

THE REAL ESTATE COUNSELOR-CLIENT RELATIONSHIP

by Charles B. Akerson, CRE

Understanding the real estate counselor-client relationship is the key to interpreting and following the Code of Ethics and the Standards of Professional Practice of The Counselors of Real Estate (CRE). Similarly, a misunderstanding of the counselor-client relationship can result in malpractice. We know the confidential nature of the relationship must be preserved, but what does this really mean? We know the relationship is fiduciary, but in what sense? These and other related questions will be addressed here from a non legal practitioner's point of view.

The counselor-client relationship is complicated because the relationship is not always the same. The confidential nature of the relationship must, of course, be preserved, but this does not necessarily mean that all the communications between the counselor and the client are confidential or privileged. Nor does it necessarily mean that all the information gathered during a counseling assignment is confidential. The requirement for confidentiality varies with the assignment, and an example will be discussed in this article to illustrate this possibility.

The counselor-client relationship is a fiduciary relationship by definition. The real estate counselor is presumed to be the client's trusted adviser, i.e. fiduciary. But, depending upon the assignment, the counselor may act either as an advocate of the client's interests, or as an impartial expert with a fiduciary duty to third parties and to the general public as well as to the client. Just as the requirement for confidentiality can vary with the assignment, the fiduciary relationship can vary. Again, an example will be offered to illustrate this possibility.

Confidentiality

The requirement to preserve the confidential nature of the client relationship is subject to misinterpretation. Certainly the counselor should not disclose private information obtained from the client without the client's permission, but, on the other hand, the requirement to preserve the confidential nature of the client relationship should not be used as a license to withhold or suppress important information that would otherwise be available to market participants in the normal course of business.

Suppose, for example, that the counselor has been engaged by the owner of a fully occupied,

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multi-tenant property to advise the owner regarding the marketability of the property in the current market and to prepare a cash flow analysis showing the expected income and expenses for the next ten years. The cash flow analysis is to be included with a rent roll and descriptive material to be distributed to brokers and prospective buyers of the property. After considering the existing leases, the current rental market for comparable space and the outlook for the renewal of existing leases, the counselor advises the client that the earning power of the subject property is low in comparison to other similar properties. The relatively low earning power is attributable to concessions granted to lessees, such as free rent and options to renew leases at favorable rental rates. The free rent concessions are temporary, but the renewal options, if exercised, would materially limit the earning power of the property during the last five years of the ten year analysis.

The counselor advises that there is a high probability that the renewal options will be exercised and that all the concessions should be considered in projecting the rental income. The owner agrees that the free rent concessions should be taken into account as long as they are in effect, but takes the position that the renewal options should not be taken into account because the options have not been exercised and there is no assurance that they will be exercised. Accordingly, the owner asks the counselor to treat the renewal options as confidential information and to project cash flow for five years only. How should the counselor respond? The counselor's dilemma is obvious. Compliance with the client's request would preserve the confidential nature of the client relationship and would not be unlawful, but the deliberate suppression of important information would be unethical in any professional discipline. Under these circumstances, should the counselor withdraw from the assignment?

Not necessarily. In a case such as this, the counselor has a duty to advise the client that it would be advantageous to permit full disclosure of all the lease provisions and that a prudent client would be persuaded to do so. The counselor should simply remind the client that the leases will be reviewed as a prerequisite to any sale and that it would be counterproductive to postpone the release of any information contained in the leases.

The preceding example illustrates the possibility of malpractice resulting from a misunderstanding of the requirement to preserve the confidential nature of the client relationship. The example demonstrates that confidentiality is not always ethical, the client is not always infallible and withdrawal from the engagement is not always the best way to avoid malpractice.

The Fiduciary Relationship

As already mentioned, the real estate counselor may act either as the client's advocate or as an impartial expert. When the counselor accepts an assignment to act as the client's advocate and when the assignment would not require or be perceived as requiring impartiality, there is no question that the counselor has a special fiduciary duty to the client. In such cases, the objective may be to find a solution for the problem that favors the client, to optimize the client's financial position, to minimize the client's risk or to strategize on his behalf. In these cases, the counselor-client relationship is not unlike the typical attorney-client relationship. The counselor is openly partial to the client and the special fiduciary duty to the client is obvious. This is not always the case, however.

The counselor is frequently engaged because of the counselor's reputation for objectivity, impartiality and expertise in a particular field. The purpose of the assignment might be to develop an unbiased professional opinion that the client and third parties can rely on, such as an opinion on the economic feasibility of a proposed project, or an opinion on the highest and best use of a certain parcel of land. In such cases, the counselor's findings may be presented to third parties in the form of a written report or offered in court as expert testimony. In these cases, it is clear that the counselor's fiduciary duty to the client has been extended to include a duty to all who rely on the counselor's opinion and, in the case of court testimony, a duty to the general public. Thus, the counselor-client relationship, although often described as a fiduciary relationship, is not always the simple two party relationship that one might expect. Failure to understand this complex relationship can lead to serious ethical problems.

The following example will illustrate a typical problem. Assume that the counselor has been retained to develop a professional opinion on the economic feasibility of a proposed shopping center and to prepare a written feasibility report with all the customary documentation. The client is the promoter of the project and the counselor is recognized as an impartial, objective expert in the field. The counselor's final report will be used to attract investment capital to the project. During the course of the study, the counselor discovers that another expert, engaged by the same client, recently found the same proposed project to be economically infeasible. The other expert states that no written report was prepared and refers the counselor back to the client for further information.

The client acknowledges the prior study, and explains that the study was aborted because of a misunderstanding between the other expert and the client. No written report was prepared because

the client had no use for a negative report and did not want it to be made a matter of record. The client asks the counselor to proceed with the study and expresses confidence that the proposed project is feasible and that there will not be a misunderstanding. At this point we must ask the obvious questions. Is the client seeking a predetermined conclusion? Does the client really want the counselor's independent opinion? More important, does the client understand that, in an assignment such as this, the counselor must act as an impartial expert, not as the client's advocate?

It is helpful to look at these questions from the client's point of view. Assume that the client is already convinced that the proposed shopping center is not only economically feasible, but potentially highly profitable. In this case, the client is not really seeking counsel, but is seeking confirmation of feasibility from a recognized authority in order to satisfy the prospective investors. From the client's point of view, economic feasibility is a foregone conclusion and there is no need for any independent opinion that does not confirm that conclusion. The client's position is understandable, but it is clear that the client does not fully understand that, in this case, the counselor must act as an impartial expert, not as the client's advocate or spokesman.

To illustrate the problem, assume that the client's confidence is misplaced and that the market evidence does not support a finding of economic feasibility. Under these conditions, another misunderstanding appears to be inevitable. What could the counselor have done to avoid it? Should the counselor withdraw from the engagement?

In answer to the first question, the counselor could have avoided the misunderstanding simply by discussing with the client, before accepting the assignment, the possibility that the proposed project would be found to be economically infeasible. This would give the client a chance to accept or reject that possibility, and, in the event of rejection, the counselor could decline the assignment.

In answer to the question of whether the counselor should withdraw from the engagement, the counselor should not take the initiative to terminate the engagement simply to avoid a misunderstanding or to prevent the counselor's negative finding from becoming a matter of record. A better solution to the problem would be for the counselor to complete the assignment by preparing and submitting a confidential negative report, complete with all the customary documentation and explanations required to support the counselor's conclusion. The report, although negative, would be helpful to the client, because it could be instrumental in dispelling a false notion and preventing a financial disaster.

The preceding example illustrates a typical problem resulting from a misunderstanding of the counselor-client relationship and the counselor's fiduciary duties. The example demonstrates that the problem could be avoided by better communication between the client and the counselor. Again, the example shows the client is not infallible and it offers a possible solution to the problem. There is no suggestion that the example covers all the possibilities for avoiding or solving problems such as this. In some cases the counselor might be able to advise the client in advance whether or not a particular project would be feasible and whether further study would be helpful. In other cases the counselor and the client might agree in advance to terminate the engagement or alter course in the event of certain findings. In any event, a full understanding of the counselor-client relationship and the counselor's fiduciary duties will be necessary.

Concluding Comments

The counselor-client relationship obviously involves two parties, and there is no single code of ethics or set of standards that controls the relationship. The standards that apply to the counselor may not apply to the client and vice versa. The counselor-client relationship varies, and it behooves the counselor to ascertain, when applicable, that there are no misunderstandings of the counselor's fiduciary duty to third parties and to the general public. The client can and should set the ground rules for a particular assignment, but the counselor can and should decline any assignment that compromises the counselor's standards.

The preceding example relates to a counseling assignment in which the counselor acts as an impartial expert, not as the client's advocate. It was not the intent, however, to suggest that the counselor acting as the client's advocate does not have a fiduciary duty to use independent judgment, and, if necessary, to disagree with the client. Whether the counselor is an impartial expert or a partial advocate, the relationship with the client must be open and uninhibited. If the counselor's fiduciary duty, i.e., duty as a trusted adviser, requires disagreement with the client, so be it.