

The Challenge of Real Estate Professionalism

by Ronald M. Green

Over the years, as a teacher of business ethics I have grown accustomed to the inevitable jibes from those outside the field, especially my university colleagues. "'Business ethics?'" my academic friends quip, "Isn't that an oxymoron, like 'military intelligence' and 'postal service'?" Or again, "'Business ethics?' That must be the slimmest book in the library." And on it goes.

You can imagine the comments I received, therefore, when I told some colleagues that I was researching the issue of real estate ethics and trying to understand the moral dilemmas of real estate professionals. To these professors -- whose own ethics, by the way, could stand some solid research -- the very concept of real estate ethics was a source of humor. My colleagues were equally cynical about the idea of real estate professionalism and the efforts by people in real estate to establish a professional identity through professional organizations, codes of conduct, and the like.

After reviewing the literature in this area and personally interviewing people working in all aspects of real estate, I have become convinced that my academic colleagues are badly mistaken. "Real estate ethics," I have come to believe, is a meaningful and important idea. I have also concluded that many of those who work in real estate are properly described as "professionals" in the fullest sense of that term.

At the same time, I have also learned that there are good reasons for the cynicism about real estate ethics. It is hard to be a real estate professional. Features special to this field place stress on one's professional commitment in ways that are less common in other professions, like accounting, law, or medicine.

This discussion is in three parts. First I defend the claim that many who work in real estate can properly be described as professionals. Second, I itemize some of the features of this field that place stress on professional commitment and judgment. Finally, I make some modest suggestions for ways that real estate professionals can work together to minimize this stress and improve the professional performance and reputation of the field as a whole.

Real Estate Professionalism

Few words are used more loosely today than the term "professional." At one extreme are those who apply the term to those who are not amateurs, who bring a high degree of skill to their work, or who earns money at what they do, as in the usage "professional athlete." At the other extreme are those who would reserve this term only for those in fields like law or medicine with advanced formal educational requirements and a high degree of professional autonomy and self-regulation. My own view lies somewhere in between these extremes. Professional identity, I believe, is not a matter of expertise alone nor of formal educational qualifications. The essence of professionalism is ethical. A professional is one who is committed to a high standard of conduct that the public can rely on.

Specifically, I would propose the following definition as capturing our deepest thinking about professional identity. A professional is someone:

- who is paid for providing services based on knowledge or expertise not available to the average lay person;
- the quality of whose services is not easily assessed by lay persons but can have a major impact on the client's well being;
- into whose hands the client typically entrusts confidential information or other resources of value;
- who is trusted to place the client's interest -- and, in some cases, the public's interest as well -- before his or her own;
- who adheres to a code of conduct and belongs to a peer organization that supports and justifies this trust.

I think you can see that medicine or law, fields that are undeniably professions, fit this definition well. What is interesting is that most areas of real estate, from commercial or residential brokerage to appraisal, property management, and real estate counseling do so as well.

Consider, for example, the familiar area of residential real estate. When a family decides to sell their home and turns to a REALTOR[®] for assistance, they are in a situation of considerable vulnerability. They have placed

what is probably their largest financial asset in another's hands. Because of the technical nature of the field, there are many ways a broker can harm them without their even being aware of it. To avoid this, they count on the integrity of the broker; and they are supported in this expectation by law and by the broker's adherence to a professional code of conduct like that of the National Association of REALTORS®. In all these respects, the family's situation and their relationship to the professional is identical to that of a person who goes to a physician for medical care or to a lawyer for legal services.

Extrapolating from this core case, we can say the same thing about the services provided by real estate appraisers, property managers, or counselors. I am aware that some believe that one or more of these fields do not qualify as professions. For example, one writer has described real estate counseling as "a business with professional motivations," rather than a profession.¹ He bases this judgment on the lack of formal educational or examination requirements. But this places too much emphasis on a non-essential consideration. Physicians were recognized as professionals long ago when apprenticeship was a common means of entry into the field and before the advent of modern medical education. Until just a few years ago, my own state of Vermont permitted entry into law by those who had "read" on their own under supervision of a senior person in the field. And ministers in Vermont are still permitted this option. Yet lawyers and ministers have always been recognized as professionals because of the ethics that govern their work.

The essence of professionalism, in my view, is the expectation that one can place one's trust in the integrity and responsibility of the service provider, an expectation sustained by that individual's adherence to a code of conduct that is publicly recognized and enforced by a peer organization. Many who work in real estate -- including REALTORS®, appraisers, and CREs -- are certainly professionals in this sense.

Features that Place Stress on Real Estate Professionals

If we keep this central model of professionalism in mind, we can also begin to understand some of the features of the real estate field that place stress on professional identity and performance. I am not speaking here of things that erode the image of the profession, such as the occasional episodes of individual misconduct that occur in any field. Rather, I have in mind those special features of the field that tend to create dilemmas for the committed real estate professional. Although these features are not absent in other fields, they proliferate in real estate and combine to threaten the professional commitment and judgment of even the most dedicated individuals.

Morally Contradictory Relationships

A first problem area is particularly relevant to those who work in commercial or residential retail brokerage. It is the morally contradictory relationships imposed by law or custom that create a rich opportunity for misconduct or misjudgment within one's professional role. Law or custom often place real estate brokers and sales associates in situations of inherent conflict of interest.

The best example of this is the legally upheld notion that the listing broker is an agent for the seller. Traditional legal conceptions mandate that the broker's loyalty resides with the seller; and so long as other laws are not violated, they require the broker to avoid any activity detrimental to the interests of the seller in favor of the buyer. This idea is a natural extension of agency law; and it may have made sense at one time in history. But it has obviously grown threadbare in our day. For one thing, it does not correspond to the human and emotional dynamics of the selling situation. No matter what is formally disclosed at the outset, the broker's natural inclination to cultivate a supportive relationship with the broker or sales-associate is working for them.

This misimpression is greatly magnified in co-brokered or MLS situations. In most instances, the co-broker does not even know the seller and understandably strives to please the buyer. According to a 1983 Trade Commission study, 71 percent of the home buyers who dealt with a cooperative broker thought the cooperative broker was their representative.² This figure may have declined since 1983 as result of legally mandated disclosure requirements; but I doubt that it has declined substantially.

¹John R. White, "Lofty Expressions of Ethical Conduct Do Not Insure Adherence."

²Neil G. Waller and Theresa H. Waller.

Article 1 of the Code of Ethics of the National Association REALTORS® pledges the REALTOR®, whether working for a buyer, seller, landlord, tenant, or other client, to a duty of "absolute fidelity to the client's interests." This is an appropriate standard and one, as I have said, that is the essence of professionalism. But the realities of real estate sales operate in many situations to undermine this pledge.

I know that many real estate brokers live comfortably and ethically with this contradiction. They believe they can fully represent the seller's best interests while developing a supportive relationship with the buyer. Full up front disclosure of agency relationships, good office practices in the handling of confidential information, and a commitment to treating everyone honestly and fairly make this seemingly contradictory series of relationships work for most parties most of the time. Nevertheless, real estate professionals also commonly report that coping with this inherent set of conflicts is ethically the most stressful aspect of their work. As one put it, "We've set up a dichotomy. On the one hand, we tell buyers whom we represent, but on the other hand, many times our actions may say something else."

Few other professions have such a serious conflict at their heart. By and large, lawyers and doctors have the luxury of being able to give undivided loyalty to their individual client or patient. Recently, developments in the health care field have begun to change this. In HMOs, for example, physicians are beginning to find themselves torn between their primary loyalty to the patient and their responsibility to their employer to reduce costs and maintain profitability. Some medical specialties like OB/GYN are also beginning to experience conflicts as a result of technical or social developments.³ For example, what is a doctor to do when a pregnant woman refuses to heed advice to stop abusing drugs or alcohol? The doctor has two patients in this case, the woman and the child she is carrying. Which one deserves the doctor's loyalty? But conflicts of this sort are unusual in most professional fields. In real estate sales, they are a less dramatic but daily occurrence.

Counselors of Real Estate are not exempt from the pressures created by morally contradictory relationships. Sometimes, for example, a Counselor is called on by a client to prepare a professional opinion that is meant to be shared with third parties in the form of a written report or document offered in court as expert testimony. It is not uncommon for the client to urge the precise direction this advice should take. One writer offers a vivid description of the problem:

A developer plans to finance a new project and needs a feasibility study to justify financing. He shops a number of professional firms to "find one that has sufficient market foresight to understand that this project is feasible," despite an oversupply of similar uses. A firm is hired to "support the mortgage financing" and agrees to that condition before beginning the work.⁴

In circumstances like these, the counselor faces the unpleasant alternative of acquiescing in a matter that violates his or her professional commitment or foregoing a lucrative opportunity.

This kind of conflict is less common in other professions. Physicians seldom face a conflict between the immediate needs of the patient and the welfare of third parties or the general public. True, the AIDS epidemic has sometimes confronted physicians with a choice between respecting patient confidentiality and protecting the sexual partners of an HIV-positive person. But these conflicts are rare and physicians are aided in handling them by legal requirements that generally put the public interest first. Attorneys, too, sometimes face conflicts between their ethically mandated loyalty to the client and their duties to the public as officers of the court. But these conflicts rarely threaten an attorney's ability to make a living; and they are eased by the existence of an adversarial legal system. This system permits the attorney to give full support to the client and puts others in the position of searching out and punishing the client's wrongdoing. Outside of the context of litigation, no similar adversarial structure exists to protect the public where the real estate counselor is concerned.

Structural conflicts of this sort are not inevitable. As the experience of the other professions shows, conflict situations can be minimized or eliminated by well thought out laws and professional arrangements. I will return to this point when I make some suggestions for ways to reduce ethical stress in the real estate profession as a

³Steven Maynard-Moody, *The Dilemma of the Fetus: Fetal Research, Medical Progress, and Moral Politics* (New York: Viking, 1994), chapter 6.

⁴Dorchester.

whole.

Problems of Valuation

A second feature of real estate that creates an occasion for ethical tension and compromise is the deeply uncertain and often subjective nature of the goods with which real estate professionals deal. "Under all is the land," says the Preamble to the REALTOR® Code of Ethics; but, unfortunately, the value of that land is often notoriously hard to determine. Unlike the securities or commodities fields, no public markets exist in land with ready price quotations at hand. One writer comments that "No other profession offers a greater opportunity for two professionals appraising the same property to arrive at widely differing estimates of value, with both being technically correct."⁵

The core difficulty in establishing valuations provides real estate professionals with an invitation to ethical compromise. Standard of Practice 1-3 of the REALTOR® Code of Ethics prohibits brokers from deliberately misleading the owner as to market value in attempting to secure a listing. But the uncertainty of property values and the susceptibility of the valuation process to wishful thinking induced by commercial opportunity inevitably place this standard under stress.

John Rutledge offers a description of this problem as it applies to real estate investment managers, who assist pension fund managers in investing in real estate along with stocks and bonds. These managers have adapted to their new surroundings by replacing acquisition and sales fees (brokerage commissions in the old days) with fees based on the value of the real estate under management. But "as honest and well intentioned as the manager may be," says Rutledge, "he has a double incentive to influence the appraisal process." First, because "an appraisal with an upward bias has a direct and favorable bearing on reported investment performance, and investment performance is critical to the success of the manager's future business survival and growth." Second because "fees which are a percentage of asset values under management obviously respond directly to appraised values."⁶

Conscientious investment managers try to reduce this problem and the appearance of conflict by rotating appraisers or by establishing "independent" appraisal audit bodies to review the work of those selected to do the appraisal. Nevertheless, this solution is also imperfect. As Rutledge observes, "There is a question about how independent anyone can be ... if continued retention in a position is dependent on the will of the employer, client, or principal."⁷

Once again it is important to note that all these problems have their start in the unavoidable difficulty and subjectivity of real estate valuation. I know of no other professional field so vulnerable to bias and personal interest in one of its core professional activities. The result is that even well intended real estate professionals occasionally find their professional judgment subject to distortion created by self-interest.

Systems of Remuneration

These problems point to a third feature of real estate that can stress professional commitment. This is the way in which real estate professionals appear in the area of real estate brokerage where reliance on commissions can run counter to the best interests of the client.

One broker illustrated the problem for me by describing a recent experience. He was approached by a woman facing retirement who was "land rich" but "income poor." She assumed that she had no choice but to sell off some of her properties, even though this might involve a substantial tax penalty. As a listing broker, the REALTOR® had good reason to support her assumption. Her properties were salable and, with little effort, he could emerge with a substantial commission. Nevertheless, he felt this was not financially her best course of action. After many hours of work, he put together a complex swap arrangement that minimized her tax liabilities and left her with a good stable income. Although he emerged with payment for his services, he felt that, at every

⁵Herd.

⁶Rutledge.

⁷Rutledge.

point, the standard sales commission arrangements worked against his best efforts for the client.

Commission arrangements certainly motivate brokers to negotiate and close a deal. Many brokers favor commissions as one of the best methods of compensation because they believe that it is based on "what you're really worth." But although commissions will, in most cases, serve the client's best interests, in some they will not. In addition, the presence of contingent fees or commissions exerts a constant pressure that can distort real estate professionals' judgment.

The problem is particularly acute where a client seeks professional investment advice. Recognizing this, the Code of Ethics of the Counselors of Real Estate requires counselors to decline any assignment which makes the fee contingent on the substance of the advice given.⁸ This is a solid response to the problem. But even counselors are not free of the conflicts generated by their commission arrangements. As we have seen, it is very hard to maintain complete objectivity when one's employment depends on how much one's advice pleases the client. Writings by CREs on ethical problems in their profession are filled with reports of clients' pressures to produce a desired outcome or predetermined conclusion.⁹ Among professionals, CPAs alone share this problem.

Compensation arrangements are probably the single greatest source of ethical problems in business and professional life. The SEC recently reported that poorly designed compensation arrangements have played a role in improprieties in the securities brokerage industry. Lawyers' contingent fees are said to contribute significantly to an epidemic of costly and unnecessary litigation. Even in medicine, the fee for service system is clearly implicated in overutilization of some costly surgical or diagnostic procedures. Although real estate professionals are not alone in having these problems, the field's heavy reliance on sales commission and other forms of performance-based compensation ensures that real estate professionals will experience tensions between their ethical responsibilities and what they must do to earn a living.

Opportunities for Self-Dealing

A final feature of real estate that puts stress on ethical behavior is the existence of numerous opportunities for self-dealing. Again the experience of a local broker of residential property with whom I spoke illustrates the problem. She was assisting an elderly couple who had retired to a country home they had owned for many years. The husband's sudden illness then forced them to return to the city, and the wife placed the sale of the country home in the broker's hands. The broker knew that, with improvements, the property was potentially of great value. She knew that by one subterfuge or another she could accrue that profit to herself or to a member of her family. There was no question in the broker's mind that both the REALTOR® Code of Ethics and her own sense of right and wrong prohibited her from profiting from the family's vulnerability. But she also knew that such practices had until recently been widespread and were still engaged in by some less scrupulous practitioners.

Even conscientious real estate professionals can run afoul of this problem. It is obviously wrong for an appraiser to have an interest in a property on which he is called to evaluate; but what are the limits of this obligation? After having submitted an appraisal on a property, say a condominium development, how much time must pass before the appraiser or a member of his family may buy a unit? This is obviously a gray area; but it is one that is rife with opportunities for self-dealing or the appearance of self-dealing.

The temptation of self-dealing is by no means unique to real estate. Securities brokers and corporate managers commonly face the problem; but, at least where publicly traded stock is concerned, their resistance to improper behavior is stiffened by tough insider trading laws or by employers unwilling to indulge errant employees. Real estate professionals often act without intensive surveillance of this sort. All this makes the exercise of their own personal sense of integrity more important -- and more vulnerable to financial pressures or temptations.

Enhancing Ethical Performance

I hope my point has been made. Many features of real estate make it difficult to maintain the highest

⁸Counselors of Real Estate, 430 N. Michigan Ave., Chicago, IL 60611.

⁹For example, see *Real Estate Issues*, Counselors of Real Estate, volume 19, number 3, December, 1994.

standards of professional responsibility. This leads me to a final question. Given these basic problems, how can real estate professionals work together to minimize ethical stress and improve the professional performance and reputation of the field as a whole? Answering this question should properly occupy the thinking of the best and most experienced people in the field. I want to make only a few tentative suggestions to spur that thinking.

Overcoming the problem of morally contradictory relationships and the conflicts of interest they create requires developing new structures and contexts for professional activity. Where broker conflicts are concerned, for example, some have argued for replacing the older notion of brokers as agents for their principal with an understanding of the broker as a disclosed dual agent or even as a facilitator whose recognized aim is to help expedite the transfer of real property from sellers to buyers. In some states, this option has been written into real estate law.¹⁰

This arrangement has worked in practice for many real estate professionals and may be a solution. However, some maintain that a dual role is too difficult to play and easily results in harm to one party or the other. In my view, the problem with this idea is not so much direct harm to clients as the inevitable diminution in the real estate professional's ability to provide the best service for each client.

A better solution, I think, is to restructure relationships to align fully the professional's obligations with the realities of the sales situation. One way of doing this is to separate the sales broker's and buyer's function entirely. Specialization would give to each party a representative whose commercial interests and skills fully matched the client's needs. Although this change requires modification in the ways brokers are compensated or transactions are financed, it is already underway in many states.

Unfortunately, if these changes are not thought through carefully, they can create new ethical problems. For example, trying to perform both functions within a single agency can lead to breaches of confidentiality and pressures on individual agents to improve overall sales performance at the expense of client interests. A total separation of these functions agency by agency might better serve client needs and allow firms to specialize in those services for which they are best suited.

This last point leads to my second proposal for enhancing the ethical performance of real estate professionals. Those in this field must develop greater willingness to cooperate with and even promote beneficial changes in real estate law. There is an understandable tendency among all business people to prefer self-regulation and to view legal intrusion as negative. But sometimes laws guide people's better instincts and help create the "level playing field" that removes temptations to take unfair advantage of others' ethical compliance. Some years ago in Vermont, many REALTORS[®] were among those who opposed legislation banning the use of billboards throughout the state. Some REALTORS[®] perceived this legislation as a threat to their ability to convey their message to the public. As it turns out, because the resulting legislation had the same effect on all agencies, no one was competitively disadvantaged; and, over time, new ways were found to communicate to the public. This proved to be a beneficial case of "mutual coercion mutually agreed upon."¹¹ Some people to whom I have spoken believe the same lesson applies to new legal efforts to mandate separate brokering functions agency by agency.

Legal change may also assist with the problems I have discussed in the area of remuneration. For example, presently it is difficult for real estate professionals who wish to introduce innovative compensation ideas to overcome the conservatism of banking practices that usually recognize only the traditional sales commission. It may be that the marketplace will correct this problem over time. But there may also be room here for new legal incentives for change.

Law and ethics are two separate but related matters. I am not suggesting that laws replace the self-regulation and higher aspirations that should characterize real estate professionalism. But just as outdated legal requirements can weaken professional integrity, so well constructed laws can make it easier for professionals to follow their best instincts.

My final suggestion for enhancing the ethical performance of real estate professionals is captured in one word: education. Almost all the commercial and residential real estate people with whom I spoke lamented how newcomers to the field can go from licensure to independent practice, without any intervening period of

¹⁰For example, Vermont.

¹¹Hardin.

apprenticeship or supervision. As one REALTORS® commented, "Having a driver's license doesn't mean that you know how to drive." There was a surprising consensus for introducing a required period of several months to several years of internship or apprenticeship.

There was also a strong agreement that training for real estate professionals comprise attention not only to the technical and legal aspects of the work, but also to the ethical standards that govern it, and that this should be done on an ongoing basis. Seminars should be conducted by the professional associations on the specifics of ethical conduct utilizing case studies. Professional associations should also foster attention to the discussion of ethical problem areas as a basis for reviewing existing principles and standards of practice. This would permit real estate professionals to stay ahead of, rather than behind, the curve of changing social developments.

The phrase "real estate professional" is partly a reality and partly an aspiration. By identifying and eliminating those aspects of their work that erode professional performance, real estate professionals can reinforce the public trust that is the ethical and economic strength of the field.