

# CORRECTED VERSION

## LAW REFORM COMMITTEE

### **Inquiry into property investment**

Melbourne — 12 November 2007

#### Members

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Mr R. Clark

Mr L. Donnellan

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#### Witness

Mr R. Pepicelli, member, Professional Board, Victorian Division, Australian Property Institute.

**The CHAIR** — Rob Pepicelli, welcome to the hearing of the Committee. The first thing I need to tell you is that any evidence that you give this morning in the half hour we have is subject to the Parliamentary Committees Act and it is subject to privilege. So whatever you say is protected by that legislation and provision, but if you say the same things that are a bit risky outside, then you will not be afforded that privilege. Hansard staff are recording what we say and you will be provided with the transcript of your evidence to make any slight amendments that might need to be made, and you will get that shortly after the hearing.

Thank you for providing copies of the code of ethics and the rules of conduct which we received earlier, and also for the submission that we received only just recently. I think people have been having a bit of a look at that, but we are not across it to the same depth as we are across the documents that you sent earlier on. We have half an hour. Take as much time as you need, 15 minutes or so if you like, to set up and tell us a bit about yourself and your organisation and your organisational views on the terms of reference, and then we will jump in and ask you some questions and have some follow-up discussion.

**Mr PEPICELLI** — If it is okay I will talk to the paper as well, which might help walk you through the key planks of our submission anyway. The Australian Property Institute is probably the peak body representing property professionals in Australia. It is a national organisation, set up with state divisions; there is a national division based in Canberra.

The paper has been prepared in response to the Committee's terms of reference for the inquiry. Really the key plank of the API's view or submission is that we firmly believe that property professionals do need to have the appropriate qualifications, standards and experience to meet the needs of the broader community in this particular asset class. We noted the particular case study in Victoria actually of the disbanding of the valuers via what was the Valuers Qualification Board under the Valuation of Land Act which occurred in the mid-1990s. Victoria is not unique in deregistering valuers, as such, but it is indicative of probably a lessening of the regulations surrounding professionals who give advice. At the end of the day valuation advice is a core of investment advice. We just put that down in our submission to note that it is different in New South Wales and Queensland particularly, where valuers are required to be registered under various state laws there. The last paragraph really just talks about our response. I will just move straight into the structure of the argument. I should mention just for the record as well that I am a member of the Professional Board of the Victorian Division of the API, hence why I am here.

We wanted to distinguish between what constitutes property investment advice. It is very important to articulate that clearly. We have highlighted on page 2 the difference between what we think is property investment advice and what are at the end of the day vendor representations. We want to draw the Committee's attention to its own I suppose publication in relation to what the Committee defines as property investment advice. We actually disagree with some of the principles associated with that. If I can just read from your own explanation:

The Committee defined property investment advice as including advertising, marketing, representations and advice.

We actually think the first three — advertising, marketing and representations — do not constitute property investment advice. We want to make that point very clear. In fact, that is the key plank and that is where there is a lot of confusion in society and the community generally. There are a lot of people who, almost under the guise of investment advisers, are not actually independent investment advisers. They either have vested interests in what they are doing; they are seeking out probably a property transaction of some sort; and it is probably fair to say their 'advice' or information is not independent. We wanted to make that distinction very clear, and we have done so on page 2. We think it is a really important distinction for the Committee.

We also wanted to highlight that this submission relates to real property not to securitised property. We think property that is wrapped up in products is quite well, I suppose, regulated by ASIC, under the AFSL (Australian financial services licensing) requirements. We wanted to highlight that this particular submission relates to real property advice. It is fair to say that real property advice can actually be given in respect of property that is contained within a product that is governed by ASIC. That is another layer of advice that needs to be provided to members of the general public so they can clearly understand what they are getting themselves into if they are making investments in products as such, so the bottom of page 2 really just highlights that distinction.

We also wanted to highlight the distinction between what we regard as investment advice and other advice that you can receive in the property industry. The table really highlights the various stages of what we would broadly regard as the investment process in acquiring, holding and disposing of any interest in real property or any other investment as such.

The thing to highlight there is in the second column where 'Service available' is highlighted, anything to do with valuation or investment analysis as such, the key types of advisers that would provide that sort of advice are actually certified practising valuers who are required to be members of the Australian Property Institute. Obviously with the deregulation of the valuation industry in Victoria the API has had to step up to the mark, so to speak, and really provide a layer of integrity and professionalism for that particular sector. But it is worth highlighting that table and really showing that this particular paper relates to the investment advice component of the broad myriad of advice that you can receive in respect of property. It does not cover lawyers or planners or what have you, who are often dictated to and come under their own associations and laws as well.

Page 4 is really there to highlight under the heading 'Why is regulation of property so important' the exposure that the broader community and the economy has to property as an asset class. It is probably the most highly emotive asset class, particularly in Australia but generally across the world, we think. Because it is so tangible it is something that a lot of mum and dad investors feel that they should move into to ensure their financial future. Again, we really want to highlight the fact that it is a large asset class in society. Based on 2004 numbers, if you include various syndicates and what have you, it represented \$249 billion of equity, which is obviously very significant.

In the second last paragraph under point 2 on page 4 we did want to highlight the fact that a lot of investment products that are wrapped around direct property or real property can often be juiced up, for want of a better term, to try to get the headline returns up to a level that almost catches people's attention. We think, again, a requirement by the marketers or managers of those products to have as part of their pack advice showing the real property returns over and above the returns being sort of juiced up through either higher gearing or what have you at the headline would actually give another layer of information to mum and dad investors out there. For example, if they had an opportunity to invest in a product that had a headline return of 8 per cent, if they knew that the underlying property return was only 6 per cent and they knew that a large percentage — 33-odd per cent — of the 8 per cent was being juiced up by various financial engineering methods that actually increased the risk of financial loss. We think it would be a really informative piece of evidence, I guess, for mum and dad investors to know the difference, and that is not a requirement of marketers or managers of those products.

Whether mum and dad investors go and get their own advice in that respect is probably going to be a difficult thing to do, because to get all the information to provide that advice for that product would be very difficult. It should be a requirement on the manager or the promoter of that product to provide that advice through an independent noteworthy property adviser, and we cannot stress enough the importance of 'independent'.

We then start to move into wrapping up our submission: 'Key issues for the property investment advisory industry', as we call it. There is probably inadequate regulation governing the real property investment industry. We definitely think there is confusion over who is appropriately qualified to give advice in respect of real property. We think that people would go to their local real estate agent, their accountant or their financial planner thinking that those people just should know everything about real property, when really they are not qualified at all to know. They probably have a very good broad understanding of it, but they are not — and I stress they are not — experts in direct property unless they have done the requisite courses and have the requisite experience.

We think therefore that there is this almost subconscious view that real property investment advice is readily available, but that is not true. We think the reason why there are so many issues in this particular industry is because of this confusion over who is appropriately qualified to give this independent property advice.

Paragraph (c) again really talks about financial planners. I note that in the weekend *Australian Financial Review* there are some big articles about ASIC taking action against Westpoint directors, financial planners and what have you. We think that is again very good evidence of, at the end of the day, a property development company which was really right up the risk curve. Clearly what we are talking about here is being played out in the public realm right now. We think that is a good thing to note in respect of this inquiry.

We think vendor marketing, at the end of the day, is what is often dressed up as independent property advice. There has been some talk that developers or vendors need to be licensed themselves. We do not necessarily think we need to go to that extreme. We do think, though, that developers should not be able to charge parties interested in their products fees for attending seminars and what have you. It is again conjuring up this, 'You are being educated here. You need to pay for the privilege of being educated'. It is just playing on the emotive heartstrings of these unsuspecting investors at the end of the day.

The concluding messages from our submission are that real property investment advice should only be provided by independent and appropriately qualified and experienced people who deal with this asset class on a regular basis. We cannot stress that enough. We do think that because of the exposure of the Australian community, and more broadly the economy, to this asset class that it is a really important issue for the community. We also think the bull market of the last 15 years has hidden a lot of — —

**Mr FOLEY** — Sins.

**Mr PEPICELLI** — Misgivings, sins. That is what we used; we did say sins. We think we are now moving into a much different part of the investment cycle and potentially there could be a lot more blood on the streets if the investment cycle does turn against some of these products. We think that regulation and/or licensing of real property investment advisers will provide clarity for the public. We think that is a really, really important aspect of it.

As a member of the API we think we are the pre-eminent body to be able to work with the government to ensure the adequate regulation of licensing. We know that one is a statutory requirement, but we think it is in the government's interest to work with the industry, particularly independent bodies. We went through a number of reasons why we think the API is at the forefront here to work with the government on this particular issue. We have very stringent requirements for associate membership and it is all covered off in our by-laws; there is a lot of information on our website, if you are interested in accessing it. We have very high standards in governance. There is an ongoing professional development requirement for our members like most professional associations. We certainly have high ethical standards. We encourage and assist our members in taking up professional indemnity insurance, which is obviously an important safety mechanism for the public. The API is independent, which is a critical plank of our submission. We hope that gives a good wrap-up of the paper.

**The CHAIR** — Thank you very much, Rob. Just to go back to what you said at the very beginning about the breadth of the canvas that we are looking at, I just remind you that in the terms of reference it says quite clearly that we are to look at property investment but also we are being asked to look at property marketeers. So the areas that you mentioned as not being part of property investment actually fall under the property marketeers.

**Mr PEPICELLI** — Yes, they do. I suppose what we just wanted to make clear is that there is a difference between the two. We are very happy that your terms of reference cover both, but the term 'property investment advice' we do not think should cover marketeering. That is just our view.

**The CHAIR** — All right. You attached a paper, the *Overpricing of Property Through Deceptive Marketing Practices*, which was put together in 2003. You mentioned just before that a multitude of sins have been covered by the current bull market and wait for what happens when there is a downturn. Could you, just by opening up with the questions, talk to us about what you think has changed since 2003 to now, 2007.

**Mr PEPICELLI** — Probably not a lot in relation to the marketeering and spruiking that is going on. This paper was obviously prepared to bring to the attention of the public that when buying property and relying on vendor representations that you are probably paying an inflated price for a particular property. This paper really tried to explain why you are probably paying an inflated price. We think that that principle and those practices are still as evident as they were in 2003.

**Mr DONNELLAN** — I could not agree with you more. In terms of people who advise on property, who should not advise on property, you are right, because I can remember accountants love cash so they always invest in restaurants. A restaurant might be a good business or it might be a terrible retail investment, but you know what I mean, that is the focus of people who come from different industries advising on property. You mentioned in section 2 and onto 3 that apart from putting market rentals which are above marketing to boost the value of a property and then putting an 8 per cent return in, are you seeing a lot of things like management fees being thrown in? I used to work at a financial planning firm and we would set up a trust and there would be 6 per cent going out and financial management fees on top of that, but you would still have an 8 per cent return. Are you still seeing a lot of that?

**Mr PEPICELLI** — In a large number of syndicates that are being set up you are right. Unfortunately \$1 invested in a syndicate by an investor is worth 95 cents almost immediately the day the \$1 is invested, so the properties have to work that much harder just to get back to par before you can actually start deriving a positive return from the property. So long as fees are disclosed clearly and it is articulated very simply for investors that

they will literally lose a part of their capital right up front, I am not sure that is really the issue. We think it is the added layer of, call it, gilding the lily that occurs even within those investments — and that is, whilst you might lose your 5 per cent up front potentially in fees, that could pale into insignificance if the forecast for returns had been embellished by 10 to 15 per cent per annum. Whilst the property market might move up by 4 per cent per annum broadly speaking, obviously it will move through a cycle, if that particular forecast has got 4.5 per cent or something like that, it is going to be difficult for a mum and dad investor there and then to know that 4.5 per cent — it seems okay; it seems reasonable — yet the compounding effect of that extra half a per cent in that forecast really increases that headline expected return which, if it does not come through, clearly that is when investors are going to start losing money.

**Mr DONNELLAN** — So really it is the projections you are more concerned about?

**Mr PEPICELLI** — We do think projections are a big part.

**Mr DONNELLAN** — So it is not the management fees so much?

**Mr PEPICELLI** — We think it is both. We think you should pay for good management. So long as the manager has a track record and can demonstrate that they are experts in their field, at the end of the day we think the market will sort out the good managers and the bad managers. There are some very good managers in retail property. Westfield is a fantastic manager and its fees are probably 50 per cent higher than the next rung down. But look at them; they have almost conquered the world. If you have invested in Westfield, you have done very well. You do not mind that, so long as they can be — —

**Mr DONNELLAN** — So are valuers being put under pressure per se — are they called valuers any more?

**Mr PEPICELLI** — They are called valuers.

**Mr DONNELLAN** — I am not being silly, but are there pressures on valuers to make projections which are higher than what would be reasonable based on historical data?

**Mr PEPICELLI** — It is a good question. I think there is, by some groups, pressure put on valuers, and it is up to us as an institute, and it is up to the profession to ensure that our members are adequately and experienced to be able to deal with that.

**The CHAIR** — We have about 7 minutes left and are running on a pretty tight schedule today.

**Mr PEPICELLI** — I understand.

**Mr BROOKS** — I have a question about the organisation. There are two questions, which I can split into two parts. One is, more broadly, how do you think the Victorian regulatory framework compares to those in other states, particularly Queensland, with the specific rules there? More specifically, does your organisation get complaints against some of your members? And what is the process there? Can you give us a broad idea of how many complaints there are and of their outcome?

**Mr PEPICELLI** — Okay. Firstly, I touched on the regulation. In respect of valuers who we do believe provide independent property financial advice, New South Wales and Queensland do have registrations, so we think they are more regulated and we think that is a good thing for the people of those particular states. In relation to complaints, there is a very detailed complaints procedure that we have as part of our by-laws. I will not bore you with it, but essentially a complaint can obviously be made against a member, and there is a process whereby a complaints adviser is appointed who advises a committee that has been set up as part of the framework for the organisation.

Essentially a complaint can be made for a breach of the constitution, by-laws, a code of ethics, rules of conduct and practice standards. That is usually the basis for a complaint being made against a member of the institute. Essentially the complaints adviser prepares a report for the committee, and then it goes through a whole process. It is quite a lengthy process. There is the rights of appeal, appeal from members, and it then goes to an external committee if it cannot be dealt with within the organisation. The external committee obviously has to be comprised of independent people, one of whom has to be from the legal profession.

So there is a very comprehensive complaints procedure in our by-laws. In terms of some statistics, I probably do not have those on hand to give you. I am happy to forward those through to Kerryn afterwards. But in light of the recent market we have been in I think a lot of people have probably been generally happy with their advice because the next day the market has moved ahead. So in the last 15 years there have not been as many complaints as there would have been under less buoyant economic conditions.

**The CHAIR** — To give everyone an update, Kerryn tells me that the next witness has cancelled, so we have a bit of time. But we also have to be respectful of Robert's time, so we can go a little bit over since we started late. As we are moving across to Martin for any questions, I will interpose and ask you about the code of ethics and rules of conduct which relate to that. If a breach is found, how do you deal with that? Presume you have had the complaint, you have heard it, and you have found that the complaint stands up — how do you deal with the breach?

**Mr FOLEY** — And have you heard it?

**Mr PEPICELLI** — Sanctions can be imposed on the member, to the point where a member can be delisted from the Institute under circumstances that warrant that, obviously having gone through the whole process. I am not sure if you are looking for anything more specific there?

**The CHAIR** — No, just so we have that. I suppose Martin's question is the test one: have you done it?

**Mr PEPICELLI** — Have we actually delisted members?

**The CHAIR** — Yes.

**Mr PEPICELLI** — Again I would probably need to get back to you with some stats on that. I am happy to send that through to Kerryn.

**The CHAIR** — Yes, good.

**Mr PEPICELLI** — I am aware of some cases where members have been deregistered as such, or delisted. I do not think it is that prevalent, to be honest, though.

**The CHAIR** — No, sure.

**Mr PEPICELLI** — I think it is one of those things. I am sure there are complaints levelled against members because people feel like the valuation has not come up — for example, if it is on a valuation — to the level they expected and that somehow that warrants complaint. It is a bit of payback.

**Mr FOLEY** — It is emotional.

**Mr PEPICELLI** — It is emotional, but clearly as long as the valuer has followed the rules, so to speak, of engagement then it does not really go any further. But I will send through some specific stats on that.

**The CHAIR** — Okay; that would be good.

**Mr FOLEY** — Thanks, Chair. I have a few questions, and I will whiz through them. I take it that you are essentially proposing a combination of a kind of co-regulation between the states and the institute as, the peak body, because of all the good reasons you have outlined. My questions go to: how do you see that dealing with compliance and cost issues for the broader people, both your own members and those covered by any envisaged co-regulation who were not your members? And is this comparable to the Queensland and New South Wales model? If it is, where is the evidence that that co-regulation has delivered a better outcome in Queensland and New South Wales? Because I think there is some evidence that for market reasons perhaps Queensland, with at least some regulation model, has not been particularly successful.

**Mr PEPICELLI** — No.

**Mr FOLEY** — And finally, you are urging Victoria to raise the bar and be a standard bearer; where do you see the debate on state versus Commonwealth regulation in this sector, noting the Senate report from a couple of years ago on this issue?

**Mr PEPICELLI** — In respect of co-regulation I suppose we do not have the silver bullet to know exactly what the right method is. We would like this to be almost the first stage of another series of engagement that we can have with the government on this particular issue, and we would be more than happy to set up a working party — if the government desires that it wants to go down this path — to work with the government on how that should work. We are not necessarily saying that it should be ‘Let’s go back to the past and set up the Valuers Qualification Board and what have you as such again’. We think there probably is a better way of doing it, which is more the co-regulation. Our options are open in relation to that. We would like to be quite flexible with working with the government. We do think it is important, though, that the government does back a professional organisation that can represent the members who provide independent property advice. We think that that gives it the legitimacy that is required by the public. So we think that something needs to be done. Because if it has the Victorian Government’s backing, it carries weight with the mums and dads out there, and that is really important.

In terms of the evidence as to whether it is worse here in Victoria because we have not had, for example, valuers registered and what have you, I think the API has probably stepped up to the mark very well in relation to what it does. It provides a lot of information to its members about topical issues and it very proactive in its committee structures and board structures to ensure that its membership is very up to date with what is going on in the world, so to speak — in the financial investment world. I think, though, that there is still a missing link in Victoria, which is that anyone can call themselves a valuer as such. If you are an unsuspecting investor and you come across someone who is apparently dressed appropriately, sounds as though they know what they are talking about and says that they are a valuer, then suddenly that carries a lot of weight with that particular person. If there is a law that says you cannot call yourself a valuer unless you are either registered or licensed — or whatever the case might end up being — then clearly that is deceptive conduct. That would be covered by the relevant acts relating to misleading and deceptive conduct but we think it would just naturally increase the height of the bar, because of that reason. You cannot then have people promoting themselves as something that they are not.

Queensland is a good example — and you raised that. I think unfortunately for Queensland, it is the high-profile state: it has all the high-rise buildings, it has the beaches. The landscape is set beautifully for people to be taken advantage of there because of everything that Queensland offers in terms of the lifestyle and what have you. I do not think it is an issue of the valuers, who are required to be registered in Queensland. They have a high degree of regulation, yet it is a state that has a lot of these schemes going on. We think that it is because there is no requirement on those marketeers of those schemes to advise the potential investors to seek independent advice. We think that that is the missing link. It is not whether you have registration or not; it is that there is no requirement on those marketeers to actually advise. It is a bit like the health hazards on the packets of cigarettes.

I am sure that cigarette companies do not actually want to have to put on those pictures of what is going on, but by regulation they are forced to do it. It is a bit like if there was a health warning on this product that had a picture of you in five years, with no house. I mean, it is a bit dramatic, but it is that type of notion. Suddenly these people would not get away with what they currently get away with. It is that type of notion that we are talking about. Then what would happen is the mum and dad investor, or the public, will know where to go to seek that independent advice. That is the process that we seek.

**Mr FOLEY** — What do you think that would do to compliance costs for your members and the broader sector?

**Mr PEPICELLI** — Registration fees and what have you were not that significant. I remember when I was working as a valuer when registration was there I went through the course and was registered with the Valuers Qualification Board and what have you. The costs were not an impost at all to valuers.

**Mr FOLEY** — So the sector would absorb them?

**Mr PEPICELLI** — I think the sector would absorb them. I think that in the scheme of things there is such a dearth of professionals at the moment that that would be a small cost, because all those costs would naturally be passed on to the end users, obviously. They would not inhibit and would not be an impost on business, in our view.

On the state versus Commonwealth, I think a national approach would be great. I think there are a lot of things that would work better. Property is a borderless asset class now. In fact, even more so — it is international. So if it could be national, like ASIC is in relation to governing financial products, we think that would be good. But we do think that there would be a requirement for the states, because of the particular legislation relating to real property,

which is very state based, there would need to be an overlay and a real dovetailing to occur. I am not sure if that is asking for too much, for the Commonwealth and the states to work like that. but I am sure there are plenty of examples where they do effectively. So that would be the ideal scenario.

**Mr O'DONOHUE** — I note your comments that the last 15 years economic expansion has meant that many advisers have got away with perhaps in other times might be artificial expectations. How, though, from a market perspective do you really control that? No-one can foresee the market and tell what the market is going to do, and what may be perceived as a conservative growth rate now may in five years time be high or artificially high.

**Mr PEPICELLI** — You are right. All we are saying is that it is like the lesser of two evils. Would you rather receive advice from someone who, through the requirements of their institute or regulation, is forced into educating themselves and keeping up to date with what is going on and how best to read the signals about the broader economy and what have you, or would you rather receive advice from someone who can sit at home and just read the *Australian Financial Review* and feel that they are on top of things? I think you hit the nail on the head. No-one has the crystal ball or the magic, but I think it is the ability to warn people if you do feel that things are turning, through your own experience and education. It might be enough to save them some money. It might mean that you are wrong and they have missed a great opportunity as well, but that is what it is all about. It is about educated risks.

**Mr O'DONOHUE** — How much of the market are we talking about that does not see a recognised valuer? If you go to a bank or to a lending institution of repute, the first thing they say is, 'Get an independent valuation'. What sort of percentage of the market are we talking about?

**Mr PEPICELLI** — The banks really just have an internal process where in lending money on any property they tick the box and say, 'Let's just get a valuation done'. What we are talking about here is specific property investment advice. Half the people who apply for loans do not even see the valuations on the property; they are not really the recipient of that advice. It is really the banks covering their own — they have their own prudential requirements obviously, and as I say, they are just ticking the box.

Unfortunately, I think that is a part of the industry that probably does not draw on the higher standards that we would like generally across the board. We think that because the banks force fees down through their requirements, at the end of the day you get what you pay for. There is even a sector of the valuation industry that we think can be caught with this tick-and-flick kerbside valuation. There should be no kerbside valuations. At the end of the day, unless it is a block of land there should be no kerbside valuations. We do not encourage them; in fact we strongly discourage them, but if you are only getting \$100 to do a valuation and you are in your car and you have 10 to do in a day, then some standards are dropped.

It is up to us to ensure that we do not drop our standards. In fact, there has been a lot of debate within the professional board in the Victorian division. There has been some push by our counterparts up north in the New South Wales division almost to allow the standard of education to drop to become a member of the institute because there are some TAFE courses versus degree courses up in New South Wales that you can do to become a residential valuer.

Basically it is these kids who know no better, who can apparently earn some pretty good money by doing a TAFE course, jumping in their car, doing a one sheet tick-and-flick residential valuation, and they feel they have a fulfilling profession. We know through experience that they will realise that too late, and they will have missed the boat so to speak. For our membership it is up to us to ensure that they are aware that that is not an appropriate thing to do. We have those issues.

**The CHAIR** — Are you all right for time?

**Mr PEPICELLI** — Yes.

**Mr O'DONOHUE** — Of your members, what proportion would be valuers and what would be from other professions?

**Mr PEPICELLI** — When I first joined it was the Australian Institute of Valuers, then it was the Australian Institute of Valuers and Land Economists. Now it is the Australian Property Institute. Valuers form the

vast majority of our membership, probably around 80 per cent. There are other members, though, who are land economists or financial investment advisers or whoever. Anyone who provides advice in relation to property can become a member, but of course, we have various stages of membership.

**The CHAIR** — Thank you very much for staying a bit longer.

**Mr PEPICELLI** — No problems. It was a pleasure.

**The CHAIR** — As I said earlier, you will receive a copy of the transcript to which you can make minor amendments, but not substantial ones. I am sure Kerryn and Susan will be in contact with you for some additional material.

**Mr PEPICELLI** — Yes. I will send a bit more information through.

**The CHAIR** — If you are happy to keep the conversation open?

**Mr PEPICELLI** — Definitely. I am more than happy, and the offer is open if you would like to follow up with any matter.

**Witness withdrew.**