

Ethics in Real Estate Business and Valuation

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Introduction

Scandals like Enron, Worldcom or the Mannesmann-Deal with the actors Esser and Ackermann have brought discussion on morale and ethics to the forefront.

This has also touched real estate industry and valuation.

- Huge outflow of capital of the real estate institute of a German bank
- Books of this bank showed a tower of them in Frankfurt with little less than € 500 Mio., now it has to be depreciated down to less than € 400 Mio.

• Real Estate Investment companies buy assets valued with 100, next day you find them in their books with 120

What is morale?

- Human beings are controlled by their instincts to a much lesser extent than animals
- Oxford English Dictionary reads:
 - “Standard of Conduct respected by good men, independently of positive law and religion”
- “Standard of Conduct” an agreement of all involved
- Not subject to any defined legal and religious values
- Therefore it is exposed to continuous changes

What is ethics?

- Philosophy judges ethics using terms like:
 - Justice
 - Freedom
 - Peace
 - Development
- RICS “Professional Ethics and the Rules of Conduct” define:

“... giving one’s best to ensure that the clients’ interests are properly cared for, but doing so the wider public interests is also recognised and respected...”

Ethics and the Blue Book I

- Introduction to the german translation of the EVS 2003 reads in one topic: “customer wishes for transparency”
- Standard 1: Compliance with Standards
 - S 1.12:
 - Optimum procedure
 - Minimum standards
 - Comparison of performance and expectations of client with regard to
 - Fulfilment
 - Ethical Standards
 - Competence

Ethics and the Blue Book II

- Standard 3: Significance of clearly and unequivocally defined terms of contract
 - S 3.02:

It shall be guaranteed without doubt that:

 - the valuator is competent and qualified
 - The valuator is not subject to conflicting interests
 - All legal provisions, statutes etc. are observed
 - Customer requirements not in line with the standard are documented in the expertise

Are these standards needed?

- Nowadays we have a sellers market in the EU
- The market value of an asset can differ significantly from the price paid
- Higher prices are paid e.g.:
 - due to missing investment alternatives with comparable Risk-Return-Profile
 - due to legal investment pressure (german open funds)
- Therefore high demands on defining e.g. the sustainable cash flow of an asset

How do we support the view that ethical regulations are expedient and necessary?

- By definitions on the one hand
 - Legal provisions
 - Standards of professional organisations and associations (TEGoVA, RICS, etc.)
 - Voluntary initiatives of the Industry (e.g. “ Initiative Corporate Governance “ in Germany
- Monitoring the compliance with regulations on the other hand
 - Leading to long term win-win-situations for the involved parties
 - Contribution to image building
 - Non-compliance should produce monetary disadvantage for

Why are ethics going to play an increasingly important role in real estate business and valuation? I

- Companies regard their properties as values within their capital resources
- Freely disposable capital resources represent the success of a company (shareholder value approach)
- Challenges from increasing internationalisation of the real estate business
 - Methods and Definitions must be comparable
 - Stronger demand for Professionalism of Valuers
 - Requirements according to International Accounting Standards

Why are ethics going to play an increasingly important role in real estate business and valuation? II

- Change in Age Structure within the EU
 - Future generations in the inter-generation contract are limited in their capacity
 - Private pension schemes are increasingly required
 - Long-term stability of private pension schemes is of utmost importance to the investors
 - Investor very much regard real estate as long-term values
 - Determination of the monetary value of real estate is becoming increasingly significant