

Guaranteed rent, guaranteed trouble

It is March 1993. The phone rings. You answer it. The voice at the other end says you are invited to attend a free seminar to show you how to repay your home loan years earlier. Of course, you attend.

At the seminar you are introduced to the world of investment and negative gearing. The slick presentation convinces you that property is the way to go. You are shown graphs and percentages. It is too late to invest in Sydney or Melbourne - Queensland is the place to be. Best of all, the taxman will subsidise your investment.

Before you know it, you are on a plane to the Gold Coast. You are whisked away in a limousine to a hotel. You are accompanied at all times, so you don't get lost. A salesperson takes you around to various properties. The last one is no more than a construction site. This is the one that is within your price range and the perfect one

for you, according to your guide. And if you buy today, you will get a free gift.

You are taken to an office to see a financial advisor. He spends hours going through your finances. The property market is booming, he tells you. How would you know, having just flown in from interstate?

Your guide returns, pointing at her watch. Your plane leaves in half an hour and you still have to see the solicitor.

You arrive at the solicitor's office. It's a Sunday, but he does not mind working. It's to help out people like you. The contract is ready to go.

Your name has already been inserted.

All you have to do is sign. Without any explanation of the contract, but of course with some encouragement from your independent solicitor, you sign.

Months after you sign the contract, settlement takes place. You are now the proud owner of a unit of some sort.

Years pass and you decide that it is time to check how your investment is progressing. Or perhaps your financial situation has changed and you need to sell. You expect a healthy return, as promised.

You ring the local real estate agent, and after laughing at ►



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you for five minutes, he tells you that the unit is worth about \$50,000 less than what you paid for it.

The story so far is not a story but fact. It has been happening in Queensland and other places for nearly 10 years, and it is still happening today. I spoke to a lawyer the other day who told me what she does on Sundays. I tried to warn her, but the lure of the money was too much to pass up.

There are variations on the theme. Maybe your seminar offered you the chance to invest by purchasing a unit in a resort run by a big hotel chain. You cannot lose with this one because there is a ten-year rental guarantee. Unbeknownst to you, the owner uses a marketing coordinator, a \$2 company set up for the purpose. The rental guarantee is just a long lease with options for the \$2 company. And, of course, there are no personal guarantees from the directors. An 'independent' solicitor will have been involved in this type of investment also, although you probably did not meet them. They simply did the conveyance on your behalf.

As a consequence of these scams, Queensland now has the *Property Agents and Motor Dealers Act 2000* (Qld). When the Act came in, hundreds of claims were lodged with the relevant tribunal. The idea was that people could make a claim and if the rogue could not pay, the government would. Unfortunately, the number of claims meant few were determined before the Act was retrospectively changed to limit those who could claim to residents rather than investors.

Disgruntled investors had no option but to resort to the traditional courts. To date, only a couple of cases have gone to trial.

The first was *Banks v Copas Newnham*,¹ in the Brisbane District Court. The investor sued the real estate agent and a solicitor for negligence and breaches of the *Trade Practices Act 1974* (Cth). It was one of those '7.5% guaranteed rent' cases. Both the agent and the solicitor were found liable. The agent's appeal was spectacularly dis-

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missed. As for the solicitor, the judge said that it was insufficient to give a general warning. A solicitor had to warn the investor specifically about the tenant and the lease.

A subsequent case was *Walker v Richards*² in the Brisbane District Court. Again, the solicitor was found responsible for failing to advise about the contract and the lease when there was a promise of guaranteed rent. Interestingly, the insurer submitted that the solicitor had been fraudulent in fabricating an exculpatory file note. The judge found that the solicitor had just been negligent. The insurer refused to indemnify anyway, citing the 'reckless indifference' clause of the policy. The standard policy was changed after this case, casting onus on the solicitor to disprove fraud when an insurer alleges it.

The latest successes involve a number of claims against the Cairns Village Resort. There are some 50 claims going through the District Court. Twenty-four were set down for mediation in the space of a week, and they all settled. The rest are proceeding.

The Cairns cases were another example of the guaranteed rent illusion. People were told it was a safe investment with guaranteed rent. What they were not told was that the resort had previously failed and that the vendor was a mortgagee in possession exercising the power of sale. The lease was again with a tin pot company with no backing.

A number of solicitors are being sued, several of whom represented multiple purchasers. The main defence of the solicitors is that they were only hired to do the conveyancing, not to advise on the contract and the lease. There are also reliance arguments suggesting that the plaintiffs would not have listened to the solicitor anyway.

In respect of quantum, the insurers

are arguing that the measure of capital loss is the difference between what the plaintiff paid at the time of the purchase and the actual value at that time. The plaintiff then gets interest on that figure. This follows cases like *Gould v Vaggelas*³ involving fraudulent misrepresentation, and the recent New South Wales Court of Appeal case of *Sydney Harbour Casino Properties v Coluzzi*.⁴

The Queensland cases awarded loss of value as the difference between the purchase and the sale price. The recent property boom has complicated things as defendants argue that had the investor held onto the unit it would now be worth more than the purchase price and, consequently, that there is no loss. It remains to be seen what a court thinks of this argument.

The Australian Competition and Consumer Commission has also stepped into the arena. It brought an action against developers, promoters, financial advisors, solicitors and a bank in the Federal Court.⁵ The facts are remarkably similar to this article's opening scenario.

On 18 December 2003, a judgment was handed down, with the Federal Court recommending that the Law Society investigate the solicitors involved. The court could do no more because the ACCC does not have the power to enforce state fair trading legislation.

The message for solicitors is simple. If the transaction involves a contract and a lease, advise on both and make it clear that the viability of the tenant is important. If the tenant can't pay, the lease is worthless. If you know that people have been told there is guaranteed rent and there is nothing more than a lease, it is your job to tell them. Sure you might not get any further referrals from your local real estate agent, but you will also not go out of business defending lawsuits. **PL**

Endnotes: 1 Unreported 21 September 2001. 2 [2002] QDC 170. 3 (1985) 157 CLR 215. 4 [2002] NSWCA 74. 5 Australian Competition and Consumer Commission v Oceano Commercial [2003] FCA 1516.