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LAW REFORM COMMITTEE

Inquiry into property investment

Melbourne — 15 October 2007

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Mr M. Armstrong, Director, and

Mr D. Johnston, Director, Property Planning Australia.

The CHAIR — We will make a start. We have a subcommittee here, so we are able to begin. Welcome to Mark Armstrong and David Johnston from Property Planning Australia. We thank you very much for coming in and thank you for your submission as well, which we received. I am required to tell you that anything you say in this forum is protected by parliamentary privilege, which basically means you cannot be sued for what you say, but if you say the same kinds of things outside, then you are on your own. Hansard reporters will be recording the discussion that we have, and you will be provided with a copy of that transcript later on. You can make adjustments to it where it is inaccurate or where you do not think it reflects what you said, but obviously you cannot change the substance of it. The way we generally run these discussions is we give you 15 minutes or so to tell us about yourselves and about the work that you do and to speak to your submission, obviously, and then we will jump in and ask what questions we have, and we will just see how we travel after that. Over to you.

Mr ARMSTRONG — I will start the ball rolling just to give you a background on our business. Property Planning Australia focuses on completely independent property advice and also home loan advice. You will probably notice me doing most of the talking here this morning, given that my area of expertise is the property market. I have been analysing the property market since I was 17 years old. I am 36 in a couple of weeks. I am a qualified accountant — a CPA. I am also a licensed real estate agent. One of the reasons that I pursued the avenue of obtaining a real estate agent's qualification was that that was the only qualification I needed to give investment advice. It caused a level of frustration. I thought there should have been other avenues, and that is why I pursued the accounting avenue instead.

David's role is as a professional in the finance industry. He heads up the finance arm of our business and is very active in the legislation surrounding independent finance advice and the issues surrounding those things at the moment.

What we see is that there is a clear gap in legislation. We see that the government actively encourages people to invest to self-fund their retirement, which we agree with. We think that is a great idea, and we think that is needed. But when it comes to property, property is thrown into a similar bag as a piggy bank — it is largely unregulated, and it is a massive problem. It means that people do not have an avenue to pursue to go and get independent and transparent advice before they act in the property market.

We identified the main reason for this as being that property is not considered a financial product, unlike the share market, unlike insurance and unlike a range of other things. Property falls outside the idea of being considered a financial product, and the reason, I think — as we all probably know here — is that there is no separation of ownership. When you buy a share in a company there is a separation of ownership, so that is one of the definitions for something to be considered a financial product. With direct property, there is no separation of ownership, and then it is not considered a financial product. We think that is ludicrous, really. The fact that there is no separation of ownership still does not mean that people do not rely on information that they are given to make informed decisions about their investment future.

We see that there is a yawning gap within the legislation, and there are two areas that we really feel need to be addressed. The first one is the legislation. Property needs to be considered a financial product. Members of the general public perceive property as a financial product: they use it as a financial product, they use it to invest, and they use it to fund their retirement. The only group that does not see property as a financial product is the government — that is, our legislators. I think that is the first point — that we need to acknowledge that it should be a financial product. I think from there we need to back that up with education — education focused on building an industry where people are able to provide independent and transparent property advice. If we look at the words 'property investment advice', there is a danger of placing too much emphasis on the word 'property' and not enough emphasis on the word 'investment'.

Property in isolation is just an asset class. Investment relates to a whole range of things around an asset class. It relates to things like finance in an asset class, it relates to asset protection issues, it relates to ownership structures, it relates to tax issues, it relates to long-term planning issues and retirement issues — a whole range of things. I just raise that point because I think the natural step is to ask, 'Who is going to oversee and who is going to regulate an industry that offers independent property investment advice?'.

I would like to just flip it and have a look at what happened in the financial planning industry. I think we can look at the financial planning industry and acknowledge that there were some right decisions made, but also look at it and acknowledge that there were some wrong decisions made. We feel that one of the key wrong decisions made was that there was not a separation out of someone selling the product — or someone broking, essentially — and someone providing independent advice.

The financial planning industry was developed essentially from insurance sales, and it evolved, in a way, from product sales. So there are people out there who call themselves advisers, but in actual fact all they are doing is selling a product, and they have a vested interest in selling that product. We touched on something before we started about Westpoint and ACR. There is a clear conflict of interest — someone providing advice to invest in a scheme or an investment product being paid a commission by someone else. That is tainted advice.

If we relate that to the property industry, I think one of the clear mistakes that we have the potential to make is to view this as a real estate issue. A real estate agent, a property developer or someone who sells property, that is their job — to sell property. They make money off the transaction of selling a property. Someone who is there to give advice is there to provide advice not tainted by a vested interest lying behind the scenes. Advice should not be tainted by the thought, 'I need to provide this advice because I'm going to get paid by this person — a third-party person — to get that advice'. We call that advice in a vacuum. It is advice to get some party from point A to point B, and to act at point B so that that person can get paid by a third party. It is not advice. It is compromised advice, so we feel that we really need to look at an industry body that is a professional industry body that is able to provide completely independent and transparent advice and not make the same mistakes that the financial planning industry has made.

Mrs MADDIGAN — That would be very hard to do, though, would it not — if I may interrupt rudely, Chair? How do you stop real estate agents giving people advice on what properties they think they should buy? It would be totally impossible to do, would it not?

Mr ARMSTRONG — I agree. I think it is totally impossible to stop a real estate agent giving advice, but I am not sure that that is where the problem lies. I think it is giving an avenue to the general public, to the community, to know that, 'Okay, I don't have to rely on that real estate agent's advice. I have this avenue to pursue. I can rely on it if I choose to, but I have an option to go to this independent person who is able to advise me in a transparent way'. At this stage we do not have that avenue for them to explore. But I agree with you; I think real estate agents will always be out there saying 'This is a great investment and you should buy this product'. It is where I touched on the second part which is about education. People need to be aware. They need to be educated that there is an avenue they can explore to be provided with independent and transparent advice. The professional industry that provides that service at the moment is accountants. They provide advice purely focused on the interests of their clients. They are not getting third-party commissions behind the scenes.

The CHAIR — Thank you very much for that. Just to start off, you have given us a very clear structural breakdown of where different bits sit, but I wonder if you can just go back a bit and paint a bit of a picture for us about the kinds of problems that the present situation has on the ground — your experience of that?

Mr ARMSTRONG — I think the present problem is vested interests. People are advising the community to act and to purchase products that are not necessarily right for their individual circumstances; that are right for the circumstances of the person advising them to buy those products. I feel that one of the great things about the financial planning industry is one of its governing laws which is 'know your client'. Understand your client and know what it is they are trying to achieve; know what is their ability to take on board risk; their time frame for investment; whether they are looking for capital appreciation, whether they are looking for income, and really getting an understanding of the individual, and then advise them accordingly.

The massive problem we have is that we have education in a vacuum again. We have very narrow tunnels of education from property spruikers who get people in, educate them about things like depreciation benefits or rental guarantees or tax benefits, and a range of things that really educate them to get them from point A to act on a product at point B, so there is no emphasis on the individual themselves. There is no emphasis on finding out about what the individual needs to achieve their objectives.

The CHAIR — Sorry to interrupt. I understand that; I am pretty clear about that, but do you come into contact — or as I said can you paint a picture — of how it impacts on individual people? You talk about people brought in — —

Mr ARMSTRONG — Yes.

The CHAIR — Who are not in a position to be able to make discriminations around the advice that is being tendered to them. Who are those people and what happens to them?

Mr ARMSTRONG — Generally at the moment those people are the mums and dads investors out there.

The CHAIR — Okay.

Mr ARMSTRONG — What happens to them is that they put themselves in extremely risk positions — extremely risky positions.

The CHAIR — Why do they do that?

Mr ARMSTRONG — Why do they do that?

The CHAIR — Yes. What is it that motivates them to choose how they invest?

Mr ARMSTRONG — It is to attain financial security in retirement. Their motivation is to achieve the goal that we are encouraged to achieve, and that is to achieve financial security in retirement, to build up a nest egg and to start building now so we can achieve that into the future, so we can retire and have the life that in this country we all feel entitled to, and we should feel entitled to. But what they do not understand is the risks they place themselves in.

We have clients who come to us who carry property portfolios worth $1 million, and on that portfolio they carry debt of $950 000. When we say to them, 'That is a very risky position' their faces go blank. They think, 'What do you mean? I have a $1 million portfolio'. We say, 'No, you do not. You have $50 000 worth of equity. You have a $950 000 debt'. Now there are people out there who advise people to build a portfolio by buying 10, 15 or 20 properties. They say, 'You can have a $1 million portfolio'. You can read all the advertising out there and all the stories in — I guess — the industry magazines including *Australian Property Investor* and those sorts of magazines that all talk about all these great scenarios of people having a $1 million, $2 million and $3 million property investment portfolio. What they never talk about is how much debt they are carrying against that portfolio and what their real position is. I think the problem is that people are just now aware of the risks they are placing themselves in. It is a great strategy from a marketer's point of view to encourage someone to build a portfolio of 10, 15 or 20 properties. That is 10, 15 or 20 transactions which is 10, 15 or 20 commissions they are receiving. There is no vested interest in explaining to those people the risk that they place themselves in, and the community is just not aware of the risks that they place themselves in.

Mr CLARK — It seems to me we all share the common ultimate objective of having honest and competent services provided to the public. It seems to me the dilemma in this area is where you draw the boundary line, or how you define the boundary. Just one thing I would like to probe with you is how you draw the line between the provision of independent advice, which is obviously your speciality, and the sort of incidental advice that Mrs Maddigan referred to earlier of an agent providing advice in the sense of when a consumer says, 'I want a three-bedroom home. What have you got on your books?'. How would you draw that boundary and how would you differentiate the regulation between those that you would classify as advice providers and those who give advice incidental to other services?

Mr ARMSTRONG — I think the first thing to acknowledge is that within the real estate industry we have two clear industries. One is designed around selling and making it quite clear that if someone is a real estate agent and their job is to sell then the community needs to be aware that that person's job is to sell that product. Their job is not to provide advice on the product. The real estate agent's client is not the person that they are selling the product to. There is a perception in the marketplace that agents are there to help the purchaser buy. An agent's job is to help a vendor sell. It is a clearly different industry.

People who are purchasing need to be aware clearly that the advice they are receiving from the person who is selling the product is in the interest of the vendor, not in their interest. We have to break down the industry. We have to have two clearly defined industries and the community needs to be aware that there are two clearly defined industries, and know on which side of the industry they sit.

The CHAIR — Does that mean that if you are selling your house and a real estate agent is handling it for you, and then you ask them a property advice question, they are allowed to answer it, or do they say, 'That is not my department. Go somewhere else'?

Mr ARMSTRONG — I think they clearly have to qualify that that is not their department. It is not their job to say, 'This is a good investment'. It is not their job to say, 'This is right for you' because you cannot tell someone that this is the right product for them if you do not know anything about that person. It falls down on the fundamental principle of know your client. That is an important principle. I cannot say to anyone that you should buy this product or that product or another product if I do not know what it is you are trying to achieve. I cannot sell you a pair of shoes until I know your shoe size. You must know what it is they are trying to achieve.

Mrs MADDIGAN — We normally put mobile phones in a jug of water when they go off!

Mr ARMSTRONG — I cannot advise someone until I know what it is they are trying to achieve. So a real estate agent who has someone walk up to the door who says to them, 'We feel this is a great investment for you' — on what grounds can they say that? They cannot say that if they do not know what that person is trying to achieve. Is that person looking for a growth strategy, to generate cash flow, to invest for the next 1, 2, 5, 10, 20 years? Are they already geared at 97 per cent or at 15 per cent? What do they know about the client to be able to advise that client in any way, shape or form? They have absolutely no right to tell someone they should do something unless they have a clear understanding of that client.

Mr CLARK — To follow up, you seem to be drawing the boundary line there by saying people are prohibited from giving advice unless they are acting as the adviser of, and in the interests of, the person to whom they are giving the advice. In a previous part of your answer you alluded to the other possible way of regulating this area, which is to force anybody who is acting in someone else's interests to disclose that. So in other words, if you go to an estate agent and say, ' I am looking for a three-bedroom home', the agent can say, 'Well, as you know, I am acting for the vendor, but these are the three-bedroom homes we have got on the market and maybe this one would suit you'. In other words it is a disclosure rather than a prohibition. Do you have any views as to which is the better approach?

Mr ARMSTRONG — In that example, if we are talking about a three-bedroom home, we are not giving investment advice. We are selling a product. To bring it back to the shoe example — if you're looking for brown shoes, well, here are some brown shoes. We are not saying those shoes will go with the suit you are planning to wear on Saturday night. We are just simply selling a product which meets the requirements they have stipulated. It comes back to — know your client. The client has said, ' I want a three-bedroom house'. The agent could say, 'I know that about you. Here are the properties that have three bedrooms that may suit your needs'.

Mr CLARK — Sure. That is another boundary issue between investment purchase of property and owner-occupier purchase of property, but what if a customer says, 'I am looking for a flat that will give me a rental yield of at least 5 per cent'? The agent may then say, 'This flat is selling for such-and-such a price. This is the gross rental yield so this meets your needs'. The same issue arises. If you are going to start prohibiting agents from saying things to potential purchasers, where do you draw the line in terms of what you prohibit them saying?

Mr ARMSTRONG — I think we need to draw the line on them making a recommendation that a person should act and purchase a property. That is where we need to draw the line. I think a real estate agent can clearly say, 'Here is an apartment that is currently let for $200 a week, which represents a 4 per cent return'. That is a factual piece of information that the real estate agent has. That is fine. We need to draw the line at that point where the real estate agent says, 'We think that is a great investment for you. You should be buying this investment' because they do not know that. They do not know that about the client. They can give factual advice: it is a three-bedroom apartment that is currently let for $200 a week. That is factual information that can be substantiated. That is fine. That is a real estate agent's job to do that. But once they cross over that line and start making recommendations on, 'We feel this is the right investment for you', they have no right to do that because they do not know that is the right investment.

Mrs MADDIGAN — In relation to people who are buying property investment, in your experience of those who have finally rolled up before you — this is a generalisation, but just from your experience — would they normally make a property investment just based on their own knowledge of stuff they might read in *Personal*

Investment, or do most of them do it through an accountant, do you think? Perhaps the accountant who does their tax or some general accountant?

Mr ARMSTRONG — What we see is that most people make an investment decision out of frustration and out of the perception in the marketplace that all property works in the same way: just get your foot in the door and you will be right. They often make decisions out of confusion and do not make informed decisions at all. I can tell you that when we speak to clients and we ask the question, 'Why did you buy that product?' the common answer that we get without a doubt is, 'I was sick and tired of looking'.

Mrs MADDIGAN — That is understandable to anyone who has ever bought a house.

The CHAIR — Buy the product or buy the property?

Mr ARMSTRONG — Sorry, why did you buy that property? Because I was sick of looking and I had to make a decision. There is so much conflicting information out there. There is an amazing amount of confusion in the marketplace, and that confusion causes frustration and that frustration means they just act and in many situations make mistakes. I used the cricket analogy yesterday saying that if a batsman is frustrated, that is when he makes a mistake. We see that happening in the community in the property industry. People get frustrated and that is when they make mistakes and act in irrational ways.

Mrs MADDIGAN — To follow up on that, if people are seeking investment advice from an accountant, would you say that accountants in their normal training have had enough training that enables them to give professional property advice?

Mr ARMSTRONG — No, I do not. I do not think there is an education platform in place at the moment to educate accountants. The most important thing we need to educate accountants or anyone who is going to give this advice on is to understand the dynamics of the property market and that not all property works in the same way. We use an example of two properties that are side by side in a street in Prahran: one doubled in value in seven years and one grew by less than 10 per cent in seven years. Getting an understanding of why those things happen — there is no educational avenue to get that out there at this stage. As I said, I am a licensed real estate agent — often I say, ' I hate to admit that'.

Mrs MADDIGAN — We quite like estate agents because they are lower on the scale of disliked people than politicians! We think real estate agents are okay.

The CHAIR — Judy, I do not think that was necessary.

Mr ARMSTRONG — One of the things that struck me in doing that qualification was the idea that it is geared around selling products and getting people to act and transact. It is a transactional education. We need education that is focused on the property market itself and understanding the dynamics of the property market. We clearly see that the property market is as complex as — and I would say in some cases more complex than — the share market. Yet we have an amazing amount of research done on the share market, an amazing amount of analysis and people advising on individual companies, management structures and beta ratios and P/E ratios and all these sorts of things. Then when we look at the property market we see it is just a void of education and a void of information about how the property market functions. Accountants do not have that knowledge at the moment; no-one in the marketplace has that knowledge at the moment, because the marketplace is geared around selling products. They have great knowledge about how to flog a product, but they do not have any knowledge about how to advise, about how a property asset functions over time.

Mr DONNELLAN — We are looking, I guess, at real estate — what experience/qualifications would you expect in that instance? Would you expect them to be able to provide an overall financial planning analysis of this, that and the other of the people's investment portfolio at the moment? Then would you look at providing them with discounted cash flows? I worked in the property market some years ago. I did commerce. I could never finish valuations at RMIT. I had one subject left that sent me mad. That being said and done, where would we start and where would we finish with getting people to a certain level to provide that advice? I have been in the industry; I have watched it. There are some great people and some ordinary people, no doubt about that. Where would you stop them, firstly, saying things? And, secondly, what would you do to have a fully qualified person? What sort of person would you expect to be able to provide that advice?

Mr ARMSTRONG — We do not view ourselves as being in the property industry. We view ourselves as being in the financial services industry or in the financial planning industry, although I still feel that there are some yawning problems and gaps within the financial planning industry — that is for another day, obviously, another argument. As you said, it needs to start with a full analysis of the individual's situation and circumstances. It is a financial plan. It is getting a clear understanding of their overall position on one side of the equation and using the knowledge of the property market on the other side of the equation to match those things together. We do have an industry at the moment that allows us to get a clear understanding of the individual. The financial planning industry does that. As I said, the know-your-client rule is extremely important. We do not have the other piece of the picture at this stage. We do not have the educational process that educates our advisers about how property will function as an asset over time. Once we have the information about the individual client and what it is they are trying to achieve and the knowledge about what asset in the marketplace can achieve that objective, we then need to match those two things together. Does that answer the question?

Mr DONNELLAN — Yes, I guess, but my concern is whether you would actually do a financial planning course for people to provide advice in terms of selling property as an investment, not as an owner-occupied thing. Or would you make them do some accounting? Or would you suggest they do valuations or property investment at RMIT? I do not even know what the subjects — —

Mr ARMSTRONG — If I can just touch on one thing you said there — —

Mr DONNELLAN — Yes.

Mr ARMSTRONG — It is not about selling an asset. It has got nothing to do with selling an asset. I think if we keep talking about selling an asset, we are going down the wrong path.

Mr DONNELLAN — Investing in an asset was what I was really meaning. What do they do?

Mr ARMSTRONG — Yes, as I said earlier, it is not about educating people on ways that they can sell an asset, it is about educating people about how an asset functions as an asset over time. What makes one property generate a strong income over time as opposed to making one property generate a stronger capital appreciation? Why is one property a riskier property to invest in given the normal growth cycles of that asset over time compared to another property? It is filling that void of information.

Mr DONNELLAN — How would you get people to that stage so they could make those assessments? That is what I am — in a sense — I understand what you are saying, I am well aware.

Mr ARMSTRONG — The advice or the community?

Mr DONNELLAN — What level of experience and qualifications would be needed to actually provide that advice over time — to satisfy you so that if you were in that situation out looking at an investment, what sort of person would you look for and what would you expect from them?

Mr ARMSTRONG — I would be looking for an accountant. Personally I think the accounting industry missed the boat about 10 years ago, and it was really left standing still when the financial services reform came through. I feel that accountants should have been the ones to be advising on the financial services and on financial planning. On the other side of that, the financial planning industry was there to sell products. But at this stage we have got it all wrapped up in one bag where people are selling products under the guise of advice. It is the group that makes their money from providing advice to clients, and they get paid by those clients. That is how they make their money. Accountants are the ones who do that. You could throw solicitors into the bag there, but they do not have the financial and numbers ability to do that. So accountants are really the ones who have the history and the reputation of providing that level of service. It is simply providing an educational model for accountants to be able to provide that advice moving forward, so people know they have an avenue; they can come back to their accountant. They can say, 'I have been offered this product here, what do you think I should do? How do you think that fits into my overall strategy?'. As I said, I think we need to learn from what happened in the financial planning industry, which essentially stemmed from product sales, from insurance sales. We have an opportunity here to not make that mistake. We need to learn from what has happened in the past.

The CHAIR — One of the key objectives of this inquiry is to try to ensure that investors in property are protected against detriment. Currently the regulatory regime is in the consumer law area in Victoria, covered by

Consumer Affairs Victoria. Could you give us a bit of a picture about what you think some of the weaknesses or strengths are in that legal regime, that regulatory regime we have got up?

Mr ARMSTRONG — I do not think there are any strengths.

The CHAIR — Okay, tell us about the weaknesses then.

Mr ARMSTRONG — The weaknesses are that I think it is based on cure rather than prevention. I think one of the biggest problems we have in property as a product is that it takes us such a long time to determine that we have actually made a mistake within that market compared to the share market. The share market is reactive. You can look at the paper each morning and see exactly what a share price is doing and know within 24 hours whether you have made a mistake or not. Property is a dinosaur compared to that. It may well take 5, 10, 15 or 20 years to really understand that you have made a mistake in the market, and by that time the person who advised you to do that is well and truly gone. I think also the cost of pursuing someone under that framework is prohibitive for the general public. It is very costly to pursue someone who has got deeper pockets than you through the courts. Maybe you have dropped $50 000, $100 000 or $200 000; it is very costly to pursue those avenues. So that is more about a cure, and I think we really need to focus on the prevention. We need to prevent these things happening before they happen.

The CHAIR — Do you think the regulators themselves operate with alacrity?

Mr ARMSTRONG — I beg your pardon?

The CHAIR — That they are fast, that they act proactively.

Mr ARMSTRONG — The regulators?

The CHAIR — Yes, like Consumer Affairs, for example, both at the federal — —

Mr ARMSTRONG — No.

The CHAIR — So you think they are slow to deal with issues as they emerge?

Mr ARMSTRONG — I think the general public does not really view it as a serious avenue to get support. I really think people think, if they lose money and they have had bad advice, it is just gone. I just do not think they take that seriously. That is probably the wrong thing to say in this room.

The CHAIR — No, not at all. You say the way you see it; that is what we want to know.

Mr ARMSTRONG — It sometimes get me into trouble.

The CHAIR — No, you will not be in trouble here. I told you before, you are protected.

Mr CLARK — Looking at the background notes on Property Planning Australia, I see you describe yourselves as a property advisory and mortgage sourcing service. The mortgage sourcing side of your business would seem to create potential for conflict of interest. Could you tell the committee how you manage those in terms of disclosure, fee restructure and those sorts of things, and flowing on from that do you think there should be any additional regulation to what there is at present as to how a combination of advisory work and mortgage sourcing is handled in order to avoid that sort of problem?

Mr ARMSTRONG — It is something that we are extremely conscious of and something that we work actively on about, the lack of regulation in the mortgage broking industry. We structure our business in a way that is completely transparent. Everyone is completely aware of the commissions that we are being paid via the banking industry. Our brokers are structured in a way that they get paid the same amount regardless of which bank or lender they refer our clients to. I guess in the mortgage broking industry we are dealing with the banks, and that is a very hard beast to change. We are aware there is a potential conflict of interest there, and the only way that we can overcome that is by complete and utter transparency, which is the focus of our business.

Mr CLARK — So you disclose to your clients the commissions or trailing commissions, or whatever, that you are receiving?

Mr ARMSTRONG — Absolutely, and we are one of the few groups in the country that do that. We give our clients a complete report when they come in with recommendations on — —

We do not have to do this, but we put together something we call a home loan planner. We make recommendations on different loan products, why they suit their individual needs — having an analysis of their position — and what it is they are trying to achieve, looking at their gearing levels and their risk profiling, looking at the amount of risk they are taking on board and making a recommendation on different products in the marketplace, showing them how much we get paid for each of those products and the trailing commission that we get paid so they can see utter transparency there.

Mr CLARK — Do you think the law needs to require greater disclosure of that sort as a matter of obligation rather than a voluntary decision such as you have made?

Mr ARMSTRONG — In the mortgage broking industry? Absolutely.

Mr CLARK — In mortgage broking, particularly where it overlaps between mortgage broking and advice, as your business does.

Mr ARMSTRONG — Absolutely. It is something that David has been working on a lot over the last few years, to bring some transparency to the mortgage broking industry. I will give you a practical example of someone who came to us a little while ago. He was a young guy who was married with a couple of kids. They had a little bit of equity in their property. He was actually an invalid and received a pension as well as working part time. He came to us because there was a recommendation via a lender in the marketplace that he should borrow over $1 million to invest in the property market, without any justification for the recommendations that were being made, without any disclosure of the fees that these mortgage providers were going to receive, without any recognition of the risk that was going to place this individual in — he had two young kids aged four and two — without any consideration of the volatility in the property market and the risk he was going to place himself in. When we sat down with him and had a look at his position we made two recommendations: maybe you should focus on reducing some debt for a bit longer, and if you want to be really aggressive, maybe you should look at borrowing $200 000 or $300 000 so if you do find you have got some cash-flow problems in the future, at least you are not going to essentially be declared bankrupt, which is the position he was likely to put himself in. So absolutely we feel there needs to be full disclosure in that industry as well. As I say, that is another battle to fight probably for another day.

Mrs MADDIGAN — If I can just follow that up from Robert. Would you think that if the government, for example, proposed to bring in a licensing regime that made some of those things compulsory, some of your colleagues would say that was an interference in the commercial confidence of their transactions and would say that therefore it could disadvantage them in a free and open market?

Mr ARMSTRONG — I would never have thought transparency in a market would be to the detriment of that industry. I would have thought it was only going to — —

Mrs MADDIGAN — And many industries go to great lengths not to be transparent, don't they. That is why we have cartels and things, isn't it? Price fixing?

Mr ARMSTRONG — It is, and this is what happened there. I would have thought for the practitioners that want that and feel they can thrive in that environment, then that is a benefit for the community, and it is also a benefit for that industry. We joked before about industries that have a bad reputation. They have that bad reputation because of those hidden agendas and because the community is not aware of what is going on behind the scenes. Industries that have a great reputation are the ones that have complete transparency, and we feel whether it is the finance industry, the mortgage broking industry or the property advice industry, the only way to bring these to the forefront and make them professional bodies that have the reputation that they deserve is to have complete and utter transparency. And if some people in the industry do not like it, bad luck, they can go to car sales.

Mrs MADDIGAN — Do you think it would substantially add to the costs of running a business?

Mr ARMSTRONG — I think in the short term it will, absolutely, but I think we have to accept a short-term cost for a long-term gain. I have a background in building as well. You spend a lot of money on the foundations of something so that it stands the test of time. If we are serious about this, we need to understand that it cannot be done in a half-baked fashion. It needs to be done in a way that ensures the industry is set up for the future of my children, of your children — I have three young kids as well. If we do it in a very short-sighted way, it is something that will need to be addressed again at some stage in the future. We may as well fix the problem right from the start. That said, I do not think it is going to be an enormous cost to industry. I do not think it will be prohibitive. If we look at some of the money that has been made in this marketplace — I do not think anyone is really crying poor out there. So for people to go out and educate themselves — courses are offered in these things for anywhere from $1000 to $5000 — it is not a cost that is over the top.

Mr DONNELLAN — In terms of property advice and also looking at financial planning, do you do it as a fee for service, whether you are doing brokerage or sort of financial planning/cash flow assessments and also then property investment advice? Is that all done for a fee for service, or, say, with mortgages does it depend on whether the banks really want the issue of the commissions paid? You know what I mean: I suspect there is some resistance.

Mr ARMSTRONG — Our business?

Mr DONNELLAN — Yes.

Mr ARMSTRONG — Our business is pure fee for service. One of the issues we see in the market is people getting paid based on how much someone has to invest. If we go out there and recommend that someone buy a property for $500 000 as opposed to buying the property for $300 000, and we get paid more on the $500 000 property, that is ludicrous. That is absolutely crazy. We have recently incorporated financial planning into our business on a pure fee for service basis. That is the way it should be done. That is the future of this industry. Pure fee for service means that it does not matter whether you have $1 million to invest or $100 000 to invest, you are viewed in our eyes as the same person; the fees are based on how much time we spend with you and the level of service that we provide to you, not based on how much money you have to invest.

Mr DONNELLAN — If you are doing the mortgage one, and a lot of the banks would have themselves set up for trailing commissions or commissions straight out — and I am guessing they would probably prefer that system because they have the mortgage brokerage market grab — do you just rebate that and then charge an hourly rate or whatever? How do you operate in that sort of environment, because I know the banks are very keen on getting some brokers out there. It is a lot cheaper way to run mortgage services than having branches everywhere, and you take on the administrative costs, so it is a good way of doing things.

Mr ARMSTRONG — On our mortgage broking advice, we do receive a commission from the banks and we do receive a trailing commission. We see that if you look at the ledger of a balance sheet the mortgage sits on the liability of the balance sheet. There is no avenue for the bank to refund a trailing commission. Basically, if we do not take the trailing commission the bank will keep it; there is no discount to the client. Essentially what the banks are doing is outsourcing their back office to us. As we touched on before, we feel that has the potential for a conflict of interest, and the way we overcome that is with complete and utter transparency, and we feel that is the way that industry needs to go as well. There needs to be complete and utter transparency.

Mr DONNELLAN — To some extent it is driven by the banks wanting to push out the backroom operations.

Mr ARMSTRONG — It is cost effective for the banks.

Mr DONNELLAN — Yes. So in other words a person who might go directly to the bank will still end up with 7.5 per cent, whether they go to bank directly or they eventually go to you guys, but the bank in that instance will be paying some trailing commissions?

Mr ARMSTRONG — Absolutely. I think the banks have become aware — in a funny sort of way the banks are privatising that part of their business.

Mr DONNELLAN — Yes, that is what I thought.

Mr ARMSTRONG — The banks are probably bogged down with labour costs and they have a very large number of staff, and there are inefficiencies within the bank, so they know that by outsourcing that to private companies they will get the scales of economy and efficiency back into their systems.

The CHAIR — We are running out of time and I have just one last question to ask you. You said in your submission that consumers do not have access to real-time sales information. I just wonder if you could talk to us very briefly about how freely you think that should be available to consumers, who should publish it, and whether banks should be required to disclose that to lenders.

Mr ARMSTRONG — I think the first thing is that there is no mandatory requirement for sales results to be reported, so there is a glaring problem. When you look at the real estate industry, real estate agents are not required to disclose the sale result of an auction and they are not required to disclose the sale result of a private sale, so already you have a glaring hole. That needs to be fixed right from the start.

The REIV encourages their members to do it. The first thing is, not every real estate agent is a member. We are seeing a large number of property sales not being disclosed, even to us who are licensed agents. We look on our databases and there are holes within the sale results. I think the first thing is that there needs to be mandatory disclosure of, particularly, auction results. Someone had the argument to me the other day that this would contravene the Privacy Act and it is someone's personal home and they do not want that information disclosed. If we use a public auction, then that is public information. If they want to use a private sale and sell very quietly to an unknown transaction, then maybe that is fair enough. But if we have a public auction, which really tells us where the market is, then that is public information. How the general public is able to get that information is an interesting question. I feel that there is an issue of privacy out there. We are aware of that — someone having the result of their house being put out to the public with too easy access. But again I think we can solve the problem by having an industry that allows the community to come to that industry, who has that information in its entirety, to then advise them in an appropriate fashion. Whether it should be disclosed in a very free-flowing way is maybe something that needs to be debated and discussed in further detail.

The CHAIR — We are out of time.

Mrs MADDIGAN — We should ask them if they are a member of the Property Investment Association of Australia. Are you?

Mr ARMSTRONG — We are not.

Mrs MADDIGAN — Okay. Any reason why you are not? They are sitting right behind you, I should say.

Mr ARMSTRONG — We have never been approached.

The CHAIR — Very good. David Johnston, Mark Armstrong, thank you very much both for your submission and for your generosity in coming in here and giving us your time and the frankness of your answers. Kerryn and Susan will probably be in touch with you to follow up any questions if that is all right with you.

Mr ARMSTRONG — That is fine.

The CHAIR — You will be provided with a copy of the Hansard transcript, as I said earlier, and thanks again.

Mr ARMSTRONG — Excellent, thanks for having us.

Witnesses withdrew.