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Inside Zillow's misadventures in iBuying

How the Seattle company accumulated billions in debt and over $1 billion in unsold home inventory

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Zillow CEO Rich Barton.

Antonio Pellegrini was stunned.

In May the real estate agent listed a two-bedroom home in Fountain Hills, Arizona, 30 miles north of Phoenix, for $342,000. After 25 days on the market, there were no takers for the 1,400-square-foot home and Pellegrini counseled his client about potentially lowering the listing price.

Then Zillow came along.

The company's Zillow Offers instant homebuying – or iBuying – division offered $406,000 for the house, 16% above listing price. Pellegrini told his client to take the offer right away.

Today, Zillow has listed the house on North Saguaro Boulevard for $364,000, which is $42,000 less than what they bought it for.

"There was no bidding war," recalled Pellegrini of **Pellegrini & DeGeorge Partners**, an affiliate of **Sotheby's International Realty**. "It was from an online algorithm, and Zillow must be so naïve and understaffed that they couldn't take the time to look at the property history."

Last week, Zillow paused home purchases made under Zillow Offers, a division of the widely recognizable Seattle-based company that makes up 60% of its operating revenue and expenses.

Zillow's primary iBuying competitors – **Opendoor**, **Offerpad** and to a lesser extent, **Redfin** – pounced on the announcement, making clear that they are open for business.

"Offerpad is continuing to expand our reach," company founder and CEO Brian Bair told HousingWire. "With one of only a few companies that provide an iBuying offering halting business, it does present an opportunity to us as customer demand for streamlined, on-demand real estate solutions remain high."

Zillow has declined to comment on its decision beyond an Oct. 18 press release that cited labor and supply chain constraints and said its home purchase program hit "operational capacity." The company said it would complete purchases that are under contract but not closed, and will continue to work on reselling existing inventory. More will be known Nov. 2 when Zillow has its third-quarter earnings call.

From what we know now, Zillow accumulated significant debt to grow its iBuying division, while perhaps not being fully sensitive to the nuances of real estate.

"It may be difficult for algorithms and folks who are making a value assessment," said Pasadena, California-based **Compass** agent Tracy Do, who has been encountering iBuyers in her deals in the past months, "particularly when they don't know that specific market and buyer preferences."

More than durable

At no point until last week did Zillow executives tell shareholders and the public that Zillow Offers is in trouble.

On the company's second-quarter earnings call in early August, CEO Rich Barton said that Zillow Offers was "surpassing our internal expectations" for both revenue and operating income. Zillow Offers purchased 3,806 homes in the quarter, paying consumers cash up front. It also sold 2,086 homes in the three-month period, generating $777 million of the company's $1.3 billion in quarterly revenue. Zillow Offers lost $59 million in quarterly net income.

Barton called Zillow Offers' value proposition "more than durable," indeed, the means by which 16-year-old Zillow would not just reinvent its own company from consumer listings website to home broker, but also reshape U.S. real estate

"Our expanded dream is to reengineer, streamline, and digitize the moving process, or as you heard me call it many times, Zillow 2.0," Barton said on the call.

Toward that expanded dream, Zillow has taken out $500 million each in revolving credit facilities from divisions of **Goldman Sachs**, **Citibank**, and **Credit Suisse**, according to public filings.

The Credit Suisse debt matures at the end of 2022. The Goldman Sachs and Citibank debt have deadlines to be fully repaid in later 2023.

Additionally, Zillow was poised to close on a debt offering bringing in $450 million more, Chief Financial Officer Allen Parker said on the company's August earnings call.

Zillow drew down $824.4 million total from these credit facilities as of June 30, according to the earnings report. As of the June 30 numbers, Zillow must pay at least $24 million in interest on the $1.5 billion debt, as each credit line has a weighted average interest rate of almost 2.9%. How much further it drew down those lines in a busy Q3 won't be known on Nov. 2.

The 3,806 homes purchased in the second quarter more than doubled the number of homes purchased in the first quarter, which was itself a major increase over the fourth quarter of 2020. Some of those homes Zillow resold within a couple of months. But others have stayed on the company's books, and as empty homes amid a severe nationwide housing shortage. Zillow reported $1.2 billion in unsold home inventory as of June 30.

Existing home inventory has likely expanded since. Data published last week by real estate industry consultant Mike DelPrete indicates that Zillow again more than doubled its number of quarterly home purchases, buying more than 8,000 homes nationally in the third quarter. At least in the Phoenix market, DelPrete reported, Zillow is paying above market value, about $65,000 more than the median market price of $400,000.

To use another example of a Fountain Hills home, Zillow sized up a house with a listing price of $509,000 that had been sitting on the market for 57 days. The company bought it for $566,000 in late July, or 10% above its listing price. Zillow has since tried reselling the property on Keymar Drive, by listing it for increasingly less than what they bought it for.

Outside observers aren't sure why Zillow bought homes over market value. One theory is that the company put too much faith in their home valuing algorithm, whose consumer-facing version is the "Zestimate."

"Zillow thought that lots of great tech and algorithms and lots of capital will suffice to be successful, forgetting that the last mile from the web sites to the purchase or sale of a home still requires a great deal of human capital," said Steve Murray, founder and senior adviser at **RealTrends**.

The company's press release announcing the iBuying pause does mention "labor constraints."

Labor constraints can mean lacking renovators to spruce up a home before a profitable resale, said Ygal Arounian, an analyst at **Wedbush Securities**. It could also mean, Arounian said, an admission that the company lacked the inspectors and back-office personnel to understand a home's value.

"They scaled up really quickly over the spring and summer months," Arounian said. "It was more than they could handle."

Zestfully algorithmic

Greg Buchak was a portfolio manager at Goldman Sachs where he became familiar with the venerable world of corporate bond trading.

The bond is a notably "illiquid asset that is hard to trade," Buchak said. It relies on intermediaries like Goldman Sachs willing to pack their balance sheets with this financial instrument, hopeful that they can resell it for a small profit.

Buchak today is a Stanford business school professor who published a paper in 2020 on iBuying – an area that the professor found strikingly similar to bond trading.

"Zillow is better at owning a home than I am," Buchak said, because they will load their own balance sheet with housing inventory.

But when it comes to selling that purchased home, "iBuyers are not particularly amazing."

Different theories have blossomed about Zillow Offers' business model.

One – expressed by DelPrete, Yousuf Hafuda of **Blackstone**, and others who have gone through an iBuying transaction's financials – flatly says the model is an unworkable way to make money. Whatever revenue Zillow can make – charging the home seller 5% of the purchase price, the difference between what the home is bought for and then resold for – is more than offset by the purchase cost, plus staffing and administrative costs, *plus* the cost of renovating and maintaining a home. Nobody at Goldman Sachs must make sure a bond is not flooded or vandalized.

Another theory – voiced by Pellegrini and other real estate agents interviewed by HousingWire – is that Zillow is not completely sharing with the public its iBuyer business model. "Could there be a tax gain or a behind-the-scenes reason for Zillow just buying property in excess of what it's worth?" Pellegrini asked. An idea here is that Zillow – or for that matter Opendoor or Offerpad – is stockpiling houses to sell and wait for a corporate investor, an **Invitation Homes** or **Colony Capital**, to buy.

But there is no evidence that large-scale corporate investment is happening – or any other stealth strategy is afoot. “The homes are marketed and sold on the Multiple Listings Service like everybody else,” Buchak said.

One Zillow Offers armchair debate is if the algorithm can predict market downturns.

Arounian of Wedbush, who has been more sanguine about iBuying’s long-term prospects than some, said that Zillow should “100 percent” be able to synthesize data on market ebbs and flows.

Buchak is not so sure. The professor’s research focused more on Opendoor and Offerpad than Zillow. With those companies, Buchak found that iBuyers suffer “adverse selection,” meaning they know less about a home’s value than the person selling the home. That could mean not knowing about a noisy neighbor, or ignorance about a local business about to close or a lake on the verge of being contaminated.

“iBuyers are in the business of buying a bunch of stuff and then getting it off their books quickly,” Buchak said. “They are not out there trying to predict the economy.”

Whatever the case, Zillow Offers likely did not adjust purchase pace as the market cooled. From January to July, U.S. home prices soared from $303,000 to $362,000, according to **National Association of Realtors** data, amid anecdotes of bidding wars and buyers waiving inspections. Since then, prices have slightly dropped, with the median average home cost at $352,800 in September, per NAR data.

The listing price of some Zillow-owned homes is also falling. On Friday, the company lowered the price of its Keymar Drive home in Fountain Hills – the one it paid $566,000 for – from $522,000 to $509,000.

“The 3-bedroom, 2-bathroom home with beautiful mature landscaping, a large lot and excellent location is sure to please,” reads the listing on Zillow. The Zestimate is also $509,000.