

# THE ETHICAL DIVIDE

Where Do  
**YOU**

Draw the Line?

By Paul Rosta

**O**n many Monday mornings, some 75 professionals in Grubb & Ellis Co.'s New York City regional office start their weekly meeting with food for thought to go along with their bagels and coffee. Managing director Alan Lurie, who also happens to be an ordained rabbi, speaks for 10 minutes or so about ethical and philosophical issues that arise in the profession. The meeting soon moves on to shoptalk, but by then, the rabbi has set an unmistakable tone.

"We begin our week talking about the more noble aspirations, emphasizing the importance of professional integrity," explained regional office president David Arena.

Grappling with ethical dilemmas that arise in real estate today often calls for a touch of Talmudic wisdom. At a time of intense competition, with so much money at stake and abundant pressures to produce, keeping to an ethical course is as compelling a challenge as ever. Changes in perception and reality are difficult to measure, but some industry veterans acknowledge that the profession has at times borne a less-than-sterling image. "Commercial real estate as a whole, years ago, had a terrible reputation," said William Lampley, president of transaction services for Grubb & Ellis' Eastern region. Fairly or not, brokers were viewed as willing to do whatever it took to complete a deal.

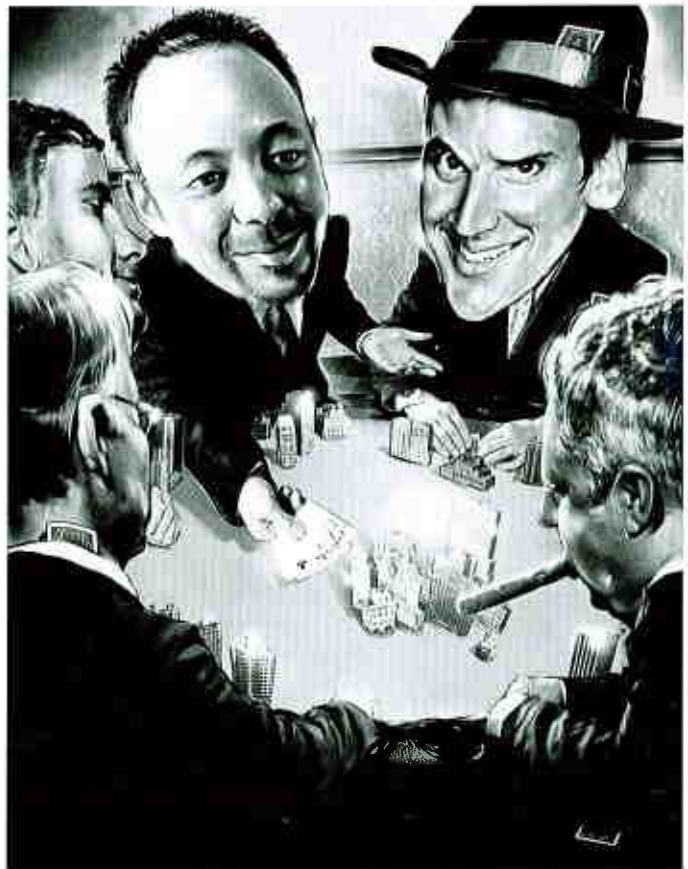
Like any business, real estate will always have its share of bad apples, but industry leaders defend the business's current ethical climate. "The profession has gotten more ethical," Arena said. Although it comes as no surprise that an insider would make such a claim, the statement seems to have a solid foundation. Many executives credit real estate's emergence as a major capital market for improved ethical practice because transactions are drawing

greater scrutiny than ever. As clients have become increasingly sophisticated about real estate, they are in a better position than ever to hold the firms with which they work accountable.

Perhaps no formal, industrywide system of conduct exists in real estate, but executives point out that in many ways, the business is self-policing. Success hinges not only on technical skill but also on long-term relationships and reputation. An underhanded move may win a short-term advantage, but once lost, a reputation is rarely regained. "Anytime you have a lot of competition in this business, the last thing you want to do is behave in an inappropriate manner because your competition will use it against you," noted Peter Ruggiero, national managing director for Colliers Investment Services Group.

That said, real estate presents real ethical dilemmas—some perennial, others relatively new. The expanding global footprint of U.S.-based firms, for instance, adds a fresh set of concerns, said Cushman & Wakefield Inc. COO John Santora. Unethical practices by an overseas affiliate—bribery, fraud, embezzlement, kickbacks—can damage a U.S. firm's reputation and result in federal penalties under the Foreign Corrupt Practices Act. "It's pretty scary out there," he said. "There are certainly some cowboys ... in different markets." Cushman & Wakefield thoroughly vets its overseas partners to detect any skeletons in the closet, yet Santora acknowledged that the thought of a few bad actors lurking among tens of thousands of his company's worldwide employees keeps him awake at night.

Firms are reluctant to discuss specific examples



of transgression but insist that they deal harshly with the most serious cases. At Cushman & Wakefield, fraud or other mishandlings of fiduciary responsibility earn a one-way ticket out the door. "We have, in the past, terminated some of our top producers," Santora said. "I don't like that, I'm not happy about it ... but no one individual stands above the firm."

### Disclosure—Full & Otherwise

Certainly no corner of real estate is immune from ethical concerns, but brokerage, in all its forms, presents some of the best-known and thorniest conflicts. Whether a transaction involves leasing, investment or finance, brokerage involves weighing the interests of multiple parties. Many issues in brokerage are enduring, but figuring out an

swers has become no easier over time.

"Just the nature of the job puts you in an ethical dilemma," observed Binswanger Corp. CEO David Binswanger. Adding to the mix is the generally healthy state of the real estate industry and the relatively low barriers to entry. Those characteristics likely lure some with less-than-honorable intentions into the business, put in Stan Johnson, CEO of net lease investment brokerage firm Stan Johnson Co.

At the core of many dilemmas is the question of what to tell the stakeholders in a transaction. In investment sales, for example, there may be a temptation to sidestep facts that might place the client at a disadvantage. "It's not what we say, but ... the things we don't say, that are the least obvious and often the most problematic," said David Rifkind, principal & managing partner for George Smith Partners Inc., which arranges financing for acquisitions and developments nationwide. "When it's black-and-white, it's easy," he added.

A client might want to retire the \$7 million debt on a construction or bridge loan, needing a refinancing to yield at least that amount, Rifkind offered by way of example. That would seem easy enough if an appraiser valued the property at \$10 million. At a loan-to-value ratio of 70 percent, the refinancing would yield sufficient proceeds to refinance that debt.

But a clear situation can quickly become murky. The broker arranging the financing might turn up comparables placing the actual market value of the client's property at considerably less than \$10 million. At the same LTV ratio of 70 percent, the property would yield less than the \$7 million required by the client. That would place the broker between a rock and a hard place. The broker's primary responsibility is to represent the borrower's interests, but the broker is also answerable to the lender that he or she has recruited to provide the refinancing.

The question is whether to alert the lender that the property's market value is probably lower than it may have appeared at first. Rifkind noted that George Smith, the late founder of George Smith Partners, instilled the principle that a broker should advocate fiercely on behalf of the borrower but not at the expense of the lender. Smith's rule of thumb, which is not always easy to follow, could be summed up as "When in doubt, disclose more."

Investment sales brokers frequently venture into other gray areas. To win an assignment, for instance, a broker may be tempted to inflate the value of a client's property, Johnson said. While the gambit might win a hotly contested listing, in the end it will backfire on both broker and client, and so Johnson demands that his brokers tell it like it is. "We're not going to tell you what you want to hear," he explained. "We're willing to lose the listing (rather than) take the listing and end up with an unhappy client."

Indeed, the burden of deciding what to tell a prospective buyer falls on the broker. "There is no law that says you have to disclose that a tenant

might be moving out instead of staying," noted Ruggiero. Like all good sales professionals, investment brokers will accentuate the positive, but making that call is more art than science. As Ruggiero framed the question, "Where does the puffery end and the questionable behavior begin?"

Further complicating the issue, the broker may also be restricted by the client's instructions about what to disclose. The best solution is probably to acknowledge the imperfection in an asset, just as a reputable dealer would tell a prospective buyer that a used car's transmission was recently fixed. Then the broker emphasizes the positive and sells around it, Ruggiero said.

#### The Dilemmas You Are Most Likely to Face ...

- Conflicting responsibilities to multiple parties
- Client's instructions conflicting with best practices for disclosure
- Insufficient disclosure to clients/stakeholders
- Professional competition/workplace stress
- High financial stakes/potential personal gain

#### ... And the Best Ways to Face Them

- Fully disclose broker's or firm's potential conflicts to clients
- Fully disclose market and asset information to clients
- Place reputation and relationships above short-term gain
- Encourage open, serious discussion of ethical concerns
- Mentor/train team members in best practices
- Rigorously screen job applicants

### Client Transgressions

Although brokers may sometimes get a bad rap, they may also be subject to less-than-honorable actions by a client, Binswanger contended. For an off-market investment sale with a non-exclusive listing, an owner might indulge in a little gamesmanship. The broker may identify a prospective client, only to hear the owner respond that the time is not yet ripe to sell. Down the road, however, the owner may connect independently with that buyer or another one without involving the broker. Binswanger speculated that some sellers try this tack in an effort to avoid paying commissions. Binswanger advocates a solution that he believes is both fair to brokers and advantageous to their clients. "My opinion is that owners should be pushing toward exclusives because they know who's representing them," he said.

Disclosure and communication also weigh heavily on leasing. Perhaps the most familiar challenge for brokerage firms is establishing a fair climate when a landlord and prospective tenant are represented by the same shop. This brings the potential for enhanced revenue but also pushes the

brokerage firm into gray areas. Some industry leaders attempt to ward off conflict through strict procedures. A broker might shortlist 10 buildings on behalf of a client seeking 50,000 square feet of space, for instance, but five of those buildings might be represented by that same firm, presenting a conflict, Lampley explained.

Grubb & Ellis brokers representing those five buildings would be required to submit proposals 24 hours before rival brokers' deadlines to demonstrate good faith by ensuring that Grubb & Ellis landlord representatives do not get a sneak peek at what representatives of competitor landlords are offering and thus massage their proposals accordingly, Lampley explained.

How leasing brokers are compensated presents a particularly sticky wicket. No matter how accepted it may be, the practice of tenant representatives being paid by the landlord rather than by their own client remains problematic. "The way to (address) this is to try to be as open, as honest—especially about representation—as you can possibly be," Binswanger said. He sketched out the following example: The landlord for Building A might pay the broker a 5 percent commission while Building B's landlord pays 6 percent. But nine times out of 10, he argued, a fixed-fee structure can resolve these dilemmas because the broker will earn the same commission no matter what choice the tenant makes. The hitch in that solution is persuading the tenant to pay any portion of the fee that the landlord is unwilling to pay, Binswanger said.

Disclosure recently arose in another leasing context in which he personally advised a corporate client on a major leasing decision. The client selected a location that carried a cost premium running to six figures, compared to an attractive nearby space that would have suited the client's needs just as well. Binswanger made sure to tell the client that the less expensive choice was available and that the more expensive choice placed Binswanger in line for a bigger fee. "If I do anything less than that, I'm being unethical," he explained.

Among the most effective ways to promote ethical professional practice, firms cite a number of reliable standbys: thoroughly vetting prospective employees, mentoring and continuing training. Industry leaders have also tried a variety of other tactics. Jones Lang LaSalle Inc., for one, maintains an ethics hotline, and its global chief counsel, Mark Ohringer, also carries the title of chief ethics officer, noted Bill Krouch, CEO of markets.

Real estate firms are dedicating a lot of time and resources to these strategies, and that undoubtedly makes a significant difference. Yet Johnson noted that sound ethics can flow from just one principle and one question. The principle: "The client comes first." And the question, no less deceptively simple: "If there were only a dollar involved, what would you do?" Answers may be elusive, but raising the question may be the first step in untangling even the most stubborn ethical knots. ■

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