For sale: iBuyers in the housing market

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In 2020 iBuying, the buying and selling of houses online, gained popularity as many sellers sought to take advantage of the COVID-induced demand. Zillow Group was a big player in this space until it, paused and then began to wind down its iBuying business, which resulted in a loss of $880mm in 2021. This pivot was potentially related to economic challenges within the iBuying model, particularly the algorithmic pricing models, that are not present in the traditional home buying market, says CIO.

Since the start of the COVID-19 pandemic, homeowners in suburban and rural areas have benefitted from a number of people departing more dense cities in search of additional space and lower living costs. Sellers have used iBuying to circumvent many aspects of the typical, lengthy homebuying process and potentially receive cash payments in an expeditious manner.

To initiate the process, an owner requests an offer from an iBuyer, a real estate company that buys and sells properties online. Theoretically, iBuyers cut out the need for a realtor or agent by buying homes directly from homeowners and selling them directly to home buyers. After a seller submits basic information about their home, an algorithm generates a price on behalf of the iBuyer, such as Zillow or OpenDoor, which the owner can immediately accept or reject.

iBuying companies took a pause in 2020 when business slowed at the start of the COVID-19 pandemic. More recently, they’ve seen a resurgence in business and today operate in some of the country’s fastest growing markets including the Southeast, Southwest and Mountain West states.

A strong housing market was a key driver in the success of iBuying. Home prices in the US soared between mid-2020 and mid-2021 by almost 7% in inflation-adjusted terms, the highest rate since 2006, underpinned by low financing costs and strong demand, according to the UBS Chief Investment Office (CIO)’s Global Real Estate Bubble Index (GREBI) report. In Southern California alone, home sales to the top four iBuying companies more than doubled this past spring, jumping 123% from the quarter before to an all-time high of 789 homes, a Zillow analysis showed.
Zillow’s Q4 results, announced on 10 February, revealed that the shuttered home flipping business lost $881mn in 2021, says The Wall Street Journal.

In a statement released in October, Zillow COO Jeremy Wacksman attributed the company’s iBuying reversal to labor and supply constraints. He said “We’re operating within a labor- and supply-constrained economy inside a competitive real estate market, especially in the construction, renovation, and closing spaces. We have not been exempt from these market and capacity issues and we now have an operational backlog for renovations and closings.”

In a new letter to shareholders, Zillow Group shared that they’re making progress on their plans to wind down the iBuying operations. The news of Zillow’s losses highlights the fact that, while mostly automated, the process includes manual steps that are unable to keep pace with the automated aspects of the process because they’re dependent on labor and materials. This reveals some of the challenges for the iBuying model but, according to CIO, it is not indicative of trouble in the larger housing market.

The iBuying model has certain challenges that have been exacerbated by a multitude of factors, including increased competition from institutional buyers, rapidly rising prices that could be negatively impacting, returns, pricing algorithms that are not optimized for such a dynamic market, a disrupted supply chain that is likely leading to longer repair and remodel times, and extended turnaround times, which lead to increased financing costs, according to Jonathan Woloshin, Real Estate & Lodging Analyst Americas.

“CIO is still constructive on the housing market,” he says. “If there is a bright spot amid the supply chain disruption from COVID-19, it’s that it will likely extend the housing cycle. There are near-term disruptions, but the market is still favorable.”

“A slowing of the housing market is not surprising given the incredibly strong upward movement in home prices over the past year, the recent increase in mortgage rates, the reopening of many large cities as vaccinations become more prevalent, and many people turning their consumption patterns toward experiences and travel,” adds Woloshin.

“We believe it is important for investors to differentiate between a normalization of what has been a red-hot market and a market that is rolling over. In our view, there is a plethora of data that is supportive of a solid housing market going forward.”

For more from CIO on the housing market see US housing: Pause, cool down, or crash? 19 July, 2021

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