iBuyers; The Good, The Bad, and The Ugly

2 HOURS CE

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Timeline

• Introduction	5 min.
• Review of Objectives	5 min.
• What is an iBuyer?	15 min.
• Who are the iBuyers?	20 min.
• The Economics of iBuying	20 min.
• “iBuyer Adjacent”	15 min.
• Living in an iBuying World	20 min.
Total	100 min.
	(2 hours)

OBJECTIVES

- Review and Understand the Current State of the Real Estate Industry and the Impact of Venture Capital's Interest in the Space
- Understand the Concepts of FinTech and PropTech
- Understand the Concept of iBuyers
- Identify the Differences Between iBuyers and Traditional Investment or Guaranteed Sale Programs
- Review and Understand the Current Crop of iBuyers
- Understand the Business Models of iBuyers
- Review the big surprises of the iBuying Process
- Review and Understand "iBuyer Adjacent" Models
- Understand the Benefits and Weaknesses of iBuyer Programs for Consumers
- Review Techniques that Agents and Brokerages use in markets where iBuyers are active.
- Identify the Business Opportunities Generated by iBuying Platforms
- Understand Potential Consequences of iBuyer Programs for the Real Estate Industry

INTRODUCTION

Fintech and Proptech have become relatively recent focal points for Venture Capital (VC) investors who specialize in tech driven companies like Facebook, Amazon, Netflix, and Google.

FinTech is defined (by Lexico.com) as *"Computer programs and other technology used to support or enable banking and financial services."* Examples of Fintech software includes companies like Kabbage (Provides lines of credit to small businesses, with online approval, often in minutes), Robinhood (commission-free trading of stocks, ETFs, cryptocurrencies and options through a mobile app) , Credit Karma (credit scores, tax-prep software, help fixing credit-report errors and alerts of new accounts opened in a user's name) , and others,

A new term, which includes some Fintech companies that are real estate based, is the term "Proptech". Proptech is loosely defined as "*a collective term used to define startups offering technologically innovative products or new business models for the real estate markets.*" Included in a list of the top Proptech companies for 2019 are some names you may be familiar with like Compass, WeWork, Zumper, and House Canary, and some names you will become familiar with today like OpenDoor, Ribbon, Knock, and Homelight.

Neither of the terms should be scary, they're just shorthand for tech driven companies that we find in an around the financial and real estate spaces.

iBuyers (or Instant Buyers) are a relatively recent phenomenon that is attracting a huge amount of attention from Venture Capitalists, Consumers, and the Real Estate Industry. Offering quick sales at narrow margins, this business model is intent on gaining a share of the 100 Billion dollars earned annually by real estate professionals, while earning returns on the investment through rapid out sales of the homes acquired.

Florida is a large marketplace with a variety of homes attracting year-round residents, seasonal residents and investors. With large areas of tract housing that are both homogeneous and modern, Florida has attracted the attention of these iBuyer companies as they begin to scale their efforts to a national level.

According to a report conducted by Redfin, Florida had three cities in the iBuyer top 20: Number 13, Orlando, had iBuyers involved in 2.2% of home purchases. At number 16, Jacksonville had 1.9%. And at number 18 Tampa had 1.5%.

As iBuyer companies garner headlines and news articles, there is, as always, a lot of confusion about who they are and what they do. It is imperative that real estate agents be able to clarify that place in the industry for consumers who have concerns or questions.

Though iBuyers represent competition for Investors, and often do not employ real estate professionals outside their company, there are a number of opportunities generated by this type of program that professionals can utilize to enhance their business.

For the real estate licensee, representing the consumer and working for the community are key, so an understanding of the practice of iBuying, the current state of the practice and the potential consequences of the process is crucial. So together we will review, dissect, and analyze the past, present, and potential of this sector of the business.

SECTION 1: What is an iBuyer?

Though there is some confusion about the term, it has no relation to an Apple Product. The name iBuyer rather than being technology based refers to the type of transaction you have when you deal with an "**I**nstant Buyer".

iBuyers solicit inquiries from Sellers and using algorithms (an automated set of rules and calculations) combined with information on comparable properties, the iBuyer can make an offer on a property (sometimes without inspections) that will settle within a short period, offering the Seller convenience and certainty, while making their real estate asset seem more liquid. These companies often have, for the most part, a tightly defined type of target property to purchase, so the algorithms and comparables can provide often a more accurate offer for their purposes. Those purposes and the seller's purposes are sometimes in conflict, as we will see when we probe into the actual results of the process a little later on.

Investors buying and reselling homes are nothing new to the real estate industry. In fact, flipping homes has become a substantial portion of the real estate market. According to Attom Data solutions, in the first quarter of 2019 homes flipped nationally represented 7.2 percent of all home sales during the quarter. They arrived at this figure by analyzing 138 markets and finding arm's length transactions where a previous arm's length transaction had taken place within the last 12 months.

The profit on this type of real estate investment is substantial, with the average investment providing a 38.7% return on investment (not including the rehab costs and other expenses which could total 20-33 percent of the property's ARV). The time it takes to complete the flip (according to Attom's research) was 180 days on average in Q1 2019.

Of the 138 markets reviewed, the shortest time to complete were in markets like McAllen-Edinburg, Texas (127 days); Memphis, Tennessee (136 days); Raleigh, North Carolina (142 days); Mobile, Alabama (144 days).

and Phoenix, Arizona (151 days) while the longest time note was Naples, Florida at 235 days. Since most of these investors financed their investments, the cost of time needs to be considered.

Flipping in Florida is big business, and a market you are all familiar with, Flips in Miami-Dade County accounted for 32.7% of the market in Q1 2019 and ranking as one of the top 5 areas for such investments during that period. But iBuyers are a different type of investor, and often disintermediate the real estate professional by appealing directly to the consumer,

Though at first glance the iBuyer phenomenon seems to be just a tech enabled version of this type of real estate “flipping”, the economics of it are quite different. Unlike the value-added efforts of typical real estate investors who buy homes and spend substantial amounts improving them, iBuyers look for “livable” houses that need little more than “polish and lipstick” types of cosmetic work, and work on a much narrower margin.

The premise of the iBuyer is that their offer is closer to the “market value” of the property, working on slim margins but high volume. Typically some sort of Automated Valuation Model is involved, and the consumer completes an online form detailing the condition and materials of the homes. As AVMs become more and more sophisticated, their accuracy improves, and theoretically, they approach market value with a smaller margin of error.

The consumer receives their offer within as little as 24 or 48 hours, possible subject to inspection or repair concessions. The consumer pays a fee to the iBuyer, between 6 and 12% in the current models, and the closing takes place with rapidity. For the consumer, the value proposition is simple, simplicity, certainty, and flexibility. Of course they “leave some money on the table”, but since the sale is within a small percentage of the market, the satisfied consumer feels the value exceeds the cost.

The phenomenon has seen tremendous growth since 2014 with iBuyers accounting for 25,500 transactions in 2018 – 15,000 purchases and 10,000 sales representing 0.2% of the 5.5 million transactions completed nationally.

In Phoenix, iBuyers market share has steadily increased. With the launch of Zillow's iBuying program in May 2018, the total market share gained 2%, growing to nearly 6% of the market, in February 2019, with Opendoor accounting for 50% of that total gaining ground rapidly.

iBuying is being fueled by multi-billion dollar organizations, where profit may not be an immediate concern.

- Opendoor $1.3 Billion dollars in Equity Raised
- Zillow $7.1 Billion dollar Market Cap
- Offerpad $150 Million dollars in Equity Raised
- Knock $60.5 Million in Equity Raised
- Redfin $1.8 Billion dollar Market Cap

But even with all of this money coming into fuel this movement, buying property this way is capital and labor intensive, and the narrow margins require these companies to sell rapidly.

Discussion Question:

What do you think the entry of a company like this means in your market?

- Some discussion point to consider
  - Who is impacted most by these companies?
  - What work do you currently do with investor buyers?
  - How much of your business is referral based?
  - Have other "disruptors" impacted your market? What happened to them?

SECTION 2: Who are the iBuyers?

- **OpenDoor** started in Phoenix Arizona in 2014, and since then, Phoenix has become "ground zero" for the iBuying movement. With a large homogeneous supply of property, scores of institutional investors, and a relatively transient population, it was a natural place for the experiment to begin.
- **OfferPad** - Similar to OpenDoor and chasing them in many markets. They will provide you with an offer within 24 hours. As an added benefit, they will pay your moving expenses if you're moving within 50 miles of your current residence.
- **Zillow Offers** - Zillow started a hard Pivot from their marketing platform into iBuying and are uniquely positioned to take advantage of affiliated businesses, with brokerage licenses in all 50 states, a mortgage company, just to name two. Though they don't have OpenDoor's "first to market" benefit, they're the best known name among the iBuyer players. Their AVM (the infamous Zestimate) has been worked and refined for a decade, and they have tremendous amounts of consumer data to fuel their algorithms. To show how serious they are, Rich Barton replaced Spencer Rascoff as CEO of Zillow not too long ago and is driving the iBuying bus full speed ahead.
- **Knock** - Founded by Trulia Veterans Sean Black & Jamie Glenn, and startup veteran and engineer Karan Sakhuja, Knock was started in Atlanta as a traditional iBuyer, but transitioned in 2017 with the soft launch of its trade in business model. This model positions them to handle both the sale of the existing homes (like other iBuyers) but also wants to help you buy your new home before you close on the sale of the current property. Phoenix was their 6th market, opened in February of 2019. Unlike other iBuyers, Knock is focused on earning 3% on each end of the transaction, looking to move more rapidly to an IPO as their goal.
- **Redfin Now** – Their entry to the iBuyer space was followed by an IPO when Redfin went public, raising a substantial amount of money. Redfin is active as a brokerage in 80 markets, and their entry into the iBuyer market lets them also take advantage of the numerous seller inquiries that don't end up in a sale to the iBuyer division of the firm.

In July of 2019, Redfin's CEO Glen Kelman announced that they had partnered with OpenDoor to offer them a brokerage option if they chose not to sell to OpenDoor.

- **Keller Offers-** Keller Williams, in their drive to be perceived as "tech forward" made the development of an iBuyer programs a natural step for them, though their leadership has indicated that they don't envision the program being a major profit center as much as it might be a lead generation program for them. It's interesting that in an interview with Inman News, Josh Team of Keller Williams said," *We don't think this a huge addressable market for all real estate. We think there's a stock value war happening and that's what you're seeing with some of these larger companies who are spending a lot of money and getting a lot of headlines. I think they're trying to send stock prices up."*
- **CataList-** In September 2018, in a partnership with lease-to-own company Home Partners of America. Initially, a pilot program for Coldwell Banker NRT agents in Atlanta, Dallas and Tampa was developed called CataList. In March 2019, program was expanded to included Century 21, Coldwell Banker, Better Homes & Gardens, ERA, Sotheby's, Corcoran Group, and Climb agents in those cities. Plans were also announced to increase the marketplaces the program was offered. This differs from other iBuyer offerings by requiring participants to have a signed agreement with an agent who presents the cash offer to the seller, who either accepts it or moves forward seeking a conventional sale.

Group Activity:

Let's get into groups and discuss which of these business models makes the most sense to you. Be prepared to discuss your answers with the entire class.

Some recommended items to include:

Market Value Estimates

Cost Comparisons	Benefits of Full Market Exposure
Coordinating more than one Transactions	Competitive Marketing
Current Market Activity	Listing Lead-Generation

Though the automation of creating market valuations has become more sophisticated in the last decade, active real estate professionals often are able to sense or react to micro-market changes that may not be immediately recognized by an AVM's calculations. Since one of the pillars of the iBuying proposition is the "market value" received by the seller, this is a matter if great importance to the consumer.

SECTION 3: The Economics of iBuying

Even though there is a tremendous amount of publicity surrounding iBuying, in 2018, all of the iBuying companies accounted for only 0.2% of the national real estate market. Even so, this business model is growing, and Morgan Stanley predicted that if iBuying grows rapidly and strongly, it might reach 10% of the national market by 2030. So why is there so much interest in this type of business from Venture Capitalists?

The larger players in the field (with the exception of Zillow) show a great deal of discipline staying in their "buy box". The buy box is defined as the targeted type of property requiring the least repair and providing the quickest turnover and maximum return. In the short time we've had to observe the ibuyers, discipline in purchasing seems to be imperative. Any real estate investor knows that your profit is made when you buy a property, not when you sell it, and iBuying is no different – lack of focus means more exposure, longer days on market, more interest paid, and the potential for greater losses.

iBuying is a low margin, high volume, type of business. As we mentioned earlier, to succeed, a company needs to scale rapidly across numerous markets. By being in different markets, the cyclical nature of the real estate market is balanced by diverse marketplaces, and the volume can grow to allow the companies to achieve significant profitability. If one city has a slowdown, another may actually see rapid growth, providing insulation from the cyclical nature of the real estate business.

In addition, as these business scale, they achieve greater national recognition (and therefore greater consumer acceptance), more favorable financing, and the potential to partner with affiliated businesses providing title insurance, closing services, and mortgage lending, as well as the obvious economies of scale obtained by any national firm. They may even achieve economies of scale through national marketing and possible on materials for their rehab work.

For companies like Redfin and Zillow, the seller leads that are generated by the iBuying company are a second source of potentially substantial income as real estate professionals pay referral fees for the opportunity to list the homes of the consumers that chose not to use the iBuying services offered. Zillow also has the benefit (and the stated intention) of being able to potentially capture the mortgage origination for the buyer of the property on the out sale.

“Red is the New Black”- was a statement made by Mike Del Prete at Inman Connect Las Vegas**.** Though most traditional real estate investor are profit motivated, these VC funded companies aren’t necessarily moved by immediate profit. Some, like Knock, see an exit through an Initial Price Offering (IPO) when their company goes public through a stock offering. Others, like Zillow and Redfin are driven by market perception and stock prices as investors perception of their profitability and future prospects move the price of their stock in, what is hopefully, a positive direction. In all of these cases, velocity (or speed of growth) is of higher perceptual value than actually turning a profit.

Zillow announced an 84% increase in iBuying activity in Q2 2019 (which is an impressive number but remember early stage growth is always huge).They earned $248.9 million, representing 41.5% of their total revenue for the quarter, but posted losses of $71.1 million during that quarter. Their stock, which had increased from their May earnings announcement took a 14% dive after the numbers were made public.

Other potential income levers include sales to the portfolios of institutional single family purchasers. Typically, the domain of “Mom and Pop” investors, operating single family rental portfolios became big business after the 2008 meltdown, and continues to be a growth business. Single-family rental companies have the advantage of being able to move with the housing cycles, profiting both from their income and their assets. Blackstone Capital, owners of Invitation homes, owns approximately 80,000 homes in 17 major markets, largely in Florida and the West. It has a 96 percent occupancy rate and continues to grow revenue, according to CNBC. They were also the largest single buyer of Opendoor properties in Phoenix, accounting for as much as 10% of Opendoor’s sales/

SECTION 4: “iBuyer Adjacent”

With all of the hoopla surrounding this new wave of Proptech driven companies, it seems that a number of other business models are being confused with iBuyers. As we pointed out earlier, Knock is more of bridge loan type of solution than an actual iBuyer, and other companies are similarly confused.

- **Haus** is a “co-buying” Proptech driven company. They replace conventional mortgages helping buyers finance the purchase of a property in exchange for equity. The company claims that the monthly payments it collects are on average 30 percent less than what a homeowner would pay in a traditional mortgage. They do however share the reward of increased equity; Haus also takes on some notable risk if the property doesn’t appreciate
- **Ribbon** is a company dedicated to helping people buy before they sell, earning a 1.5% fee and an agreed upon rental until the consumer’s original home is sold. Realogy, not to be outdone is developing a similar product called **OfferBoost**
- **Zavvie** is an iBuyer comparison tool, created by Lane Hornung, a broker in the Denver Colorado area. He has also created a product where an investment fund can make competing instant offers if the consumer desires. His main objective is converting the sellers that don’t accept an instant offer to listing clients.

- **Knockeasy-** A company aimed at releasing liquidity, Knockeasy will buy 70% of the equity in a home and then rent the unit back to the sellers. Though not a typical iBuyer, they can assist sellers release liquidity and remove the need for contingency sales.
- **Homelight's Simple Sale** is an iBuyer aggregator tool, created by a Homelight, an agent referral portal. Simple Sale General Manager, J.J. McCarthy said in their press release, "Through buyer relationships we've established in more than 40 U.S. markets, Simple Sale lets home sellers find the best iBuyer for any home on one platform." Of course, sellers who don't sell to one of those programs becomes available for referral to an agent in the Homelight program – making this another lead generation play for the referral company looking to collect 25% of the listing fee
- **iBuyerconnect** is a product of WR Studios. It creates a feature in their Cloud CMA program, that notifies a seller that their home qualifies for an Instant Offer based on parameters set by a group of investors participating in the program. The program is currently limited to a small group of investors in Southern California, but the company intends to take the process to other markets.

SECTION 5: Living in an iBuying World

With all of the business models, and Morgan Stanley predicting only a 10% market penetration by 2030, what does it mean to real estate professionals who go to work every day to list and sell residential real estate?

Though iBuyer companies seek to solve a perceived problem for consumers, not all of them will succeed. Some of the companies that are new startups will probably either pivot (change to a different business model), be absorbed by competitors, or fail.

Some issues that may arise in the marketplace include the potential for vandalism and squatters as the vacant homes accumulated by these investors accumulate. This may increase their maintenance and legal costs to repair or evict when this occurs.

Because access to these homes is often automated, an individual could pose as a buyer and gain entry to the property, rekey it, steal items of value, or just utilize the property for some purpose unintended by the owner.

Further, the iBuyers run the risk of having their algorithms provide them with purchases of homes that have adverse conditions that are not readily apparent to the program. A neighbor that parties late, has numerous transient tenants, has smelly or noisy pets may not impact the AVM, but it will certainly impact showing of the property, or its eventual sale price.

According to a report developed by Collateral Analytics, “In all, the typical cost to a seller appears to be in the range of 13% to 15% depending on the iBuyer vendor.” While people may be willing to accept less in exchange for convenience, certainty, and speed, losing between $39,000 to 45,000 on a $300,000 sale is an awful big discount for most consumers.

As the market becomes more crowded, buying disciplines may fall by the wayside creating even narrower margins for the institutional iBuying companies.

Market slowing (even more than possible downturns) may create massive additional interest and carrying costs, that aren’t easily recoverable by “waiting it out” or making additional improvements to the property

Properties that are vacant for a longer time makes the properties available to squatters, vandals and drug use. In some markets, sophisticated squatters may occupy a property for months before possession is recovered.

Traditional Agents will begin offering iBuying options and will additionally make themselves useful to consumers by analyzing iBuyer offers and helping consumers choose the options and the offers that net the consumer the most money.

Exercise:

Sam is an experienced real estate professional. He has worked in sales, mainly concentrating on listing properties in his marketplace. Joe lives in a 20 year-old community of single family homes, and he constantly works with neighbors to help them sell their homes to achieve the best price, terms, and time frame for the seller.

Sam has recently had consumers come to him to ask if working with an iBuyer would be good for them. The consumers hear that they can sell for market price and settle quickly, with a simple visit to a website or a phone call.

What would be the next steps for Sam? How would he explain the pros and cons of selling to an iBuyer in the most objective manner.

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Summation:

In the final analysis, we know that there is a section of the market that will be served by Instant Buyers, and a far larger section of the market that will not. We also know that these business models, like all technology-based models, will change and morph with time as the businesses learn from the market, face business challenges and the competition of 2.0 and 3.0 business models. Whether the real profit in these businesses come from IPOs, acquisitions, or the sale of seller referrals to the real estate industry, one thing is for certain. Real Estate professionals and their businesses will adapt to these changes in the market as they have adapted to so many and will continue to provide high levels of service and value to their clients and customers.

We hope you have enjoyed this course and are leaving class with a better understanding of Fintech, Proptech, the place of iBuyers, and other tech driven business models, the economic and business forces at play, and how to position your real estate practice and your real estate career to grow and prosper today and in the future.