BECOMING BETTER

What happens to character when the crisis stretches beyond a moment?

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"NO UNIVERSAL SELFISHNESS CAN BRING SOCIAL GOOD TO ALL."

— W. E. B. Du Bois

The cliché that crisis reveals character is usually stated in relation to standalone events. The doctor's character reveals itself when treating a victim in the emergency unit. The firefighter's character reveals itself when running into a burning building. The Samaritan's character reveals itself when it finds the wounded traveler on the road.

But what happens to character when the crisis stretches beyond a moment?

By the time this article is published, it will have been nearly a year since COVID-19 first spilled into the human population. Today, more than 52 million cases have spread across the world; more than a million have died; millions more now suffer from long-term conditions, and economies and civil balances around the world are on thin ice. The pandemic has tested character at all levels—personal, relational, organizational, national, and political.

That the pandemic become so rife and prolonged has not only revealed each person's character, for better or for worse, but it has also elevated typically subconscious social and ethical behaviors into the realm of everyday discourse. Whereas the measured ethical intentions of corporate social responsibility (CSR) and environmental, social, and governance (ESG) principles have emerged as the de facto conscience of corporate behavior over the past decade, mounting civil unrest, racial tensions, and economic inequality have forced business leaders and organizations to face fundamental ethical questions once politely reserved for elective college courses.

In this brave new world, mere compliance with standards is not enough for an organization to bolster its reputation and maintain the trust of its stakeholders and customers. Values are not an afterthought. Determining the values that matter, as well as specific behaviors that accompany those values—and the degree to which those values can guide difficult decisions—is of greater importance now as we stand at the intersection of economic opportunity and existential necessity.

Right now is when organizations have both the time and the need to take ethics seriously. As noted by Kelly, McGowan, and Norris in the February 2020 of *Real Estate Issues,* "without a command of the ethical vocabulary that is being presumed in the discussion, without a thoughtful study of the concepts expressed in that vocabulary, and without the ability to make a critical judgment about the applicability of such concepts, such an executive is ill-equipped to make, explain, and carry out basic leadership functions."[1]

In other words, without an ethical vocabulary, and the organizational prioritization to understand that vocabulary—especially during the crisis—businesses can get sick too. And some might disappear entirely.

RESPONDING TO THE CALL

Well before COVID-19 changed the world, AFIRE members began building the foundations of an ethics initiative to create a global vocabulary for our industry. In their Summit Journal essay, "A Call to Ethics," authored by AFIRE's ethics chair, El Rosenheim, along with Tali Hadari, the initial case was made "that improving the ethical business environment must be considered a matter of vital necessity."[2] Even as the purpose of investing is to profit, say Rosenheim and Hadari, there is no real long-term value to be gained by pursuing profit at all costs.

TRANSPARENCY

areas of focus for transparency
(1) Allocation of opportunities
(2) Shared beliefs
(3) Flow of information
(4) Using big data—honestly
(5) Telling the complete story

5

THE WORK

Ethics take constant work to balance and re-balance social behaviors, institutional responsibilities, and personal values against the mercurial expectations of everyday life.

Philosophically, it would be difficult to reject the importance of good ethics, but ethical clarity often becomes obscured when aspirations meet reality. While the corporate principles of transparency, loyalty, and service are touted as core ethical values, the struggle—belied by the dozens of ethical codes and certifications circulating in our trade—is to define what these principles look like in practice.

In his essay, "Craving the Light," also published in Summit Journal, G. Andrews Smith, advanced the conversation a bit farther towards practicality for investment managers. He posits that now—especially in the era of COVID-19—"Being intentional and open in our dealings with investors, employees, and communities will bring closeness to all our relationships—particularly those between managers and investors."[3]

According to a 2017 report from the Economist Intelligence Unit focused on investor considerations for alternative investing, respondents ranked transparency as the top priority for both alternative and traditional investing considerations, followed by regulation, policies, and other factors.[4] With these priorities in mind, Smith proposed five examples of what transparency looks like in practice, regarding (1) allocation of opportunities, (2) shared beliefs, (3) flow of information, (4) using big data—honestly, and (5) telling the complete story. In summary, Smith says, managers whose dealings are grounded in transparent practices will be better positioned to deliver better investments.

But the truth underscoring the practice of transparency can be elusive when it confronts the politics and dynamics of personal and organizational relationships fundamental to our industry.

To shed light on this dynamic, AFIRE held its first-ever Ethics Summit in October 2020, led by the James B. Duke Professor of Psychology and Behavioral Economics at Duke University, Dan Ariely. As the New York Times-bestselling author of The (Honest) Truth About Dishonesty, The Upside of Irrationality and other groundbreaking books in behavioral economics, Ariely focuses on the connection between behavior and ethicality.

Core to Ariely's ideas is the specter of the "slippery slope", or the notion that one small lie can lead to steady and often unconscious increases in egregious and amoral decision-making, a la Elizabeth Holmes and Theranos. As he writes in The (Honest) Truth, "Understanding how slippery slopes operate can direct us to pay more attention to early cases of transgression and help us apply the brakes before it's too late."[5]

Much of the behaviors in finance and investing were built over decades of best practices and behavioral algorithms. Routine has its own way of obfuscating ethical awareness, and an overreliance on habit contributed to the Great Financial Crisis in the early 2000's. In the following years, organizations took social responsibility much more seriously. "In response to this man-made disaster," Ariely says, "we've taken some steps toward coming to terms with some of our irrational tendencies, and we've begun reevaluating our approach to markets accordingly. The temple of rationality has been shaken, and with our improved understanding of irrationality we should be able to rethink and reinvent new kinds of structures that will ultimately help us avoid such crises in the future. If we don't do this, it will have been a wasted crisis."[6]

While some organizations, particularly among AFIRE membership, are leaders in corporate responsibility (in accordance with these charges of overcoming irrationality and defying the slippery slope), the COVID-19 crisis and impending long-term economic damages have thrust the real estate and financial industries into the limelight. Economic livelihoods aren't the only things at stake. During a pandemic—especially one dominated by an airborne, transmissible, and deadly disease that spreads most easily indoors—people's lives could be lost if we rely on the amoral comforts of routine.

DIALOGUE

AFIRE will foster these conversations through ongoing virtual events and forums, as well a series of case studies (as in the study on the following page) designed to assess ethical behavior for real estate, communities, and the unpredictable post-pandemic world.

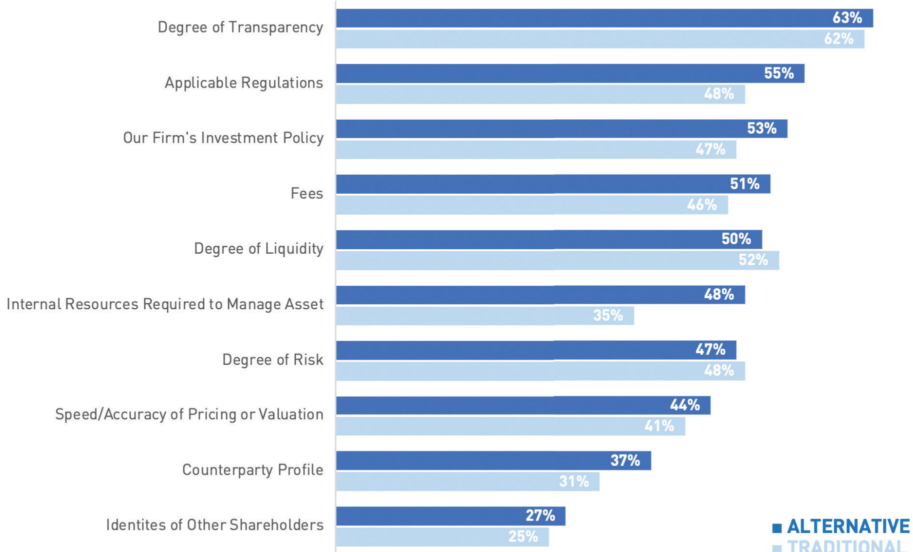
FIGHTING THE ROUTINE

Ethics are dynamic. There is no one moment where a person or organization becomes ethical. Ethics are dialogical, which is precisely what makes them easy to overlook. Ethics take constant work; balancing and re-balancing social behaviors (per Ariely), institutional responsibilities, and personal values against the mercurial expectations of everyday life. This is precisely why it's easy to let habituation and routine replace ethical consciousness, because if something worked okay yesterday and the day before that, why should I question that it will happen differently tomorrow?

To counter that, one must pause and reflect. Before COVID-19, there space or permission for such reflection was scarce. Many had become so habituated by the rapid pace of business that a learned reliance on routine (and subsequent ethical languor) left many confounded by the COVID-19 crisis. And now that the pandemic has forced a pause (and now that there are actual lives at stake, even for seemingly simply everyday decisions, such as going to the grocery store) we have been given the opportunity—in Ariely's words—to not waste another crisis.

Exhibit : Top investment considerations

% of respondents selecting "very important"
Source: Northern Trust/EIU Transparency in Alternatives Investing Survey, 2017



Because ethics aren't a fixed point, building responsible, ethical behavior through this crisis will demand productive dialogue—and for a way to understand the implications of each decision made as investors, leaders and global citizens. AFIRE will foster these conversations through ongoing virtual events and forums, as well a series of case studies designed to assess ethical behavior for real estate, communities, and the unpredictable post-pandemic world. Tried and true ethical answers to case studies that have become endemic to our responsible and "routine" business thinking must be examined through a post-COVID lens.

If we learn from one another through dialogue, perhaps we can become better.

If you would like to participate in AFIRE's ethics initiatives through case study development, research, or other collaboration, visit afire.org/ethics to learn more.

About the Author

Benjamin van Loon leads communications and publications for AFIRE, the association for international real estate investors focused on commercial property in the United States. He is also the Editor-in-Chief of Summit.

Notes

[1] Hugh F. Kelly, Desmond F. McGowan, Steven R. Norris, "Real Estate Ethics in Practical Applications," *Real Estate Issues* 44.2 (February 18, 2020): 1-12; https://www.cre.org/real-estate-issues/real-estate-ethics-in-practical-applications/

[2] Elchanan Rosenheim and Tali Hadari, "A Call to Ethics," *Summit Journal* (Spring 2020), https://www.afire.org/summit/calltoethics/

[3] G. Andrews Smith, "Craving the Light," *Summit Journal* (Summer 2020), https://www.afire.org/summit/cravingthelight/

[4] Economist Intelligence Unit, "The Path to Transparency in Alternatives Investing," *The Economist* (May 24, 2017), eiuperspectives.economist.com/financial-services/pathtransparency-alternatives-investing

[5] Dan Ariely, *The (Honest) Truth About Dishonesty* (New York: Harper Perennial, 2013), 219.

[6] Dan Ariely, *The (Honest) Truth About Dishonesty* (New York: Harper Perennial, 2013), 407.

ETHICS CASE STUDY

Closing a Fund at the Cusp of a Pandemic

An investment manager was eight months away from closing a $200 million fund when the COVID-19 pandemic brought the world to a screeching halt. A successful manager known for their strong ethical values and a committed base of investors, many of whom had invested in their previous four funds, had a complicated strategic decision to make.

The fund was opened 14 months earlier, with commitments of $120 million from private investors. The final $80 million of capital to raise would come from four additional investors who had already expressed a willingness to commit. The fund was already co-invested in multiple property types in various cities in the US and Europe, including a retail center in the UK; 3,226 multifamily units in various US locations; a logistics facility and a hotel in the Midwest; and ten office investments totaling more than 2.1 million square feet.

In previous funds, this manager usually doubled their commitments during the final two quarters of the capital raise. The investors believed that a fund at that point of maturation would be less of a "blind pool," with a substantial share of the fund typically deployed by final closing, allowing investors to benefit from a clear view of the fund's portfolio and performance. This strategy had been particularly effective during previous periods of predictable growth.

The few investments in which the investment manager had lost money in its history were made in periods of unpredictable growth, as in the three years leading up to the Global Financial Crisis. Alternately, the manager's best-performing investments were made during and shortly after the recession. Understanding this, the manager was confident that co- and post-pandemic investments (from opening a new fund or other vehicle) would have much more potential to achieve alpha than the existing fund.

Tried and true ethical answers to case studies that have become endemic to our responsible and "routine" business thinking must be examined through a post-COVID lens.

The manager knew that raising capital for a post-pandemic fund would be easy but questioned where that would leave the existing fund and its investors. Understanding that COVID-19 offered a sensible explanation for potential losses or underperformance, the manager considered the impact of a cold exit on the trust between their firm and their investors, especially if the losses of this decision would prevent investors from being able to enter into any post-pandemic offerings. After several internal meetings with their research, legal, and marketing teams, the manager was left with a core question: what investors—if any—would want to work with us again if our decision tarnished our reputation, even if that decision was based in our core principles?

Meanwhile, the short-term difficulties of the pandemic and financial crisis were taking their toll on the investment manager's operations and financial position. A percentage of tenants were not paying their rent, making debt service increasingly difficult. Staff members were unable to leave their homes as travel to assets became almost impossible. And re-tooling operations in order to allow for virtual operations took significant resources, all with a diminishing amount of income to cover those costs.

Without knowing the true duration of the COVID-19 crisis, but still having a fast-approaching date for closing the existing fund and expecting a host of critical questions to be raised on its next investor call, the manager seriously considered multiple approaches, including their ability and precedent to continue raising commitments. This approach would benefit the manager, as they had a significant portion of their own capital in the fund. This would also dilute the weight of the pre-pandemic portfolio investments for existing investors, and potentially provide them with some financial benefit (or guard them against more serious losses), as any new investors in the fund would effectively subsidize losses incurred by the assets acquired to date.

The manager had built its committed base of investors over several decades by using its values of investor service, transparency, and fairness to guide their decisions. But as the severity of the pandemic mounted around the world, indicating that it would become a critical historical inflection point, any decisions the manager may make would inevitably impact their reputation—for better or worse—and have real existential repercussions for its investors, owners, and other stakeholders.

On the next call, the investors expect more than a recitation of principles. They need answers.

QUESTIONS:

1. What are other potential approaches the investment manager can take for closing or continuing the existing fund?
2. As the existing fund has a closing date, how does the expected or forecasted duration of the crisis affect the dilutive approach or other potential approaches?
3. The investment manager has a statement of values that prioritize investor service, transparency, and fairness. Is a dilutive approach consistent with these values? What are the ways other potential approaches are more or less aligned with these values?
4. Recognizing that a global pandemic introduces a set of unique circumstances into routine operations, how should the investment manager value and prioritize (or re-prioritize) the needs of existing investors, their own firm, and new investors?