SLEEPING WELL WHILE MAKING A LIVING

by Arnold S. Tesh, CRE

"Power without ethics is profane and destructive in any community. While many have come to see that this is so in interhuman ethics—hence the outcries for human rights for justice and charity, for peace—few as yet have seen how the escalating human use of the world, unchecked by any ethic, prevents us from appreciating values on the earth where we reside. The outcry for a life ethic, a land ethic has only begun."

Holmes Rolston, III

With integrity now in the forefront, those of us in the real estate industry are constantly being confronted with ethical issues and how to deal with them. In a desire to be honorable and at the same time not paralyzed by the perception of impropriety, real estate professionals are being forced to make tough decisions. The ethical route can be viewed as either an obstacle to overcome or a standard to follow.

How the real estate counselor approaches ethical behavior in his practice is a very personal thing. The Counselors of Real Estate has established ethical standards of professional behavior which all of its members are required to follow. However, the manner in which each member abides depends upon his individual personal experiences. Becoming professional does not make us automatically honorable. We have to focus on the challenge with every assignment.

The Golden Dilemma

When we do unto others as we would have them do unto us—we are acting ethically. Unfortunately, the golden rule, though self-evident, is a tough thing to apply in practice. Depending on what the Counselor is doing, it may or may not be possible to advocate a client's position the way the client would like it advocated. When a real estate counselor is hired to help the client, he should not be expected to lie, cheat, steal or fib, trick or pilfer. Absolute moral duties are the standards within the real estate community. You cannot be half-ethical.

Ethical practice for the real estate professional presents a perplexing challenge. The professional is expected to serve the client and the public in an honest, selfless way and at the same time remain in business. However, for some real estate practitioners ethics is not natural; honesty requires conscious thought. How would you respond to the following scenarios?

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Knowledge Equals No Commission
Think about the broker who recommends to his client not to invest in real estate until the prospects are better. How many brokers separate knowledge of negative market trends from a need to make a living?

Knowledge Post Mortem
In commenting on the obvious market softness in 1993, a spokeswoman for the Chicago real estate brokerage community said, "It's no wonder—with all these people paying big prices in the 80s, the bubble was bound to burst." If the market fall was predictable or "no wonder," did those in the profession have an obligation to inform the public of the danger? Should the individual practitioner in 1989 have told his client that prices were far outpacing achievable rents and/or availability of debt capital?

Guarantee But Don't Bother Me
Those who lend or develop are also faced with tough decisions. We are experiencing the final chapter in the biggest bust in the history of real estate—the Resolution Trust Corporation sell-off. Years of de facto unregulated lending by institutions offering federally guaranted savings made it possible for even the most incompetent and dishonest to prosper. Panic set in once it was realized that the underlying real estate assets were woefully inadequate to secure the hundreds of billions of dollars circulating in the market. A lack of ethical behavior by every sector of the real estate community combined to create the crash. The thrifts needed to lend money to survive and the opportunistic developers needed to get as much money as they could. Collateral lost its meaning and the taxpayer ended up indemnifying the savings and loans in a helter skelter environment.

The structure created to solve the problem also has had its own share of ethical challenges. The RTC has been besieged by scandal resulting from interference by both congressional and executive branches. And now, halfway through the next decade the public is still supporting vacant monuments to private greed and government irresponsibility.

Pointing Fingers
Today, we have a complicated and strained relationship between the U.S. Congress, the Resolution Trust Corporation and the White House. In everyone's attempt to dodge the bullet and avoid the appearance of unethical or unprofessional behavior, more and more unsavory activity is coming to the attention of the public and, ultimately, the judiciary. When the problems started, The Counselors of Real Estate proposed that a special court be created to administer the national savings and loan bankruptcies. This was strongly opposed by those who did not wish to deal with court approvals. Today, instead of a smooth judicial oversight of a bankruptcy, we are witnessing practically endless investigation, accusation and costly litigation. The U.S. Congress, the Resolution Trust Corporation and the White House each claim a monopoly on ethical behavior while accusing the other of self-serving deceptions and unethical practices.

Was it ethical to create an agency which was not sheltered from partisan politics? The answer lies in the perception of any wrongdoing. Did the real estate community have an ethical duty to take a stand? Clearly, the overall community did not see enough wrong with the formation of the RTC and its lack of protection from political interference to wage an ethics-based battle against the arrangement.

Failure Is An Orphan
Ethics has not always been the hot topic it is today. A failed market exposes many warts. The real estate boom of the 1980s was a time of easy leverage and inflated prices. It was a time when we heard little from within the industry about any unethical behavior. There was some strong criticism at the beginning of the Reagan years because of the administration's support to raise federal savings deposit insurance limits simultaneous with deregulating the savings and loan industry. There were a few who foresaw potential ethical dilemmas (but they were seldom heeded) until the bust occurred. The whole arrangement proved the big bang theory. Through the taxpayer, an industry was protected by government's hands-off policy.

At the time of the banking failures, what was touted by government as bipartisan support for deregulation and increased insurance, is now denounced by Democrats and Republicans alike. More than a decade after the enabling legislation was placed in force, it is still difficult to find an elected official who admits to any historical support of such a scheme.

Being Consistent Might Still Be Inconsistent
Whether the answer is good or bad, it is still the answer. In real estate, consistency and ethics are always inextricably intertwined. The appraiser is required to reflect the market, and what he personally believes is not necessarily germane to the appraisal. Conversely, the counselor is generally retained for advice and knowledge which does not necessarily comport with market perception. Thus, many counselors recommended against jumping aboard the "hot market" in the 80s, while many ethical appraisers reflected the market perception of unlimited hyper growth. Those inside the trilogy of equity, debt and asset were warning their clients about imbalances in the market.

Appraising and counseling often are very different functions. Appraisers are supposed to appraise. That normally means studying the market to conclude what the market reflects. Counselors generally are asked to express what they think, based on their experience and insight, even if their conclusions are contrary to market beliefs.

Multi-Disciplinary Hot Potato

In the last decade, foreign investment in real estate, particularly big city Class A office buildings, was fertile ground for the potential ethical dilemma. Though the market was chasing prices faster than the underlying income streams justified, the real estate economy was booming. Ten year rental projections in the Washington, D.C. downtown office market often reflected over $50 per square foot. This was the level of income logically foreseen by the investors. They needed those rents, and even more, to justify the prices being paid. The rest of the story is common knowledge.

Though Washington is now probably the strongest downtown office market in the United States, top effective rents are about 60% of the forecasts given 10 years ago. Putting personal anticipations aside, the appraiser had a duty to project the rents at $50 per square foot. The CRE, generally cognizant that the market was a balloon looking for a pin, had an ethical duty to reflect this information in rendering advice. Did the broker have a duty to do the same?

The appraiser's job was to rely on market data to determine the market value of the asset. After all, that is the job of the appraiser. The market data was all there and what was the appraiser to do? Lenders wanted to lend, builders wanted to build and buyers wanted to buy. The data was plentiful, particularly with all the limited partnership transactions then in vogue. In retrospect, many question whether the prices were truly representative of market value.

During the easy money, deregulated, open economy for most developers, the plan was to acquire land with someone else's money and then to subordinate that land to construction lending. Eventually, this lending would convert to permanent financing at the highest possible ratio to value and at the lowest possible rate. This is part of what developers were expected to do. Their opportunity to deal with ethics occurred at each point of the funding process. Is it enough to truly believe in what one is selling? After all, real estate is risky and not everyone knew the market would collapse. Besides, few of the loans were available without a professional appraisal.

The Next Challenge?

From an ethical viewpoint, the real estate counselor might want to consider the extent to which today's REIT's share prices are reflective of the pro rata value of the underlying asset. Is it possible that the limited partnership of the 80s is the REIT of the 90s? Only adequate research and impartial professional introspection will provide the answer. As CREs, will we have to defend our ethics and the behavior of the real estate profession in the first decade of the 21st century?

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