate index as it does not involve the direct collection of transaction prices from businesses.

8. Technical concerns (pricing difficulties)

Quality changes in the real estate industry is difficult to quantify, and there is currently no reliable estimate of the effect of productivity changes on price movements.

In commercial property the basket of properties changes over time. However the private commercial organisation which produces capital value indicators and rent series is able to estimate and compensate for quality "creep" so that their series reflect real price change in the market. Where there are no vacancies in a particular building, proxies are used to estimate the equivalent achievable rent.

Difficulties have been experienced in the collection of data and compilation of the index. Initially house prices were divided into ranges and the average fee for each price range collected. However a portion of the price change was being driven by changes in the mix of respondents between quarters, and the number of observations for each price range continually changed. For some price ranges the number of observations were too small to be representative, or were totally absent for the quarter. This meant that state-wide averages had to be adjusted to exclude these ranges and the data re-weighted to compensate. The latter was itself problematic because the exclusion of some ranges meant the weights did not sum to one.

While the matched sample methodology can result in a deficiency in useful observations for the index and a small sample size, the sample mix problems were largely overcome. The accuracy of the index could be improved by aggregating data by locality, although there are difficulties involved with identifying and specifying localities and the agents which belong to them.

9. Survey vehicles

Survey development began with background research on the real estate industry and market structure. Stratified sampling is used with respondents identified by location using details from the ABS business register. The type of specifications for the survey are obtained predominantly by interviews with industry associations, and the specifications are reviewed periodically to ensure they remain appropriate. Respondents are rotated out of the sample every 3 years. Replacement real estate firms are selected from a similar location to that of the firm retired.

10. Industry developments

The real estate market has continued to grow, due to buoyant conditions in the domestic economy, high consumer confidence and strong supply. Some uncertainty in the market is being experienced this year because of the Sydney 2000 Olympics and the introduction of The New Tax System (TNTS). There has been a great deal of commercial construction in the Sydney CBD, and increasing demand for residential housing ahead of the new goods and services tax (GST) which is an integral part of TNTS.

In the commercial sector, tenant demand has been quite strong with increasing pressure on rent prices at the top-level, but slowing growth rates in other markets. This can be attributed to high business confidence (and growth in employment in the finance sectors) and competition to secure limited high-quality space. However, with the exception of industrial buildings, the lack of new construction in most markets and consistent demand has meant that vacancies have decreased nationally. Keen competition at the premium end of the high-technology business markets has had a negative impact on the more traditional suburban fringe office locations. Investor sentiment has been high, due to the strong economy and anticipation of the GST.

Demand and supply have been quite strong in the residential sector, although it has been speculated that supply and demand rates will most likely decline in the period immediately following the introduction of the GST. There has been a consumer swing towards units and townhouses in the residential sales market, and real estate agencies are trying to develop more of these properties. It is uncertain how the Sydney Olympics will impact on the construction industry.

A trend in shopping via the internet has been observed over the past year, and will probably increase. Internet shopping allows consumers to cut down on search time and provides them with information on properties over an unlimited location range. Real estate agents are being pushed to advertise more widely on the internet.

11. Need for future work

Further work needs to be undertaken to clarify the residential data collected. Currently, forms request the total agents' fee on sales, for which some have given the fee for their agency only and not the total paid by the vendor. There are also inconsistencies with figures provided for property management fees. Respondents are reporting commissions for rental collection only, rental collection and property maintenance, or a range of commissions for various types of property (e.g. furnished vs. unfurnished property). As long as prices don't change by a large amount between quarters for a given respondent, it is generally assumed that there is consistent reporting and that changes in the numbers (or averaged numbers, if more than one is reported) reflect price movements of the same quality property.

The ABS believes that most agents would be able to supply separate figures for rental collection and property maintenance, since property maintenance is not always offered and depends on the type of client and the contract. Most agents would also be able to supply separate fees for furnished and unfurnished property. This proposition will be further investigated.

12. Conclusion

The real estate index has been established for more than 5 years, and has a large number of respondents. It is a relatively complicated index, making use of CPI series and data from a major private commercial property organisation. The industry is heavily localised and mostly deregulated. The two primary factors affecting real estate agents' fees are the property value and the commission from the vendor. Swings in prices can be expected after the implementation of the TNTS and during the Sydney 2000 Olympic period. Further work needs to be done on more clearly specifying data required on survey forms.