Vol 1, Issue 5: September 2018

The Game of Platforms
Technology Edition

Observe. Orient. Decide. Act.

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Observe.

INTRODUCTION

I initially wanted to write on the Q2 earnings reports from the public companies in real estate since tracking what Zillow, Redfin, Realogy and now eXp are doing gives us all a good idea of what's happening in residential real estate. But a few things happened in the last couple of weeks that changed my mind.

First, all of the Q2 reports more or less confirmed and validated all of my thoughts from the June Report on Q1 earnings. I titled that report "The Shape of Things to Come" and I see very little in the Q2 earnings reports that changes my mind. I am likely to do a series of posts perhaps following up with updates for Q2, but I didn't think it deserved a full Red Dot.

Second, Zillow's moves are important, if not exactly a surprise. The acquisition of Mortgage Lenders of America (MLOA), as well as other things we're seeing out of Zillow, tells me that Spencer & Co. have seen the same strategic shifts that I have been seeing.

Third, it seems obvious to me that the tech side of real estate has a new buzzword: platform. Sure, we still hear a lot about AI and AR (Augmented Reality) and Big Data and so on, but the new buzzword is "platform" as in every single tech company out there is trying to position itself as a "platform" of some sort. Major companies from Compass to Keller Williams are talking about either becoming or producing a "platform"—sometimes, they even add the helpful phrase "end-to-end" so we all know they're talking about something really major.

Thing is, I think there is a serious misconception in the real estate industry about what a platform actually is. Sure, some of it is semantics—how do you define the word "platform"? But then, any debate can devolve into a semantic debate, which usually ends up being uninformative and advances nothing.

So, we're going to devote this issue of The Red Dot to the question of "platform". What is it? What are its essential characteristics? What challenges exist? Who are the players, and why?

We will reference the frontrunner in the race to become the real estate platform today: Zillow. In part because, well, Zillow is the frontrunner. And in part because Spencer Rascoff is remarkably open and transparent in discussing Zillow's strategic views. However, we will also reference both Redfin and Realogy, as their CEOs have been pretty open as well in earnings calls.

The real estate industry is at an important turning point, and will be over the next couple of years. The Game of Platforms has been going on for a while, but it has become visible enough for the rest of us to see.

Robert Hahn
August 2018

EXECUTIVE SUMMARY: TECHNOLOGY

In the June Report, I wrote about the play to become the real estate platform, invoking the pop culture phenomenon of *Game of Thrones:*

> What is actually at stake here is nothing short of the real estate industry's version of the Iron Throne: **who will be the platform for real estate?**
>
> ....
>
> What we are looking at, then, are the initial forays into centralizing and consolidating the rest of the real estate experience *outside of seeing what's for sale*. Redfin has been at that game for ten years. Zillow is now entering that game with Zillow 5.0.

Having an API or connecting to other applications does not a platform make. So, what does?

The Platform: Essential Characteristics

If you own the supply chain, you're a linear business.

Platforms, in contrast, own *networks* – the means of connection referenced above and provides four core functions to its network:

- Audience building
- Matchmaking
- Providing core tools and services
- Setting rules and standards

These four are essential characteristics of a platform.

The Hybrid: Linear Plus Platform

An important concept for us is what Applico calls the hybrid model, in which a company has both linear and platform characteristics. The best example they use is Amazon.

Amazon continues to sell a number of items direct to consumers despite lower margins because they are "ones that Amazon has identified as major sellers and where it is strategically important for Amazon to have quality, inexpensive items available."

The linear part of Amazon's business allows it to control the quality and availability of important items that keep bringing shoppers back to its website, which in turn brings more and more merchants into the Marketplace. The linear business also subsidizes the investment and costs of the infrastructure that Amazon has built, from warehouses to logistics to technology, which can then be used for the Marketplace platform business as well.

This hybrid model is important for us because what we are witnessing is the evolution of pure platform plays, such as Zillow, into a hybrid model. It is necessary in real estate because of the peculiarities of the home sale and purchase transaction.

The Industry's Spin Problem

That definition is in sharp contrast with how most of the real estate industry thinks a Platform is: a series of products that interact with and are connected to each other.

All of this is spin and marketing. These tech platforms are concerned above all with facilitating the exchange of value between real estate agents and consumers and limit the network accordingly. These are not Platforms, as we have defined the term, but software products for real estate agents.

The benefits of being a pure platform are amazing scalability, margins, network effect, and so on and so forth. The downside is lack of control over the consumer experience.

Nothing wrong with that, of course, but the whole point of this Red Dot is to help you understand what is and is not a contender for the Real Estate Platform.

The Real Estate Platform

By now, the intelligent reader is thinking that given the definitions above, a real estate brokerage sounds a whole like a Platform business. A brokerage doesn't own any inventory. It does not own the supply chain. It facilitates connection between buyers and sellers. It has networks. It has and tries like crazy to get an audience. It has core tools and services.

What the brokerage lacks is "rules and standards".

Furthermore, when brokerages turned to the agent-centric business model, they restricted their networks to those agents affiliated with them. Besides, brokerages didn't really feel the need to become a platform: they had the MLS.

It turns out that the MLS is a classic platform business: network, matchmaking, core tools and services, and rules and standards. It has long been the dominant force in American real estate.

So why isn't the MLS the frontrunner in the Real Estate Game of Thrones, instead of Zillow?

Limits of the Pure Platform

Pure platform businesses are undoubtedly extraordinarily rewarding for companies that achieve scale. Margins are unbelievable, since there are no inventory costs, no production costs, no supply chain costs.

The benefits of being a pure platform are amazing scalability, margins, network effect, and so on and so forth. The downside is lack of control over the consumer experience.

The Exchange of Value and the Pure Platform in Real Estate

What is the exchange of value that is to be facilitated?

Somewhere along the way, the industry forgot the all-important insight captured in the quote from Theodore Levitt, often called the father of modern marketing: “People don’t want a quarter inch drill; they want a quarter inch hole.”

Buyers do not actually want to buy brokerage services; they want to buy a home. Sellers do not actually want to buy brokerage services; they want to sell their homes. The real exchange of value is a property for money, not services for a commission.

However, real estate is a mediated transaction for a variety of reasons, though changes are afoot.

Mediated Transactions

There remain some products and services in the 21st century that require someone to mediate our purchase of them.

For example, pharmaceuticals and medical services often require mediation. Legal services are another such area. But without question, housing remains the largest and most common mediated consumer transaction.

There are numerous reasons why consumers use a real estate agent to buy and sell homes, but three main reasons stand out.

Regulation

Real estate is a heavily regulated transaction. There are multiple layers of laws, ordinances, and regulations involved.

Fact is that even if you decide to go FSBO or direct purchase without a real estate agent, you are likely going to want someone to help you with the process because of all of the laws, rules, and regulations involved in the purchase or sale of a piece of real estate.

Convenience

Selling anything to the public is difficult and annoying, as anyone who has ever done a garage sale knows. Selling real estate to the public is even more difficult, stressful and plain old annoying.

Buying a home is not easy either, since each home is unique, extremely expensive and not subject to returns and refunds. Most buyers will need to finance the purchase as well, which then subjects them to the horrors of the modern mortgage process.

And of course, should any repairs be necessary, whether as the seller or as the buyer, you have added on additional burdens of making sure that work is done on time and on budget.

Psychology

The home is usually the most expensive purchase of a typical American family. Most buyers enter into a debt that is expected to take *three decades* to pay off. A home is also something you can't return after a few days if you realize that you've made a mistake.

If selling, then the homeowner is typically selling the single largest store of family wealth.

As Mike DelPrete of Adventures in Real Estate Tech notes:

> The psychological desire to engage a specialist in these high-value transactions is loss aversion at work. People are willing to pay top dollar to secure a form of insurance on the transaction; someone to hold their hand through the process. Even when cheaper, tech-focused alternatives are available.

I agree with Mike DelPrete up to this point. He's absolutely correct about loss aversion, about low-frequency and high-value nature of the real estate transaction.

Limits of Technology and the Platform

Technology might make agents more efficient, and does improve the customer experience somewhat, but it does not improve the customer experience *enough*. In fact, in a perverse way, the same technology that makes agents more efficient tends to create worse customer experiences.

Importantly for our purposes, **technology does not impact regulation, inconvenience, and the psychology of the real estate transaction all that much**.

A pure platform play like Zillow prior to the pivot, or the MLS systems of old, has no way of changing the transaction itself.

The Real Estate Platform Must be a Hybrid

Because the real estate transaction is mediated, and there are deep fundamental reasons for the mediation that are not subject to transformation through technology alone, the Real Estate Platform must be a hybrid of a platform play with a linear business model that solves some key strategic problems for the network, which includes consumers.

Removing Consumer Pain Requires *Capital*

The brilliance of Keith Rabois of Opendoor is that he saw that improving the customer experience past providing information requires capital—enormous amounts of capital—in order to cut through some of the burdens of regulation, inconvenience, fear, uncertainty and doubt.

For real estate, then, iBuyer is the key strategic product that must be offered as a linear business by any wannabe Platform. Just like Amazon offers certain key strategic products to control pricing, quality, and availability, which then keep consumers coming back to its site who may end up purchasing from a third party seller from the Marketplace instead of from Amazon itself, the future Real Estate Platform must offer some sort of iBuyer services to keep consumers coming back.

The conclusion that we can draw is that to be a contender for the Iron Throne of Real Estate Platform, a company must have access to significant amounts of capital. For it is not technology but *capital* that removes consumer pain and delivers the key strategic value that will keep consumers coming back over and over again.

The Infrastructure

Just like Amazon built out its infrastructure for itself, then leveraged that infrastructure to expand and empower its platform play, the real estate platform must build out the infrastructure to support the iBuyer linear business, then leverage that infrastructure for the Platform.

The Ultimate End

While I believe that the iBuyer linear business is necessary for anyone contending to become the Platform, the ultimate end will see the Platform detached from the linear iBuyer business.

We will see the emergence of multiple market makers who specialize in certain geographic areas or certain types of properties or certain kinds of buyers and sellers or a mix of all of the above. Those market makers would trade on the Platform, the marketplace, just like market makers trade on NYSE, NASDAQ, CBOT, etc.

Contenders and Pretenders

If the Platform must be a hybrid of a linear business model that offers a key strategic value to consumers (i.e., iBuyer services in some form or fashion) and therefore, the company who wants to be the Platform must have access to enormous amounts of capital, who then are the contenders and the pretenders to the Iron Throne?

As iBuyers and their logical heirs, the market makers, change consumer behavior, the MLS will face serious problems with holding onto its status as the Platform even for real estate agents.

The Platform Formerly Known as MLS

The MLS is the original platform for real estate. It has enjoyed that status for decades, and in some parts of the country, it remains the platform… of sorts.

The MLS provided all of the core functions of a Platform: audience/network, matchmaking, core tools and services (books, terminals, databases, etc.), and of course, rules and standards.

So why the "formerly known as"?

The MLS focused its efforts and its energies on facilitating the exchange of value between real estate agents, rather than between buyers and sellers.

The other significant misstep was the failure of MLSs to consolidate rapidly after the advent of the internet made it clear that they were no longer the most cost-effective form of advertising.

The MLS remains relevant because it remains the platform for real estate brokers and agents. The MLS and Associations still provide a number of tools—such as the lockbox, legal forms, and dispute resolution mechanisms—which are important for how homes and bought and sold today.

As iBuyers and their logical heirs, the market makers, change consumer behavior, the MLS will face serious problems with holding onto its status as the Platform even for real estate agents.

The Frontrunner: House Zillow

Through smart and savvy product design, fantastic marketing, smart hiring, and a healthy dash of good luck, there is no denying that Zillow is the dominant real estate portal today.

And in the last year or so, Zillow has made a decisive move towards becoming the Platform for real estate by launching its iBuyer service: Zillow Offers.

Zillow Offers and the Platform: Spencer Speaks

There are a couple of interesting updates from Zillow's Q2 earnings call.

First, Zillow's CEO Spencer Rascoff made it clear that the leadership team at Zillow sees Zillow Offers as something far more than a small experiment with house flipping. He made it clear that they believe Zillow Offers appeals to a much broader segment of the market.

Second, Zillow also announced the acquisition of a lender: Mortgage Lenders of America (MLOA).

The MLOA Acquisition: Building Infrastructure

To become the Real Estate Platform, you must offer some kind of an iBuyer service and evolve it to eliminating consumer pain. That is the key strategic product.

The MLOA acquisition is about *building the infrastructure* to support the linear business, but then to support/enable the Platform.

Zillow doesn't know the mortgage lending business. It bought MLOA to learn it. This is no different strategically than Amazon building warehouses and getting into logistics.

Becoming the Hybrid

Zillow is not abandoning its core Platform business. It is becoming a hybrid, which allows it to contend for the Iron Throne. That it is not interested in becoming a real estate brokerage, or going strictly into some linear business, is evidenced by the other major piece of news that was completely overlooked: the rollout of its new lead validation and distribution system.

He talked about pushback from real estate agents "every time we change the rules on them." Spencer understands perfectly well that Zillow has built a Platform business, but one that is completely reliant on the sellers (i.e., the agents) for the quality of its services to buyers (i.e., consumers).

Zillow's pivot is not away from being a media advertising company to becoming a brokerage, or a iBuyer. Zillow's pivot is towards becoming a hybrid.

Traffic, Technology, Capital

Zillow is the frontrunner for the Real Estate Platform for many reasons.

Its advantage in audience (which we might think of as size of its network) is significant, and not in any immediate danger.

Its advantage in technology is more difficult to assess, but one potential indicator is that Zillow has not slowed down in the least in spending on technology and development.

As for access to capital, Zillow raised an additional $750 million in Q2 through debt and stock offerings, bringing its total war chest to $1.5 billion.

Given all of the above, there is no compelling reason to think that Zillow is anything other than the frontrunner to become the Real Estate Platform.

Contender: House Opendoor

Prior to Zillow's pivot, my pick for the frontrunner for the Platform would have been Opendoor, the brainchild of Keith Rabois.

I have long held that Opendoor is the most important company in real estate, because I had long thought that Opendoor was making a play for the Platform. Then a couple of years ago, Opendoor got its mortgage brokerage license, opening to door to unlimited seller financing.

I will freely admit that Opendoor has done no such thing, yet. Opendoor has shown very little interest in revolutionizing mortgage financing.

And in some respects, Opendoor is not a Platform play at all, but an interesting linear business. So how in the world are they a contender for the Iron Throne?

A real estate brokerage does not control the supply chain or the means of production; it controls, instead, the means of connections.

Experience, Infrastructure, and Access to Capital

The one thing that Opendoor has over everybody else is experience in the iBuyer game. They were the originators of the concept, and have been at it the longest in the most markets.

What Zillow is just now learning about what to do with a house it just bought from cleaning to staging to maintenance, Opendoor already has learned those lessons.

Plus, Opendoor has access to capital. Its founder is Keith Rabois of Khosla Ventures and one of the members of the Paypal Mafia. Furthermore, Opendoor has been forging alliances with homebuilders. Lennar co-led its latest funding round for $325 million.

There's a very good chance that Opendoor has access to as much capital as it needs.

Add the Platform

If Zillow began as a pure platform play, and is evolving towards becoming a hybrid in order to become **the** Platform, then Opendoor has the opposite challenge: it began as a pure linear business, and therefore must add a platform to become a hybrid.

There are signs that Opendoor is trying to do this.

Opendoor recently launched a Preferred Partnership program for real estate agents that allows them to put an offer from Opendoor in front of their clients—just as they can with Zillow Offers.

Still a Contender

Even without some major acquisition, Opendoor remains a contender because consumer behavior could change very rapidly. One of the benefits of building a network is that people in the network often recruit others to join it rapidly.

As a final consideration, Opendoor may not have any ambitions of trying to become the Real Estate Platform even if they could contend for that position. Opendoor may be perfectly happy to be a major market maker in housing, and perhaps even operate on whatever Platform comes into existence in the future.

Contender: House Redfin

A real estate brokerage does have strong characteristics of a Platform. It does not control the supply chain or the means of production; it controls, instead, the means of connection.

A close look at the design of Redfin's business model, its systems, its designs, and the what its senior leadership constantly tell us about *why* Redfin exists shows that like Zillow, Redfin from its birth was consumer-centric in a way few other brokerages are.

Experience, Quality Control, Audience, Access to Capital

What Redfin has in spades is experience with the actual buying and selling process.

With W2 agents, systems designed around their processes, and a culture built around the consumer, Redfin has a greater ability to control the consumer experience whether a traditional pain-filled transaction process, or the iBuyer process through Redfin Now.

Redfin also enjoys a massive and growing consumer audience with over 28.8 million average monthly uniques in Q2/2018, an impressive feat considering that Redfin is only in 80 or so markets.

And in July, Redfin raised roughly $247 million with a public offering of stock and by selling convertible bonds.

They have all of the necessary tools to contend. But will they?

Is Redfin Committed?

I wrote in the August Red Dot that Redfin Now appeared to be "merely an add-on service to that core [of low-cost, technology powered brokerage services], for consumers who are willing to take less money from Redfin in order to have certainty and fewer hassles."

In the Q2 earnings call we learned that some of the money raised in July was for Redfin Now. More importantly, we learned that Redfin is in the iBuyer game for the long haul.

Redfin is certainly a contender.

Sleeper Picks: House Compass and House Realogy

There are two companies that I consider to be "sleeper picks" for the Platform: Compass and Realogy.

House Compass: The Referral Economy?

One reason to consider Compass as a possible sleeper is its CEO Robert Reffkin's recent appearance at Inman Connect in San Francisco.

Reffkin talked about there being a single platform in real estate, and that his vision for Compass is that 10 years from now, people will not just buy homes from Compass agents, but everything afterwards as well from mortgage, title, insurance, moving services, furniture, etc.

Given that Compass has raised almost $800 million from investors to date, access to capital doesn't appear to be a real issue for them.

Compass is a dark horse sleeper pick.

House Realogy: Waking Up Pissed Off

As of this writing, there's no real reason to think that Realogy is at all interested in trying to become the Platform like Compass appears to be. So why are they in the mix, even as a sleeper pick?

Realogy is still a company with the largest brokerage, largest franchise operations, some of the most respected brands in the industry, whose agents touch 20-25% of every residential sale transaction in the U.S.

It has access to capital, but even more impressive is the cash flow it generates: $192 million in free cash flow in Q2 alone.

Realogy lacks a strong network of consumers, like any brokerage not named Redfin. But as I mentioned above in talking about Opendoor, network effect is a powerful thing.

Realogy has said and done nothing to make anybody think that they have such ambitions in mind. But I keep them in the dark horse sleeper pick column simply because they *could* if they actually put their mind to the task.

A Note About The Truly Great Houses

One thing to mention here is that I did not address some of the potential Real Estate Platforms that come from outside the industry.

The reason is that any of the truly great houses in technology or finance could snap up any of the contenders… for cash.

Hypothetical scenarios and analysis involving companies already in the real estate space is one thing. The same involving tech giants and major commercial banks is… frankly uninteresting. That sort of thing makes for a cool Black Swans of Real Estate presentation, but not for an actual attempt to understand what the Real Estate Platform must be and who can be that.

"This is how we've always done things" is just about the most dangerous thing you can say today. The second most dangerous thing you can say is, "We can't afford it."

Summary of Recommendations for Brokerage

Because of the importance of iBuyer to the Platform, I advise you to read the recommendations from the August report as well. In addition, consider the following:

- **Don't Believe the Hype**

  Don't believe your own hype when you're doing strategy work instead of sales and marketing work.

  As a linear business technology company, your strategic priority should be identifying your role on the Platform.

  If you are genuinely trying to contend for the Platform, or even if your goal is to become a sub-platform within the larger Real Estate Platform (as the MLS will become, if they play things right) then…

- **Capital > Technology > Inertia**

  We could even boil down my thesis in this paper to this formula: capital > technology > inertia.

"This is how we've always done things" is just about the most dangerous thing you can say today. The second most dangerous thing you can say is, "We can't afford it."

- **The MLS Monopoly Gets Broken**

The MLS will lose its monopoly power over real estate agents because of the emergence of non-traditional businesses post-Platform, the growth of importance of data from market makers (Bid/Ask, volume, real-time demand information, etc.), and superior core tools/services from the Platform.

If you service only the MLS segment of the industry, it's time you start thinking about diversifying your customer base.

If your customers are mostly brokers and agents, and you have only needed to get data from the MLS, it's time to start architecting your system to take market makers and the Platform into account as data sources.

- **Opportunities in the Post-Platform World**

There will be new opportunities for technology companies as agents and brokers discover new ways to make money.

Two I have sketched out involve becoming more of a retail distribution channel for the Platform and its market makers, as well as a stronger emphasis on advisory skills and services.

Today, there is precious little demand for something that processes, analyzes, and distributes institutional knowledge. I can see that changing in the post-Platform world. So think about how you might take advantage of such a shift.

- **Consumer Tools vs. Professional Tools**

The Platform must provide "core tools and services" to the network but the Platform only has to provide the **core** tools.

Today, the residential real estate industry is in a funny place where consumer technology tools are often superior to professional tools.

There may be opportunities in developing a new class of professional tools that go beyond what consumers have, but at greater cost, and requiring far more training and education to use.

Orient.

MAIN SECTION

The Platform. It's the new buzzword in real estate.

To be fair, it's always been there. Every tech company dreams of becoming a platform no matter its DNA. A company that builds IDX websites dreams of becoming a platform, like Facebook or Amazon. I saw a Google Ad for a paperless document storage company claiming to be a real estate platform. Sometimes, it feels as if any company that has a simple API claims to be a platform for real estate.

Semantics do matter, of course. If you define "platform" as "we have an API" then anybody anywhere could be a platform.

In the June Report, I wrote about the play to become the real estate platform, invoking the pop culture phenomenon of *Game of Thrones:*

> What is actually at stake here is nothing short of the real estate industry's version of the Iron Throne: **who will be the platform for real estate?**
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> What we are looking at, then, are the initial forays into centralizing and consolidating the rest of the real estate experience *outside of seeing what's for sale*. Redfin has been at that game for ten years. Zillow is now entering that game with Zillow 5.0.

Having an API or connecting to other applications does not a platform make. So, what does?

The Platform: Essential Characteristics

We might as well begin with the quote from Harvard Business Review's 2017 article called Finding the Platform in Your Product:

> Five of the ten most valuable companies in the world today—Apple, Alphabet, Amazon, Facebook, and Microsoft—derive much of their worth from their multisided platforms (MSPs), **which facilitate interactions or transactions between parties**. Many MSPs are more valuable than companies in the same industries that provide only products or services: For instance, Airbnb is now worth more than Marriott, the world's largest hotel chain. [Emphasis added]

That explains why companies would want to be perceived as platform companies, since that would make them far more valuable than being a software vendor. But the key characteristic is the highlighted portion: "facilitate interactions or transactions between parties."

A better definition of the difference comes from Applico, a consultancy that specializes in platforms and helping traditional enterprise companies develop platforms and platform strategies.

A good starting point is this article, titled "Platform vs. Linear: Business Models 101." It would do real estate leaders a lot of good to read the whole thing. The key graf:

> As we've defined before, a platform is a business model that facilitates the exchange of value between two or more user groups, typically a consumer and a producer.
>
> An important part of the platform business model is that inventory is **owned by third parties** and is not on the balance sheet of the platform. The platform is solely focused on building and facilitating an external network. Platforms don't own, to use a common phrase, the means of production – instead, they create the means of connection.

In Applico's thinking, Netflix is not a platform because it licenses all of the movies and TV shows it then streams to its millions of users.

YouTube, on the other hand, is a platform because most of its content comes from third parties and it pays nothing for its content.

The key concept that Applico, and its founder Alex Moazed, stresses is the idea of "owning the supply chain." If you own the supply chain, you're a linear business.

Platforms, in contrast, own *networks*—the means of connection referenced above—rather than the supply chain. As Applico says, this means that platforms are neither new businesses (marketplaces, bazaars and auction houses of ancient Rome are examples they use) nor dependent on technology (although modern platforms are nearly impossible without technology as it cuts the cost of connection to near-zero).

But every individual has a network of friends, colleagues and acquaintances. Every company has a network of supplies, customers, allies and competitors. With the internet and advances in communications technology, everyone has the means of connection, no? What sets a platform apart from other networks?

The answer is that a platform provides four core functions to its network:[1]

- Audience building
- Matchmaking
- Providing core tools and services
- Setting rules and standards

Easiest way to think about this is to think about a shopping mall—once the pre-eminent platform for retail.

A shopping mall has to build an audience, of both shoppers and retailers. It does so through advertising, marketing, promotions, etc.

[1] Note that Applico has some other definitions as well of these four core functions, substituting "Building Liquidity" for "Audience building" and "Providing functionality" for "Providing core tools and services." But the way Moazed defines "Building Liquidity" more or less means somehow getting people to join the network, often through subsidies. We'll delve into this more below.

It has to engage in matchmaking: letting shoppers know where certain stores and products are located. Something as simple as a map of the mall is an example.

It has to provide "core tools and services"—the building itself, the walkways connecting one store to another, parking lots for shoppers, loading docks for retailers, the lighting, air conditioning, etc.

And of course, it has to provide rules and standards. Certain kinds of stores will not be allowed into the mall. (I have yet to see a suburban shopping mall with an adult video store.) The mall provides security, bans smoking in parts, and establishes rules for both shoppers and retailers.

These four are essential characteristics of a platform. Miss even one, and what you have is something close to but not quite a platform.

The Hybrid: Linear Plus Platform

An important concept for us is what Applico calls the hybrid model, in which a company has both linear and platform characteristics. The best example they use is Amazon:

> Amazon also has combined a linear and platform approach in its B2C e-commerce business. While Amazon started as a linear bookseller, much of its success in other areas of e-commerce has come from combining its linear approach with Amazon Marketplace, which consists of third-party sellers listing items on Amazon and has been one of the fastest growing areas of Amazon's e-commerce business.

Applico points out that 80% of the products on Amazon are actually from its Marketplace. The profit margins are far better for Marketplace than for direct sales.

The Marketplace also generates an immense amount of data on consumer behavior, which Amazon can use to improve its algorithms, its technology tools, and its merchandising.

Nonetheless, Amazon continues to sell a number of items direct to consumers despite lower margins because they are "ones that Amazon has identified as major sellers and where it is strategically important for Amazon to have quality, inexpensive items available."

The linear part of Amazon's business allows it to control the quality and availability of important items that keep bringing shoppers back to its website, which in turn brings more and more merchants into the Marketplace. The linear business also subsidizes the investment and costs of the infrastructure that Amazon has built, from warehouses to logistics to technology, which can then be used for the Marketplace platform business as well.

For example, one of the reasons why Amazon has become such a powerful platform for ecommerce is its Fulfillment By Amazon program which lets sellers keep their inventory in Amazon warehouses, then handles all of the pain-in-the-ass that is shipping and handling. Plus, Fulfillment By Amazon means that shoppers who are Amazon Prime members (and there are millions of us) can take advantage of that sweet deal.

This hybrid model is important for us because what we are witnessing is the evolution of pure platform plays, such as Zillow, and brokerage companies, such as Redfin, into a hybrid model. It is necessary in real estate because of the peculiarities of the home sale and purchase transaction.

The Industry's Spin Problem

That definition of a platform is in sharp contrast with what most of the real estate industry thinks a platform is. While it is impossible to say that there is only one common definition, some of the language and concepts put forth suggest a common misperception.

For example, we have Adam Contos, CEO of Re/Max, talking about how Re/Max is building "an online platform":

> In Re/Max's second quarter earnings call this morning, CEO Adam Contos formally announced that his company is developing "an online platform that will deliver substantial value to consumers and allow Re/Max agents to connect with homebuyers and sellers in a more meaningful way."
>
> The new Re/Max agent tech platform will be built by booj — which stands for "be original or be jealous" — a fellow Denver-based startup that Re/Max acquired in February 2018.

> "Leveraging booj's existing technology stack, **we're building an integrated platform with products that interact and evolve with one another**," Contos said in the call.
>
> "Included will be a CRM [customer relationship management software], integrated with agent office and team websites, lead cultivation tools, marketing resources, social integration and more – all built with today's increasingly mobile agent in mind."

To be fair, Contos did consistently use the phrase "tech platform" but the emphasized portion illustrates the real estate industry's general concept of what a platform is: a series of products that interact with and are connected to each other.

These are not platforms, but software products for real estate agents.

Underlying that tech platform, then, is a pool of data. That explains the real estate industry's obsession with "protecting our data" despite the fact that most of the so-called data it is trying to protect is (a) advertisements of homes for sale, and (b) not copyrightable.

An example of this focus on data comes from Keller Williams, which recently announced that they were no longer a real estate company, but a technology company. Gary Keller's Vision Speech earlier this

year drew a sharp distinction between “tech-enabled agent” and “agent-enabled tech” and argued for the development of a technology platform that fights for the former and against the latter.

And of course, just about every technology vendor in real estate touts itself as a “platform” because it has APIs, or offers “single sign-on” features.

All of this is spin and marketing. As Contos’s words illustrate, no matter how connected, no matter how integrated, we’re still talking about technology built for agents and with their needs in mind. The consumer is not truly considered, except as the target for all of this technology.

These tech platforms are concerned above all with facilitating the exchange of value between real estate agents and consumers and limit the network accordingly. These are not platforms, as we have defined the term, but software products for real estate agents.

Nothing wrong with that, of course, but the whole point of this Red Dot is to help you understand what is and is not a contender for the Real Estate Platform.

The Real Estate Platform

The intelligent reader by now is thinking that given the definitions above, a real estate brokerage sounds a whole like a Platform business. A brokerage doesn’t own any inventory. It does not own the supply chain. It facilitates connection between buyers and sellers. It has networks. It has and tries like crazy to get an audience. It has core tools and services.

What the brokerage lacks is “rules and standards”. It gets close but is not a platform business because of that. The rules and standards of the brokerage come from three external sources: the government, the Code of Ethics (for those who are members of the National Association of REALTORS), and the most important, the Multiple Listing Service.

Furthermore, when brokerages turned to the agent-centric business model in the late 70’s and early 80’s and began thinking of the real estate agent as their customer instead of the actual buyers and sellers themselves, they restricted their networks to those agents affiliated with them. Besides, brokerages didn't really feel the need to become a platform: they had the MLS.

It turns out that the MLS is a classic platform business: network, matchmaking, core tools and services, and rules and standards. It has long been the dominant force in American real estate.

So why isn't the MLS the frontrunner in the Real Estate Game of Thrones, instead of Zillow? And how in the world could Zillow be a platform frontrunner, especially in light of the pivot to Zillow Offers?

Let us try to make sense of all of this.

Limits of the Pure Platform

Pure platform businesses are undoubtedly extraordinarily rewarding for companies that achieve scale. Margins are unbelievable, since there are no inventory costs, no production costs, no supply chain costs.

Take Ebay as an example. There is no doubt that Ebay is a pure platform play. Its $7.345 billion in gross profits against $9.567 billion in net revenues representing gross margins of 76.7% are… shall we say, amazing?

But there is a weakness to Ebay, as eCommerceBytes points out:

> In most markets, eBay is a third-party marketplace, meaning that unlike Amazon, it doesn't own any the goods for sale on its site. **That means eBay is at the mercy of sellers as to what's for sale on its marketplace and at what price, and with which policies**.
>
> However, eBay has gotten a taste of what it's like to operate as a first-party marketplace. In Korea, eBay uses its scale to buy consumer staples at a discount to resell on its marketplace to get people coming back. It's a perfect testing ground where it can learn about the benefits and challenges of being a retailer.
>
> In other markets, **eBay is forced to use other strategies to try and control aspects of its marketplace**, such as implementing policies and fees that coerce sellers into certain

> behaviors such as offering free shipping and generous returns policies, or listing in fixed-price versus auction format. [Emphasis added]

The benefits of being a pure platform are amazing scalability, margins, network effect, and so on and so forth. The downside is lack of control over the consumer experience.

That Ebay is experimenting with "first party inventory program" in Korea—in other words, becoming a direct retailer like Amazon—should tell us that there are situations where even enormously profitable and successful Platforms might want to take on a linear business.

The problem is that somewhere along the way, the industry forgot the all-important insight captured in the quote from Theodore Levitt, often called the father of modern marketing: "People don't want a quarter inch drill; they want a quarter inch hole."

Because facilitating an exchange of value in the network is fantastic, as long as there's value to be exchanged. As a pure platform, Ebay is completely reliant on the sellers on its platform to offer that value for buyers to want to continue using it. That works as long as the buyer is looking for either a bargain on a used item, or some rare collectible that isn't sold in stores, or some such. It does not work if the buyer is looking for staple goods or products at a certain price.

Amazon works far better for that, especially for strategically important staples, which it sells directly in a linear retail business model.

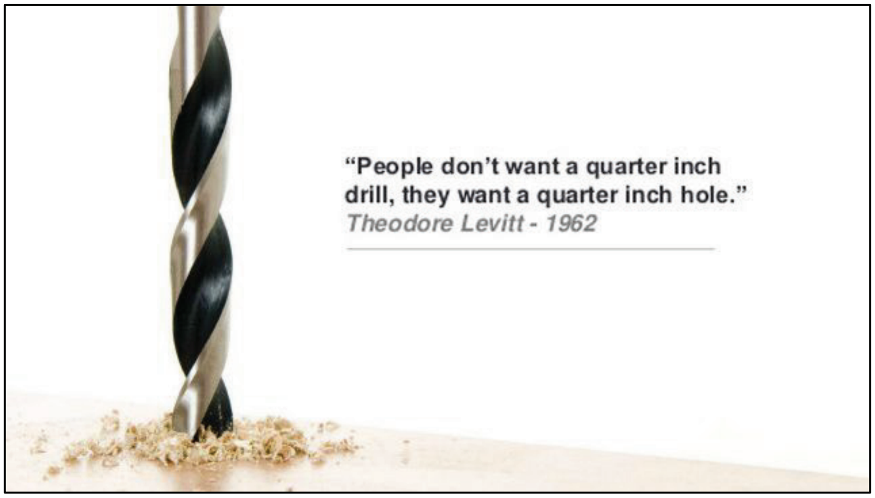
What is interesting is that both Amazon and Ebay are attempting to become a hybrid, which combines the control over quality, quantity, and price of the linear business with the advantages of the Platform. Amazon came to the Platform out of its linear roots, while Ebay is testing out the linear business out of its Platform roots.

Let's apply this to real estate.

The Exchange of Value and the Pure Platform in Real Estate

What is the exchange of value that is to be facilitated?

For years, decades, perhaps even centuries, that exchange of value was real estate brokerage services for commissions. The entire system of real estate we have in the United States is built around that concept: brokerage services for commissions.



The problem is that somewhere along the way, the industry forgot the all-important insight captured in the quote from Theodore Levitt, often called the father of modern marketing: "People don't want a quarter inch drill; they want a quarter inch hole."

Buyers do not actually want to buy brokerage services; they want to buy a home. Sellers do not actually want to buy brokerage services; they want to sell their homes. They're willing to pay someone to help them, but the real exchange of value is not for that service but for the result. Real estate brokerage is not a spa experience that people purchase for the service itself.

The real exchange of value is property for money, not services for a commission.

However, real estate is a mediated transaction for a variety of reasons, which we will cover below. That was especially true pre-Internet when consumers had no real way of knowing what was for sale, whether that asking price was high, low or just right, whether the market was heating up or cooling down, etc. Because of information asymmetry, consumers were more or less forced to hire a real estate agent with his access to the MLS to get into the transaction.

Real estate remains a mediated transaction, but changes are afoot.

Mediated Transactions

There remain some products and services in the 21st century that require someone to mediate our purchase of them.

For example, pharmaceuticals and medical services often require mediation. Some doctor, or at least a licensed nurse, must give us a prescription before we can purchase the drug. Most medical procedures require the assistance of a medical professional. Are there over the counter drugs? Of course, there are. Are there in-home kits for testing now that do not require a prescription? Yes. Are advances in technology and changes in laws and regulations trying to make it easier for consumers to buy medicine and medical services with minimal mediation? Yes.

But for prescription drugs and most medical procedures, we require someone to get involved.

Legal services are another such area. Legalzoom and other legal startups may be trying to make it easier than ever for self-service, but for most situations involving the law, you need a lawyer. That there are individuals who choose to go *pro se* doesn't change the fact that in the vast majority of situations, consumers go through a lawyer for everything from writing a will to getting a divorce to entering into a contract.

But without question, housing remains the largest and most common mediated consumer transaction. Just like with medical care or legal system, there are small percentages of people who try to do it themselves, but according to NAR, 87% of buyers and 89% of sellers used a real estate agent.

There are numerous reasons why consumers use a real estate agent to buy and sell homes, but three main reasons stand out.

Regulation

Real estate is a heavily regulated transaction. There are multiple layers of laws, ordinances, and regulations involved. Federal law and federal regulations are certainly involved, from Fair Housing Act to RESPA to hundreds of regulations from HUD, CFPB, and others. All 50 states have laws governing real estate, financial services, and transfers of title. Counties and local municipalities often have their own laws and regulations around housing. And oftentimes, the local Homeowners Association has rules and regulations that affect the purchase or sale of a home.

And then you have the laws and regulations around financing a home purchase, not to mention underwriting standards that have much to do with whether the GSEs like Fannie and Freddie will purchase a loan or not.

Fact is that even if you decide to go FSBO or direct purchase without representation by a real estate agent, you are likely going to want someone to help you with the process because of all of the laws, rules, and regulations involved in the purchase or sale of a piece of real estate.

Convenience

Selling anything to the public is difficult and annoying, as anyone who has ever done a garage sale knows. You have to advertise the sale, merchandise the product, price things, then haggle over pricing, and so on. Selling real estate to the public is even more difficult, stressful and plain old annoying.

Buying a home is not easy either, since each home is unique, extremely expensive and not subject to returns and refunds. In most cases, the home is occupied, which means scheduling a tour to see the property. Photos and video tours are good, but they're no substitute for actually walking into the place where you and your family hope to spend a great deal of time for a very long period of time. Most buyers will need to finance the purchase as well, which then subjects them to the horrors of the modern mortgage process.

You have the paperwork of the actual transaction given the amount of laws, regulations, and rules surrounding the transfer of real property.

And of course, should any repairs be necessary, whether as the seller or as the buyer, you have added on additional burdens of making sure that work is done on time and on budget.

Psychology

The home is usually the most expensive purchase of a typical American family. Most buyers enter into a debt that is expected to take *three decades* to pay off. A home is also something you can't return after a few days if you realize that you've made a mistake.

If selling, then the homeowner is typically selling the single largest store of family wealth. This chart comes from Wallethacks:

Net Worth with and without Home Equity

Age of Householder	Median Net Worth	Median NW excl. Equity
Under 35:	$6,900	$4,138
35 – 44	$45,740	$18,197
45 – 54:	$100,404	$38,626
55 – 64:	$164,498	$66,547
65 – 69:	$193,833	$66,168
70 – 74:	$225,390	$68,716
65+:	$202,950	$57,800
75+:	$197,758	$46,936

As Wallethacks notes: "The median net worth of all Americans is $80,039. The median net worth excluding equity is $25,116 – which means equity is 68.62% of total net worth."

In fact, in a perverse way, the same technology that makes agents more efficient tends to create worse customer experiences.

As Mike DelPrete of Adventures in Real Estate Tech notes:

> On the other end of the spectrum, it is more difficult to disrupt low-frequency, high-value transactions with technology, because the potential loss from a mistake is so much greater. People typically go to specialists to help with these transactions: divorce lawyers, investment bankers, and expert consultants.
>
> A real estate transaction, by comparison, is off the charts: it is ultra low-frequency, ultra high-value. The potential loss that occurs from making a mistake is huge.
>
> The psychological desire to engage a specialist in these high-value transactions is loss aversion at work. People are willing to pay top dollar to secure a form of insurance on the transaction; someone to hold their hand through the process. Even when cheaper, tech-focused alternatives are available.

I agree with Mike DelPrete up to this point. He's absolutely correct about loss aversion, about low-frequency and high-value nature of the real estate transaction.

Limits of Technology and the Platform

Where I diverge from DelPrete is in the next statement:

> When it comes to real estate, technology has a dual role: making agents more efficient, and providing a better customer experience. It's not about replacing agents or removing the insurance of having a specialist involved.

Technology might make agents more efficient, and does improve the customer experience somewhat, but it does not improve the customer experience *enough*. In fact, in a perverse way, the same technology that makes agents more efficient tends to create worse customer experiences.

For example, take the most basic customer service scenario. You want to know how many potential buyers have viewed your home. Before the advent of information technology that made agents far more efficient, you might call the agent, or have the agent call you on the kitchen telephone. You might then exchange a few pleasantries, ask after each other's' families, and the agent would have a conversation with you about showing activity.

With technology, you might just get an automated email report showing how many times the lockbox has been accessed. No personal touch, no personal conversation, worse customer experience.

Furthermore, agents who become more efficient do not use the extra time to provide more personal service. They use the extra time to do more deals.

Importantly for our purposes, **technology does not impact regulation, inconvenience, and the psychology of the real estate transaction all that much**. Technology has certainly closed the information asymmetry gap, as consumers now have as much or more information about the market, the property, comps, etc. at their fingertips as the real estate agent does. But technology cannot change the laws or regulations. Technology alone cannot do necessary repairs or make mortgage approvals happen. And technology does not change the psychology of loss aversion.

So a pure platform in real estate could help with information asymmetry, and it has in the last 10-20 years, as the online real estate revolution brought information that was once kept inside the local MLS onto the web. It has made the internet the most cost-effective form of advertising a property, which means it is also the most cost-effective way of finding out what's for sale. It has dramatically improved the matchmaking function, compared to reading through printed books.

But the real estate transaction itself with its regulations, inconveniences, fear, uncertainty and doubt remains undisturbed.

A pure platform play like Zillow prior to the pivot, or the MLS systems of old, has no way of changing the transaction itself. Like Ebay, the Platform is entirely at the mercy of third parties over whom the Platform only exercises indirect control via rules, fees, and incentives.

The Real Estate Platform Must be a Hybrid

Because the real estate transaction is mediated, and there are deep fundamental reasons for the mediation that are not subject to transformation through technology alone, the Real Estate Platform must be a hybrid of a platform play with a linear business model that solves some key strategic problems for the network, which includes consumers.

Just like Amazon "seeds" the value exchange by selling directly to consumers at lower margins, then leverages that investment as well as the investment into infrastructure to power the platform, the Real Estate Platform must find a way to "seed" value exchange for the consumer even at lower margins, then leverage that to power the platform.

Removing Consumer Pain Requires *Capital*

The brilliance of Keith Rabois is that he saw that technology alone could not remove (enough) consumer pain to seed the value exchange. He saw that improving the customer experience past providing information requires capital—enormous amounts of capital—in order to cut through some of the burdens of regulation, inconvenience, fear, uncertainty and doubt.

I wrote at some length about this in the August Red Dot on the iBuyer, so I will simply urge you to go back and reread that paper. But let me summarize briefly.

Real estate transactions are both inconvenient and time consuming, but the critical pain point, the critical roadblock, is the need for financing. The pain and uncertainty for the buyer is obvious. But for the seller as well, when he accepts a buyer's offer all that he's accepted is the opportunity to wait to see if the buyer's loan would close. Also common is the sale contingency where the buyer enters into a contract to purchase the seller's property, but only if he can sell his own house first.

Add on the fact that much of the laws and regulations and the paperwork and the documentation requirement are wrapped up in mortgage financing—the vast majority of which requires at least indirect government support by way of the GSEs—and you have an inevitably long and uncertain process.

For it is not technology but capital *that removes consumer pain and delivers the key strategic value that will keep consumers coming back over and over again.*

Rabois's insight is that it is possible to circumvent that entire mess by paying cash to the seller for the house, then reselling that house to the ultimate buyer. The company he founded, Opendoor, does just that. By acting as the middleman, Opendoor eliminates a great deal of the pain, inconvenience, fear, uncertainty and doubt.

Actual reviews from consumers who have used iBuyer services suggest that consumer pain with the transaction process is sufficiently high that thousands of families are willing to pay pretty significant fees to avoid it.

This review from Stephen B. of Nashville, TN, a Verified Reviewer on the consumer reviews website Highya, is not atypical:

> Opendoor stepped in and saved me a year of my life. I was looking to sell my home in Nashville, Tennessee as the real estate market heated up to prices I wanted to sell at. I tried listing with a real estate agent but the volume of showings and the low offers was too much to deal with day after day. I really needed to spend months with contractors fixing some issues outside with a retaining wall having to be rebuilt, trees that needed to be trimmed, a front porch that needed work, and a very small structural problem. I called Opendoor and received a quick offer at the marker price. I had a quick inspection and their quotes to fix the issues in my house were all cheaper than the prices I had quoted! They also deducted the fixing costs from my offer price so I had no out of pocket costs.
>
> My Opendoor experience was of excellent responsive customer service, quick turnaround, and I think they are the

> future of real estate acting as the buyer, seller, and fixer leaving the home seller to avoid the hassles of selling a home and leaves you to live your life.
>
> I would recommend anyone using Opendoor and have already done so with friends in Nashville. I think Opendoor is the Uber of Real Estate, making the complex simple and the hard work easy.
>
> Thanks to Opendoor for making my house sale easy and allowing me to retire to my dream home in the country and live happily ever after.[2]

For real estate, then, this is the key strategic product that must be offered as a linear business by any wannabe Platform. Just like Amazon offers certain key strategic products to control pricing, quality, and availability, which then keep consumers coming back to its site who may end up purchasing from a third party seller from the Marketplace instead of from Amazon itself, the future Real Estate Platform must offer some sort of iBuyer services to keep consumers coming back.

The conclusion that we can draw, then, is that to be a contender for the Iron Throne of Real Estate Platform, a company must have access to significant amounts of capital. For it is not technology but *capital* that removes consumer pain and delivers the key strategic value that will keep consumers coming back over and over again.

The Infrastructure

Again, just like Amazon built out its infrastructure for itself, then leveraged that infrastructure to expand and empower its platform play, the real estate platform must build out the infrastructure to support the iBuyer linear business, then leverage that infrastructure for the Platform.

[2] To be fair, there are a number of negative reviews of Opendoor on Highya as well. But most of those are based around cost, disagreeing with Opendoor on repairs and concessions, which leads me to believe that those individuals likely valued money over convenience and are not good targets for iBuyer services.

For example, all iBuyers have to get really good at cleaning and maintaining a house in order to support the linear business model. Once they have built the necessary infrastructure and processes of cleaning and maintaining an empty house, they could easily offer that service to homeowners or to real estate agents who wish to use the Platform to sell their properties.

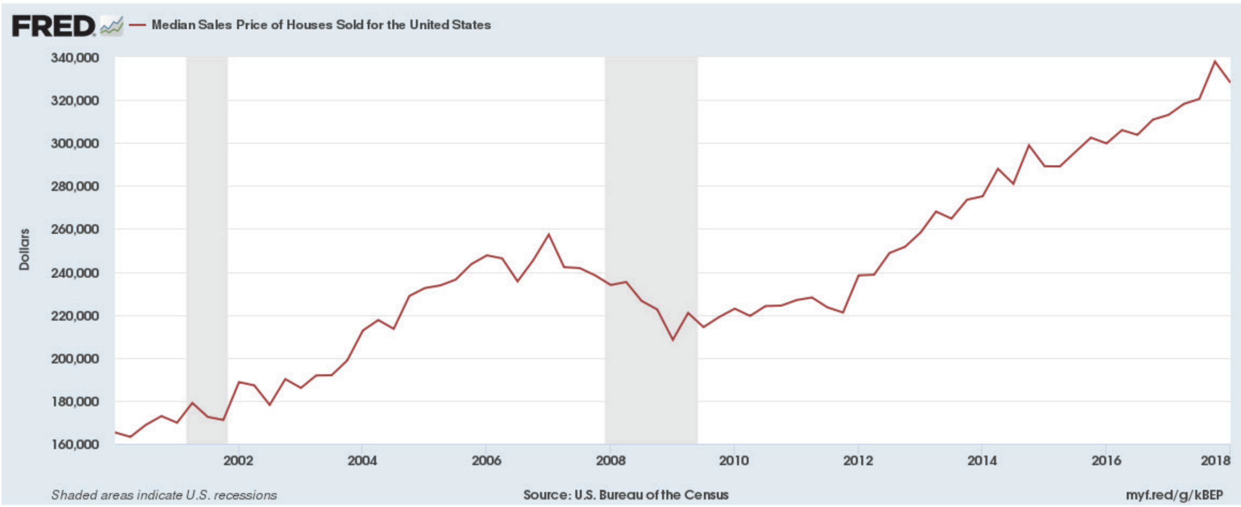
If the Platform moves towards a Market Maker type model, with seller financing offered on all homes in inventory, they're going to have to get very good at packaging those loans and selling them on the secondary market, likely as white-label RMBS. There's no reason to think that the Platform couldn't offer that as a service to other lenders as well, for a fee of course.

The point is that the infrastructure that the iBuyers have to build for their linear business of acquiring properties on their own account, then reselling it as quickly as possible, can be leveraged to subsidize the Platform play in much the same way that Apple leveraged the infrastructure of iTunes and Amazon leveraged its investment into warehouses.

The Ultimate End

While I believe that the iBuyer linear business is necessary for anyone contending to become the Platform, the ultimate end will see the Platform detached from the linear iBuyer business. That separation might be informal, or it might be formal, but it has to happen for strategic and financial reasons.

This may be a failure of my imagination, but I cannot conceive of a single company that becomes a market maker for all residential properties in the United States. The value of residential real estate in the U.S far exceeds the value of the entire financial markets. The St. Louis Fed reports that mortgages are almost $1,800 *trillion* in value. In comparison, the U.S. stock market is now worth $30 trillion.



Let's not forget that the bursting of the real estate bubble in 2007 destroyed Lehman Brothers and Bear Stearns, two of the largest financial firms in the world, and those two held but a fraction of outstanding mortgage bonds. In fact, the crisis threatened the entire global financial system.

Therefore, I cannot conceive of a company (or for that matter, a sovereign nation) with the financial strength to be a market maker for the United States.

More feasible is the emergence of multiple market makers who specialize in certain geographic areas or certain types of properties or certain kinds of buyers and sellers or a mix of all of the above. Those market makers would trade on the Platform, the marketplace, just like market makers trade on NYSE, NASDAQ, CBOT, etc.

The strategic reason is related. For there to be a Platform, other market makers will have to want to use it. It would be a difficult thing to use a platform developed, owned, and operated by a direct competitor.

Contenders and Pretenders

If the Platform must be a hybrid of a linear business model that offers a key strategic value to consumers (i.e., iBuyer services in some form or fashion) and therefore, the company who wants to be the Platform must have access to enormous amounts of capital, who then are the contenders and the pretenders to the Iron Throne?

Keeping in mind that the Platform is not a technology play, but an ancient business model that harkens back to ancient Roman bazaars. Real estate has always had a platform—or more precisely, hundreds of platforms: the MLS. We start there.

The Platform Formerly Known as MLS

The MLS is the original platform for real estate. It has enjoyed that status for decades, and in some parts of the country, it remains the platform… of sorts.

One of the things I realized about the industry early on in my consulting career is that the MLS became powerful in the pre-Internet era because it was the *most cost-effective way to advertise a home for sale*. This is something that most people in the industry either never thought about or have forgotten.

The MLS focused its efforts and its energies on facilitating the exchange of value between real estate agents, rather than between buyers and sellers.

Pre-Internet, when your advertising options are newspapers, magazines, flyers, postcards, and walk-in traffic, and buyers had no choice but to contact a real estate broker to find out what was for sale, putting the house in front of hundreds of thousands of other real estate agents was the most cost-effective form of advertising.

That created the network effect, and that network effect was strengthened by the affiliation with REALTOR Associations. It eventually became mandatory to join the Association in order to have access to the MLS.

The MLS provided all of the core functions of a Platform: audience/network, matchmaking, core tools and services (books, terminals, databases, etc.), and of course, rules and standards.

So why the "formerly known as"? Why isn't the MLS the Platform for Real Estate? The Council of MLS, after all, has a marketing campaign out today under the tagline of "Making the Market Work".

There are many reasons, but the simplest explanation is that the MLS lost its crown as the most cost-effective channel for advertising a home for sale when the internet came of age. Suddenly, the World Wide Web was the most cost-effective channel for advertising.

Rather than realizing that the change meant that the MLS had to expand its network to embrace consumers, the MLS chose to keep its network to its broker and agent customers, while trying to use the Internet as a way to funnel leads to its customers. The growth in and the struggles over VOW (Virtual Office Website) and IDX (Internet Data eXchange) over the past couple of decades illustrate that attempt.[3]

Put differently, the MLS focused its efforts and its energies on facilitating the exchange of value between real estate agents, rather than between buyers and sellers. That worked as long as the real estate agent was the only conduit for buyers and sellers to access the market, but that model is crumbling in the internet age. To be fair, the MLS was perhaps forced into that role due to the peculiarities of the complex politics of the MLS and the REALTOR Association, but the marketplace is unforgiving and does not care about your reasons.

The other significant misstep was the failure of MLSs to consolidate rapidly after the advent of the internet made it clear that they were

[3] Only one MLS that I know of recognized the importance of remaining the most cost-effective channel for advertising: Houston Association of REALTORS or HAR. By launching HAR.com as a public-facing listing portal in 1997, HAR managed to remain relevant in the internet era to consumers. But even HAR is at a crossroads as the Platform evolves.

no longer the most cost-effective form of advertising. That has almost everything to do with the peculiarities of MLS ownership by the local REALTOR Association and governance by its customers. That failure still continues to this day, as despite massive pushes for consolidation by MLSs, by brokerages, and by NAR itself, we have gone from over 800 MLSs in 2010 to over 600 MLSs in 2018.

Because the MLS and Associations restricted the network to licensed real estate professionals, they were never in touch with changing consumer preferences and were ignorant of consumer pain points.

The impact of the failure to consolidate is significant.

First, small businesses simply do not have the capital to invest into core tools and services. The state of technology for the MLS industry is at least a couple of generations behind consumer technology.

Second, since the value of a Platform is directly related to the size of its network, small networks are punished. Imagine if Uber were limited only to San Francisco, or AirBnB only available in Miami. None of us would even know their names.

While the woes of the MLS can and probably should fill multiple Red Dot Reports, for our purposes it is sufficient to note that while the MLS was the Platform for real estate for years, perhaps even decades, its failure to adapt to the advent of the Internet means that it is no longer in the running for the Iron Throne.

The MLS remains relevant because it remains the platform for real estate brokers and agents. Cooperation and compensation remain important, even in jurisdictions where government rules require cooperation. And the MLS and Associations still provide a number of tools—such as the lockbox, legal forms, and dispute resolution mechanisms—which are important for how homes and bought and sold today.

The key word there is *today*. Because the MLS and Associations restricted the network to licensed real estate professionals, they were never in touch with changing consumer preferences and were ignorant of consumer pain points. As a result, rather than thinking about ways to eliminate consumer pain, the MLS and Associations have focused almost entirely on ways to eliminate agent and broker pain, and have consumers cope with their pain.

As iBuyers and their logical heirs, the market makers, change consumer behavior, the MLS will face serious problems with holding onto its status as the Platform even for real estate agents.

The MLS does not have access to capital. Even the largest MLS in the country, California Regional MLS (CRMLS) based in Orange County, has roughly 93,500 members with estimated annual revenues in the $42 million range.[4] That meets Gartner's definition of a small business. So the vast majority of the 650+ local MLSs in the U.S. are far, far smaller than CRMLS with even less in the way of revenues or assets.

Furthermore, most MLSs are setup as nonprofit organizations or as divisions of a nonprofit REALTOR Association. Even the minority which are setup as for-profit corporations are operated as if they are not-for-profit, oftentimes with language in the by-laws that prohibit things like distribution of profits or even in some cases, raising fees beyond covering expenses and setting aside reserves.

What investor is going to give them money?

Finally, most MLSs are governed by its users, whether brokers or agents, who tend to take a very dim view of the MLS "competing" against them. Simply opening up the network to consumers would be controversial, as has been and continues to be when the MLS starts talking about a "public facing website". Accordingly, even if an MLS could somehow get the necessary capital, it is difficult to imagine the MLS engaging in a linear iBuyer business in order to build a Platform.

[4] I estimated this based on OCAR's pricing for MLS-only membership, found here: https://www.ocar.org/Membership/MLS-Only-Salesperson.html. Actual revenues are likely higher due to various ancillary revenue streams, but not significantly so.

The Frontrunner: House Zillow

One of the consequences of the MLS failing to realize the need to expand its network with the advent of the internet is that third party real estate portals have stepped in.

We won't rehash the entire history, except to note an interesting phenomenon: the fall of Realtor.com.

Why Didn't Realtor.com Win This Race?

It is easy to forget that Realtor.com was the first truly national real estate portal, and that at one time, its lead over startups like Zillow, Trulia, and others seemed insurmountable. In fact, it was the only game in town for years.

Realtor.com was a classic platform even in its early days. It had a massive audience, offered matchmaking, a solid set of core products and services, and had rules and standards. It had access to all of the listing information thanks to its relationship with NAR.

Where the MLS and Realtor.com are and were agent-centric at their core, Zillow and Redfin are and were consumer-centric at their core.

So what happened? How is it that today, many people think that the "R" in ZTR stands for Redfin instead of Realtor.com?

While books can (and probably should be) written about what happened to Realtor.com, my thesis is relatively simple.

Much like the MLS, due to its relationship with NAR and the resulting control by NAR over some of its key strategic decisions, Realtor.com was always far more industry-facing than it was consumer-facing. It consistently failed to treat consumers as a real part of its network.

To put it differently, where Realtor.com thought of consumers as the means to the end of keeping agents paid, Zillow and Redfin from the very start thought of agents as the means to the end of facilitating the exchange of value between buyers and sellers, between renters and landlords, and between borrowers and lenders. Where the MLS and

Realtor.com are and were agent-centric at their core, Zillow and Redfin are and were consumer-centric at their core.[5]

With that distinction in mind, we must acknowledge that from the outside, Zillow did and does the exact same thing that Realtor.com did and does. The bulk of its revenues (still over 70%) comes from advertising dollars spent by real estate brokers and agents who buy leads from Zillow. Zillow built audience in more or less the exact same way that Realtor.com did: putting listing information on the web, generating interest, and selling that interest to paying customers.

However, there are a couple of interesting things that suggest radically different philosophies between Realtor.com and Zillow.

First, my friend Greg Robertson, CEO of W&R Studios, relayed a story on a podcast we do together[6] that he once saw a poster on display in Zillow's HQ that showed their original business plan: an auction site for real estate. Zillow was forced to pivot because the real estate bubble had burst just about a year into Zillow's existence. It never set out to be an agent advertising business.

Second, the fact that Zillow held on to its controversial Zestimate feature, which was hated and reviled by real estate brokers and agents from day one, and created all manner of challenges for Zillow (including at least one recent lawsuit), suggests that its North Star was always and remains the consumer, not the agent who pays the bills.

Through smart and savvy product design, fantastic marketing, smart hiring, and a healthy dash of good luck, there is no denying that Zillow is the dominant real estate portal today. Traffic of 187 million monthly unique visitors is almost three times its closest competitor,

[5] This is not to knock the executives at Move or at Realtor.com; I know for a fact that a number of them saw what was happening, and what was coming, and tried to do something about it. But they were stopped by NAR, which held actual board seats at Move and had significant control over Realtor.com's product offerings, until it was too late.

[6] The Industry Relations podcast, available on iTunes.

Realtor.com, and six times the third place portal, Redfin. "Zillow" overtook "real estate" as a Google search term sometime in 2017.

And in the last year or so, Zillow has made a decisive move towards becoming the Platform for real estate by launching its iBuyer service: Zillow Offers.

Zillow Offers and the Platform: Spencer Speaks

Since I wrote at length about Zillow Offers in the August Red Dot, I won't get into it at length here. Please go read the August issue.

There are a couple of interesting updates, however, which came out after the August Red Dot was published during Zillow's Q2 earnings call.[7]

First, Zillow's CEO Spencer Rascoff made it clear that the leadership team at Zillow sees Zillow Offers as something far more than a small experiment with house flipping. During the Q&A, he said:

> To address the investor concern or media concern about this overall business expansion, **I think it is a gross mischaracterization and misunderstanding to call this a flipping business**. Flipping requires distressed homes and distressed sellers, people that are selling their home under duress, and it only applies to a very small segment of the market. Most people are not willing to sell their home to a flipper because their home doesn't meet that type of criteria. They're not desperate. They're not willing to sell it for 20% or 30% below market.
>
> **What we're doing at Zillow Group appeals to a much, much broader segment of the market**. It appeals to anybody that values speed, certainty, ease, convenience, the ability to sync up the timing of the sale of their home and the purchase of the next home. That is appealing to a much broader swath of consumers. Arguably, most people need to lighten up the sale of their home with the purchase of the

[7] The transcript is available on Seeking Alpha: https://seekingalpha.com/article/4195568-zillow-group-inc-z-ceo-spencer-rascoff-q2-2018-results-earnings-call-transcript?part=single

> next home. So you can think of it as a service for which we charge a fee. It is not a flipping business.
>
> And the early stats that we've seen are providing the data, hopefully, for skeptics to start to wrap their minds around this, things like the 10,000 home sellers coming through our funnel in just the first couple of months representing over $2.5 billion of total real estate. **It's broadly appealing. So we're comfortable with people misunderstanding this for a long period of time, as I say, but we have conviction on it.** We think it's a service that is very appealing to home sellers and can be very profitable for us in its core but also profitable in its attached mortgage business and its attached listing lead generation business for a Premier Agent.

Why, it's as if Spencer reads my writings! And unlike many in the real estate industry, he takes them seriously. <Insert smiley face here.>

Like most of Zillow's moves, however, that big bet is based on data. Earlier on, Spencer Rascoff mentions that Zillow "sees" about 15% of all dollar value being sold in Phoenix, after just two months of having Zillow Offers in operation there. (I assume that by "seeing", he means that sellers owning 15% of the dollar volume have contacted Zillow to see about getting an offer.) That's a lot of people, all of whom are pretty serious about selling their homes.

But it doesn't stop there. As we all know by now, Zillow also announced the acquisition of a lender: Mortgage Lenders of America, or MLOA. That had to have thrown everyone who doesn't subscribe to the Red Dot for a loop.

Those of us who had read the August Red Dot yawned and said, "Oh, that's entirely predictable."

Because to become the Real Estate Platform, you must offer some kind of an iBuyer service to eliminate consumer pain.

The MLOA Acquisition: Building Infrastructure

Those who do not understand that the iBuyer business is ultimately about applying capital to the problem of consumer pain with the real estate transaction likely looked at Zillow's acquisition and freaked out.

That would explain the 16% drop in Zillow's stock right after the MLOA announcement.

The negative reaction makes sense if you view Zillow as a pure platform play with 92.1% gross margins (2017). Why in the world would you risk that moneymaker by getting into mortgage lending, with its compliance headaches, its risks, lower margins, and the possibility of alienating some of the Premier Agent advertisers not to mention just about all of the lenders and mortgage brokers on the Mortgage Marketplace?

I imagine it would be no different than if Ebay decided to expand its "first party inventory" program (aka, direct to consumer retail) to the U.S. Why in the world would you want to endanger your highly profitable Platform business by getting into that?

By this point of this report, you know the answer. Because to become the Real Estate Platform, you must offer some kind of an iBuyer service to eliminate consumer pain. That is the key strategic product, and like Amazon does, you must control the key strategic product.

In light of that, this quote from Spencer Rascoff during the Q2 earnings call makes far more sense:

> **In pursuit of a better consumer experience**, more of an on-demand customer experience where she expects to be able to press a button on a smartphone and have something magical happen, **we'll undoubtedly move into other businesses that put us as more of a principal**. That increases complexity, but it dramatically expands the total addressable market of the opportunity.

What he didn't say in so many words, but clearly implied, is that the MLOA acquisition is about *building the infrastructure* to support the linear business, but then to support/enable the Platform. Here is an example:

> So we're trying to create a digitized purchase experience, including origination. And it starts with the Zillow-owned homes, and maybe someday, it moves into other types of transactions as well.

Zillow doesn't know the mortgage lending business. It bought MLOA to learn it. I suspect that we won't see any major moves anytime soon, but I also suspect that people up and down the organization at Zillow are going to learn a whole lot about how mortgage lending works over the next few quarters.

This is no different strategically than Amazon building warehouses and getting into logistics—a business that Bezos and his team knew nothing about when they launched the Amazon distribution network in 1997. But five years later, when Amazon launched Marketplace, that expertise with distribution was a major reason for its success as a Platform.

Becoming the Hybrid

Zillow is not abandoning its core Platform business. It is becoming a hybrid, which allows it to contend for the Iron Throne. That it is not interested in becoming a real estate brokerage, or going strictly into some linear business, is evidenced by the other major piece of news that was completely overlooked: the rollout of its new lead validation and distribution system.

Here's what Spencer said about this development, which was overshadowed by the MLOA and Zillow Offers news:

> In terms of the Premier Agent question, when we think about what we're doing on this new lead distribution system, we're switching from a one-to-one concept to a one-to-many concept, wherein we call Premier Agents serially until we are sure that the consumer can get on the phone with a Premier Agent.
>
> Remember, these are not -- these Premier Agents aren't just advertisers. They're really small business owners that have built their business on our platform.
>
> And every time we change the rules on them, even if it's well-intentioned and even if it's long-term beneficial for them and long-term beneficial for the consumer and long-term beneficial for Zillow Group, anytime we change the rules, that can cause pushback in the system.

Is there any doubt that Spencer understands perfectly well that Zillow has built a Platform business, but one that is completely reliant on the sellers (i.e., the agents) for the quality of its services to buyers (i.e., consumers)?

Zillow is going to try to influence that by changing the rules and standards (a key feature of a Platform). That's risky, because of pushback, but that is a risk that Zillow will take and seek to hedge with its new iBuyer linear business. This is an important step strategically.

How do we know that? Here's Spencer again:

> In that case of home shoppers, the new Premier Agent, one-to-many lead distribution system helps a consumer press a button and get a real estate agent on the phone. Now I know that may not sound particularly cutting edge, but in our industry, that actually is quite cutting edge.
>
> There are very few places that you can press a button and get a real estate agent on the phone, including a real estate agent's own website. And so the new lead distribution model really is adapting to changing consumer expectations of the on-demand economy by switching to a one-to-many lead distribution system and then just to pick one more business.
>
> …
>
> The days of pressing a button and buying a home are -- it's -- there's a lot that has to happen between here and there in terms of readying the industry and readying regulators for that type of on-demand consumer expectation. We'll clearly be at the forefront of catering to consumer and real estate agents' needs, as all of these aspects of home buying, selling, renting and financing become digitized.

Zillow's pivot is not away from being a media advertising company to becoming a brokerage, or a iBuyer. Zillow's pivot is towards becoming a hybrid.

Traffic, Technology, Capital

Zillow is the frontrunner for the Real Estate Platform for many reasons.

Perhaps the most important is that its senior leadership appears to understand that the goal is to become the Platform. With some of the other contenders, that isn't as clear. So far, they're doing everything correctly.

But there are obvious other advantages as well.

Its advantage in audience (which we might think of as size of its network) is significant, and not in any immediate danger.

Its advantage in technology is more difficult to assess, since nobody including Zillow is opening up the kimono as far as technology details are concerned. But one potential indicator is that Zillow has not slowed down in the least in spending on technology and development. In Q2/2018, Zillow's Technology and Development expense line broke $100 million. In comparison, Redfin spent $13 million.

As for access to capital, well, many of you already know that Zillow raised an additional $750 million in Q2 through debt and stock offerings, bringing its total war chest to $1.5 billion.

Given all of the above, there is no compelling reason to think that Zillow is anything other than the frontrunner to become the Real Estate Platform.

Contender: House Opendoor

Prior to Zillow's pivot, my pick for the frontrunner for the Platform would have been Opendoor, the brainchild of Keith Rabois.

I have long held that Opendoor is the most important company in real estate, because I had long thought that Opendoor was making a play for the Platform.

In 2016, I wrote the following about Opendoor:

> I don't think Opendoor cares all that much about real estate brokerage; this is a *play to revolutionize mortgage financing*. Let's get into it.
>
> …

> I don't think you can go raise $720 million in equity and debt for a two-year old startup without this being a specific part of the plan. Since I'm not privy to those plans, all I can speculate on is some combination of the following words:
>
> - Seller-financing, by a well-capitalized "market maker"
> - Private-label RMBS, at above market rates, which avoids the whole "conforming loan" business and all of the regulations that surround that
> - Private mortgage insurance
>
> Given the parlous fiscal state of the *federales*, and the announced intent by every Administration since W's to reduce taxpayer involvement in the mortgage markets, do we really think we'll see a lot of people saying that's a terrible idea?
>
> Now, imagine walking into a house, with your buyer agent by the way, liking it, then putting in an offer to have Opendoor say, "If you have a job, we'll finance your purchase and close it within 48 hours!" The paperwork would be going to Opendoor.com and putting in some basic info and giving Opendoor access to your bank accounts. (Quicken Loans already does most of this with Rocket Mortgage, by the way….)
>
> The alternative is to save 1.5% to go through the financial proctology exam that your traditional Fannie/Freddie/FHA/VA lender would put you through… with no guarantee that the loan would actually close 90 days out… depending on the appraisal… and a hundred other unknowns of whatever underwriting standards are in place at the lender.
>
> Which would *you* choose?

Shortly thereafter, Opendoor got its mortgage brokerage license, opening to door to unlimited seller financing.

I will freely admit that Opendoor has done no such thing, yet. Here we are almost a year and a half later, and Opendoor has shown very little interest in revolutionizing mortgage financing.

And in some respects, Opendoor is not a Platform play at all, but an interesting linear business that controls the supply chain, by purchasing properties with cash and putting them on the balance sheet, rather than the means of connection.

So how in the world are they a contender for the Iron Throne?

Experience, Infrastructure, and Access to Capital

The one thing that Opendoor has over everybody else is experience in the iBuyer game. They were the originators of the concept, and have been at it the longest in the most markets. And they have now been at it for five years—practically an eternity in the technology space.

They have innovated all along the way, including the use of technology to allow unaccompanied tours of homes in Opendoor's inventory by potential buyers. They didn't buy a mortgage lender, but they did get a mortgage broker's license, and have been working with lenders for years now.

What Zillow is just now learning about what to do with a house it just bought from cleaning to staging to maintenance, Opendoor already has learned those lessons. Presumably, Opendoor has built up the infrastructure to support the iBuyer efforts along the way as well.

Opendoor's weakness is that it does not have the consumer traffic that Zillow or even Redfin enjoys.

Plus, Opendoor has access to capital. Keith Rabois of Khosla Ventures—a member of the Paypal Mafia—is one of its cofounders. Opendoor has also been forging alliances with homebuilders; Lennar co-led its latest funding round for $325 million. There's a very good chance that Opendoor has access to as much capital as it needs.

Add the Platform

If Zillow began as a pure platform play, and is evolving towards becoming a hybrid in order to become **the** Platform, then Opendoor has the opposite challenge: it began as a pure linear business, and therefore must add a platform to become a hybrid.

There are signs that Opendoor is trying to do this.

Opendoor recently launched a Preferred Partnership program for real estate agents that allows them to put an offer from Opendoor in front of their clients—just as they can with Zillow Offers. It is unclear just how much take-up there has been of this program (and yes, I've asked) but it is a sign that Opendoor would like to expand its network to include third-party "sellers" (i.e., real estate agents).

But clearly, Opendoor's weakness is that it does not have the consumer traffic that Zillow or even Redfin enjoys. Consumers in their 13 markets are likely becoming aware of them slowly but as we know from public comments from Zillow and Redfin, it is neither easy nor cheap to do consumer awareness marketing campaigns. And it takes quite some time for those awareness campaigns to bear fruit.

An easier path might be for Opendoor to make a big acquisition that does make it a Platform. For example, acquiring Move/Realtor.com from News Corp might be one such move. Or merging with Redfin could be interesting for both companies.

But that's getting far too speculative, even for me.

Still a Contender

Even without some major acquisition, Opendoor remains a contender because consumer behavior could change very rapidly. One of the benefits of building a network is that people in the network often recruit others to join it rapidly.

Uber and AirBnB both came almost out of nowhere to take their respective industries by storm. People were telling their friends and family about this amazing new service, where you push a button and a car shows up, or how they booked a vacation in some hotspot at a fraction of the cost using AirBnB. Viral growth is absolutely possible.

As the example of Amazon vs. Ebay is showing us, it may be easier to build out a platform from a strong linear business than it is to build a strong linear business out from a platform because of positive network effects.

We don't know what kind of traffic Opendoor generates, because they simply don't talk about it. But if we extrapolate from Zillow's reported 15% of the value of sales in Phoenix after only two months, Opendoor in 13 markets might actually be getting quite a few consumers onto their website and apps.

As a final consideration, Opendoor may not have any ambitions of trying to become the Real Estate Platform even if they could contend for that position. Opendoor may be perfectly happy to be a major market maker in housing, and perhaps even operate on whatever Platform comes into existence in the future.

Not everybody wants to be NASDAQ or the NYSE. Some are perfectly happy being Citadel Securities.

Contender: House Redfin

It may seem surprising to put Redfin into this bucket of being a contender to be the Platform for real estate. It is, after all, a full-blown real estate brokerage without apology. It does get listing information directly from other brokerages by way of the MLS, in which it is a full participant, but it isn't as if other agents are clamoring to get onto Redfin's website and pay them for leads. Redfin leads are for Redfin agents, and those select few Partner Agents who get overflow leads or leads that Redfin does not want to service for a variety of reasons (unprofitability being the top one).

Yet, if you look at the discussion above, a real estate brokerage does have strong characteristics of a Platform. It does not control the supply chain or the means of production; it controls, instead, the means of connection.

What was missing were the rules and standards, as well as the refusal (or failure) to expand the network to include consumers as brokerages became agent-centric.

Redfin does not suffer from the second problem, as its agents are not independent contractors but W-2 employees. But it does still suffer from the "rules and standards" problem.

A close look at the design of Redfin's business model, its systems, its designs, and the what its senior leadership constantly tell us about *why* Redfin exists shows that like Zillow, Redfin from its birth was consumer-centric in a way few other brokerages are.

A real estate brokerage does have strong characteristics of a Platform. It does not control the supply chain or the means of production; it controls, instead, the means of connection.

Experience, Quality Control, Audience, Access to Capital

What Redfin has in spades is experience with the actual buying and selling process. Zillow is trying to go deeper down the funnel with Zillow 5.0 (announced in the Q1 Shareholder Letter). Redfin has been deep down in that funnel for 10 years now.

With W2 agents, systems designed around their processes, and a culture built around the consumer, Redfin has a greater ability to control the consumer experience whether a traditional pain-filled transaction process, or the iBuyer process through Redfin Now.

One thing that Redfin's Quinn Hawkins and Jani Strand told me that didn't make it into the August Red Dot is that they pointed out that Redfin has significant experience, as well as a wide network of contractors and vendors, with all of the things that go with buying a house. They built that skillset and infrastructure to service their seller and buyer clients, but they can easily leverage that for Redfin Now. Opendoor might have been in the iBuyer game longer, but Redfin has been in the weeds of the housing transaction game for longer than Opendoor.

Redfin also enjoys a massive and growing consumer audience with over 28,777 average monthly uniques in Q2/2018, an 18% YOY growth. That figure is even more impressive considering that Redfin is only in 80 markets or so in the United States, while Zillow and Realtor.com cover the entire country.

And in July, Redfin raised roughly $247 million with a public offering of stock and by selling convertible bonds. Glenn Kelman, Redfin's CEO, then further clarified things during his Q2 earnings call:

> The Redfin Now team will be busy. One reason, we've raised $247 million last month was to fund expanded operations for Redfin Now. But we expect the capital buy homes will, in 2019, come from lenders who allocate money specifically for

> this purpose, using the homes we buy and not Redfin's bank account as collateral.

They have all of the necessary tools to contend. But will they?

"But we decided we can win, because we believe nobody is better at selling homes than we are. We believe that nobody in real estate is better at combining local service and technology."

- Glenn Kelman, Redfin

Is Redfin Committed?

In Q1, I wondered if Redfin were really committed to Redfin Now as it had raised the capital limits to $25 million from the original plan of $20 million. So I wrote in the August Red Dot that Redfin Now appeared to be "merely an add-on service to that core [of low-cost, technology powered brokerage services], for consumers who are willing to take less money from Redfin in order to have certainty and fewer hassles.

Since then, we have learned in the Q2 earnings call that some of the money raised in July was for Redfin Now. But more importantly, we learned that Redfin is in the iBuyer game for the long haul:

> Encouraged by these results, we're now investing in Redfin Now as a long-term business. This will involve hiring more software engineers to build online tools for meeting owners for pricing properties and preparing offers, for managing renovations and then selling the homes we buy. We'll also start expanding beyond Southern California, with field operations led by Jason Aleem, who already has nearly eight years of experience running our Texas brokerage.
>
> …
>
> In committing to Redfin now long-term, we eyed our competitors warily as many are well run, some are willing to take risks we aren't and seemingly all of them are well funded. But we decided we can win, because we believe nobody is better at selling homes than we are. We believe that nobody in real estate is better at combining local service and technology.

> Newer entrants don't have the online audience we do, and pure websites don't have as much operational expertise. We believe few companies have our spending discipline. This audience field experience and penny-pinching should let us acquire and sell homes at a lower cost, which will let us offer homeowners more money. For the person selling her home to Redfin Now that money is almost all that matters, and a war on price is the one we feel best prepared to win.

That certainly sounds like commitment to me. It also sounds like confidence, and one that is justified.

Redfin is certainly a contender.

Sleeper Picks: House Compass and House Realogy

There are two companies that I consider to be "sleeper picks" for the Platform: Compass, which bills itself as a hybrid tech-enabled brokerage, and Realogy, the largest real estate conglomerate in the United States.

They're both brokerages (NRT is the largest brokerage in the country) and as discussed above under Redfin, a brokerage has many qualities of a platform business.

They're not pretenders to the throne as they both have access to capital, a prerequisite for playing the iBuyer game, which is the key strategic product for the Platform.

But they are sleeper picks rather than true contenders because:

1. Neither have announced any intent to provide iBuyer services;
2. Neither have much of an ability to control the quality of their services to consumers; and
3. Neither have much in the way of a consumer audience. Consumers have relationships with their independent contractor agents, not with them or their brands.

One suspects that senior people at both companies are studying iBuyers closely to see if that is something they want to do, but as yet, neither have made a move.

House Compass: The Referral Economy?

One reason to consider Compass as a possible sleeper is its CEO Robert Reffkin's recent appearance at Inman Connect in San Francisco.

Here's how Inman News reported that session:

> "What the world deserves is everything that an MLS has, everything that a consumer site has, merged with the agent services, merged with the CRM that the agent has, all of their marketing and brochures, digital newsletters, social media, everything in one place and all on mobile," Reffkin said.
>
> "There will be a single platform in real estate," he added. "There will be one. There's not going to be 10 Googles. There's not going to be 10 Amazons. There's going to be one real estate platform."

Even more interesting for our purposes, Reffkin said:

> The vision I have for Compass is that 10 years from now, majority of people buy homes from compass agents. The agents at Compass are viewed almost like brokerages in themselves—they're personally branded, their own sites—we're a platform.
>
> And they're not just buying the home from agents, they're buying everything afterwards: mortgage, title, insurance, escrow, moving services, furniture. 10 years from now you're not going to print out a floorplan and go drive to a furniture store. You're gonna put on your 3-D goggles, link into the Compass platform, see 3-D image of the home, drag and drop, and two hours later the furniture will be there.[8]

[8] You can watch the video of the session here: https://www.inman.com/2018/07/26/watch-robert-reffkin-spills-the-beans-on-what-compass-pays-for-acquisitions/

Although earlier in the session, Reffkin said he wasn't interested in becoming the one platform in real estate but in creating the best brokerage ever, those words sound an awful lot like something somebody who wants to be the platform for real estate would say.

Given that Compass has raised almost $800 million from investors to date, access to capital doesn't appear to be a real issue for them.

I would watch what Compass does over the next several months very carefully to see if they are serious about being the Real Estate Platform at the center of the referral economy or not.

Definitely a sleeper pick for the Platform.

House Realogy: Waking Up Pissed Off

As of this writing, there's no real reason to think that Realogy is at all interested in trying to become the Platform like Compass appears to be. So why are they in the mix, even as a sleeper pick?

In my June Report, I called Realogy dead man walking. I have since heard from a number of Realogy executives who took me to task for that. One in particular said, "It's not that we're the walking dead; it's that we're the 800-lb gorilla who just woke up pissed off."

But what could an angry gorilla actually do?

In the Q2/2018 earnings call, Ryan Schneider laid out some initiatives: at least one new brand under Realogy Franchise Group, changes to NRT's commission plans, some new agent productivity technology. But then, who isn't touting some new agent productivity technology these days?

I put Realogy into the sleeper pick based almost entirely on Ryan Schneider and his background in finance. He has consistently talked about being more data-driven in all of Realogy's businesses. He comes out of a world in which markets, platforms, market makers, and technology are all far more mature than in real estate. He understands capital markets better than most brokerage CEOs.

He inherited a giant company that was losing on its core battlegrounds: recruiting and retention. I look at what Realogy has been doing as trying to stanch the bleeding, then reversing momentum in its core businesses. It's hard to expect game changing pivots out of Realogy given its urgent need to return to fighting form in its core brokerage and franchising businesses.

But I don't believe that Schneider and the senior leadership team at Realogy is ignorant of what's happening in the industry. Nor do I think they're not thinking about the consequences to Realogy should a true Platform emerge. It's just that they're a little bit busy putting out fires right now.

So suppose they manage that. Suppose they emerge from 2018 with a changed culture that values speed of execution and taking smart risks, as opposed to a culture that values stability above all. Suppose they start thinking about the long term strategic issue of the Platform.

Realogy is still a company with the largest brokerage, largest franchise operations, some of the most respected brands in the industry, whose agents touch 20-25% of every residential sale transaction in the U.S.

It has access to capital, but even more impressive is the cash flow it generates: $192 million in free cash flow in Q2 alone. Realogy is currently spending that cash buying back shares; it can easily repurpose it for something else. Like standing up a pretty impressive iBuyer program if it wanted to.

Realogy lacks a strong network of consumers, of course, like any brokerage not named Redfin. But as I mentioned above in talking about Opendoor, network effect is a powerful thing once consumers start to tell their friends and family about whatever magic happened when they pushed a button.

Again, Realogy has said and done nothing to make anybody think that they have such ambitions in mind. But I keep them in the dark horse sleeper pick column simply because they *could* if they actually put their mind to the task.

A Note About The Truly Great Houses

One thing to mention here is that I did not address some of the potential Real Estate Platforms that come from outside the industry. The reason is that any of the truly great houses in technology or finance could snap up any of the contenders… for cash.

Amazon, for example, could easily acquire Zillow, Move, *and* Redfin as an expensive experiment. Hell, forget Amazon—Jeff Bezos personally could acquire all three of them, for cash, and still have more than $100 billion left over.

Major mortgage banks like Bank of America, JP Morgan Chase or Quicken Loans could easily snap up any of these companies as well.

Or they could acquire a smaller player and seek to learn about the space. Just that act alone instantly vaults any of the Truly Great Houses into the frontrunner ranks for the Real Estate Platform.

Hypothetical scenarios and analysis involving companies already in the real estate space is one thing. The same involving tech giants and major commercial banks is… frankly uninteresting. That sort of thing makes for a cool Black Swans of Real Estate presentation, but not for an actual attempt to understand what the Real Estate Platform must be and who can be that.

So if you're interested in discussing the possibilities of one of the Truly Great Houses to enter the real estate space, please feel free to reach out to me. I do love entertaining interesting scenarios.

Better yet, if you happen to be from one of the Truly Great Houses and find real estate interesting, well, by all means, drop me a line.

The Real Estate Industry, Post Platform

Let us suppose that one of the Contenders wins the race and establishes the Real Estate Platform as a hybrid with a strong market maker linear business at least in a dozen markets or so. Let us further suppose that the frontrunner, Zillow, wins that race for the sake of this hypothesis.

As per the discussion above, the Zillow Platform would provide:

- A large audience/network
- Matchmaking
- Core tools and services
- Rules and standards

Because real estate is a mediated transaction, the Platform's network would include consumers and professionals.

Zillow Offers would form one of the core services, which keeps consumers coming back. Because of the size of the real estate market, other companies would function as market makers on the Zillow Platform, whether by geography or by property type or some other category. Major financial players would get involved as market makers or as funding sources for market makers, once that business model is proven out by startups like Opendoor.[9]

The other core services would need to include various technology tools and services to enable the transaction on both the direct retail and third-party operations. In real estate, we're talking about things like access to the property (showings, lockboxes), legal forms, payment processing, financing, getting the property ready for sale, and so on.

The rules and standards would need to include items that most Platforms provide today, such as reputation management (think ratings of Uber drivers *and* passengers), enforcement, and dispute resolution. Importantly, just like Amazon and Ebay handle payments to sellers on their payment processing platforms, the Real Estate Platform would need to ensure that professionals get paid.

So what does the industry look like then?

[9] Note that as Spencer Rascoff mentioned in the Q2 call, any regulatory uncertainty around market maker services would need to be removed. The involvement of the finance industry, and how it gets involved, is important to what happens there.

Traditional Brokerage Remains

Even in a market maker system, the traditional buyer and traditional seller would remain, at least for the foreseeable future. AirBnB did not eliminate hotels, nor did Uber get rid of taxis. Amazon and Ebay dominate ecommerce, but online retail including giants like Walmart and Target are going strong.

So traditional brokerage will remain. In many cases, the buyers and sellers will be forced into it because there won't be a market maker for their properties (at least not at a bid-ask spread that makes sense). High end luxury properties come to mind. In other cases, the seller would get the bid offer but turn it down, as happens today in 9 out of 10 cases for Zillow.[10]

My expectation is that in the Platform world, traditional brokerage would be the minority rather than the vast majority of transactions. DelPrete's insight about the psychology of loss mitigation does not argue for opting for a traditional sale—it argues for a narrower gap between the cost of traditional sale and the cost of selling to a market maker as well as wanting professional *advice* from an agent rather than having the agent list and sell the home. The traditional transaction experience is just that painful.

So traditional brokerage would remain, but it will become increasingly concentrated in certain markets and certain property types with extremely low liquidity (luxury properties, rural properties, unique homes, investors, etc.) which makes a private sale far more attractive than selling to or buying from a market maker.

Brokerage as Retail Distribution

While traditional brokerage declines, we will see the rise of real estate brokerage as retail distribution of market maker services.

[10] As iBuyers get better and more efficient and narrow the price gap between the 5-6% of traditional real estate sale and selling to an iBuyer, we should see that 9 out of 10 no deal number go down. Plus, a shift to a buyer's market or even a more neutral market would also change that.

We're already seeing this with Zillow Offers, Redfin Now and Opendoor's Preferred Partner program.

In these programs, a real estate agent is able to present an offer from an iBuyer to the homeowner along with the traditional listing presentation—or at any time during the listing if time, convenience and certainty become more important to the seller than final sale price.

In an interview with executives from HAR for this report, I learned that one of the top sources of properties for Opendoor is a Preferred Partner agent in Houston who is more than happy to refer sellers to Opendoor for a 1% fee. As Bob Hale, longtime CEO of HAR, put it, that agent feels it is far better to make 1% doing nothing after making the referral to Opendoor than making 3% and having to do all of the work of preparing, listing, negotiating, and selling the house. This dynamic is going to take hold in every market where iBuyers are active.

This is really not that different from how insurance brokers ("I'll shop around with all of the top insurance companies to get the best quote!") or mortgage brokers ("Let me shop your deal around for the best rates and terms!") work.

On the buy-side, a homeowner could find buying from a market maker to be a far less painful experience. That doesn't mean that he should buy that house at this time for that price under these terms.

These brokerages end up being retail distribution channels for service providers. They will do lead generation and conversion at the consumer retail level, offer advice to consumers, but refer the actual business to other companies on the Platform. Sure, they'll make less money per transaction, but (a) they can make that up with volume, and (b) their costs are far lower as well since they're not spending on marketing a property or on driving a buyer around.

Accordingly, we will see the emergence of agents and brokers whose primary business is not the listing of homes or showing homes to buyers, but the referral of sellers and buyers to market makers. They may even choose to refer out the traditional sale to other brokers and agents. This business model already exists in real estate under the name of "paper brokerage". There is absolutely no reason to think it will not adapt easily to the Platform world.

Advisory Services Become More Important

One of the distinctions between discount stock brokerage (like a TD Ameritrade) and a full-service brokerage (like Edward Jones) is that the latter provides investment advice to its clients.

They both provide trades—that is, placing orders to buy or sell on the appropriate financial exchanges, which means from a practical standpoint, finding market makers to sell or buy those shares or commodities.

They both provide tools, apps, market data, research, etc. If you want to DIY, discount and full-service brokerages both provide what you need.

The full-service brokerage, however, will provide investment advice: "It's time to sell your IBM shares; we think it's headed south."

The same analysis could hold for real estate in the Platform future.

Just because a homeowner could sell their home in three days to a market maker doesn't mean that he should. It depends on the homeowner's goals, financial situation, condition of the property, etc. Furthermore, the offer they receive from an iBuyer might be reasonable, or it might not be—again, depending on that family's goals and situation.

On the buy-side, a homeowner could find buying from a market maker to be a far less painful experience. That doesn't mean that he should buy *that* house at *this* time for *that* price under *these* terms.

As Mike DelPrete mentioned, there are some very strong psychological reasons why consumers will want to work with a specialist on a high value, infrequent transaction like buying or selling a house. But that doesn't mean consumers have a psychological need for inconvenience. It means they have a psychological need for advice from an expert reassuring them that they're making the right decisions.

We may even see the emergence of pure advisory services—true real estate consultants who will advise buyers and sellers for a fee but not take a commission since they won't be involved with the transaction itself at all. That's more likely because....

The Dynamics of FSBO/FPBB Change

As we saw, For Sale By Owner (FSBO) activity has actually been in steady decline over the past decade or so. Part of the reason is increased inconvenience, but another part of the reason is the emergence of low-cost "MLS-only" companies that will put your home on the MLS for a flat fee. Those transactions will show up as brokered transactions in the MLS.

When the Platform emerges, however, the dynamics of FSBO change as well. The infrastructure that the market makers will need to build to service their linear businesses can be leveraged to help third parties do their transactions. Those third parties include FSBO sellers (and FPBB buyers or For Purchase By Buyer, a phrase which I just invented).

Rather than paying a real estate agent 3%, perhaps the FSBO owner can pay Opendoor a fee to have their cleaning and maintenance people do that work on his property. Rather than having to deal with the buyer's financing issues, the FSBO can just refer potential buyers to Zillow's mortgage program to get prequalified. Instead of having to do all of the burdensome paperwork, a FSBO owner could find a licensed transaction coordinator on the Platform who will do the work for a fee.

With a Platform in place, service providers from title to escrow to attorneys to marketing companies and staging companies and anybody else involved with housing are almost certain to see the benefit of getting in front of millions of consumers and professionals who are on the Platform. All of those service providers then change the dynamic of FSBO and FPBB and make it easier than ever.

Market makers would not mind having more FSBO and FPBB consumers on the Platform, so they can market to them directly. If the price is right, FSBO and FPBB consumers have no reason not to take advantage of a simpler process.

Remember: not the drill, but the hole.

Decide. Act.

RECOMMENDATIONS: TECHNOLOGY

So, the Game of Platforms is on for real. What should technology companies in the real estate sector be thinking about and doing as the well-capitalized great houses struggle against each other?

Because of the importance of iBuyer to the Platform, I advise you to read the recommendations from the August report as well. In addition, consider the following:

Don't Believe the Hype

As we discussed, much of the industry thinks a platform is just a series of connected apps on top of a database. Some think a platform is about a suite of products that help a real estate agent do traditional brokerage tasks from lead generation to document storage.

If you want to call your SaaS product a platform to generate additional sales, hey, do whatever you want. Effective marketing is effective marketing.

But don't believe your own hype when you're doing strategy work instead of sales and marketing work.

For example, word came down as I was finalizing this report that Move has agreed to acquire Opcity for $210 million. The press release keeps calling Opcity "the market-leading real estate technology platform."

Having read this report, you know that Opcity is no such thing. It's a nice linear business that does lead qualification, similar to how Zillow's new lead distribution system works. It controls the supply chain: buy leads from Realtor.com, Zillow and elsewhere, spend money on staff who qualify those leads, and then sell those leads for a referral fee to paying broker and agent customers.[11]

As a linear business technology company, your strategic priority should be identifying your role on the Platform. This is actually an opportunity for most tech vendors since the Real Estate Platform must be a hybrid, and requires a strong set of linear businesses that offer real value to its network of consumers and professionals.

If you are genuinely trying to contend for the Platform, or even if your goal is to become a sub-platform within the larger Real Estate Platform (as the MLS will become, if they play things right) then…

Capital > Technology > Inertia

We could even boil down my thesis in this paper to this formula: capital > technology > inertia.

The Real Estate Platform will become that by applying enormous amounts of capital to solving consumer pain with the transaction process. Technology is important, but its impact is limited in mediated, infrequent, and high value transactions like real estate.

Furthermore, capital can buy technology. The reverse is often not true, a fact to which the corpses of thousands of innovative startups with cool technology that never saw the light of day can attest.

And technology beats inertia every day and twice on Sunday. If that were not the case, the real estate industry would still be using carbon paper and typewriters instead of electronic signatures and text messaging.

[11] Move/Realtor.com itself is a pure platform. I did not include them as a Contender because it has not gotten into the iBuyer game—a necessary requirement to be the Platform in real estate. At this point, I do not believe that adding Opcity to its portfolio of linear businesses does not fundamentally change the strategic outlook for Move. If anything, this is to catch up to Zillow's moves on lead distribution.

“This is how we’ve always done things” is just about the most dangerous thing you can say today. The second most dangerous thing you can say is, “We can’t afford it.”

Consumers do not care about the way things have been done in real estate for a hundred years. Nor do they care what the technology stack that supports The Way We Were is and why.

If consumers do not care, then you have to ask how long it will be before your broker and agent customers do not care either. They have to go where the consumer is, because it will be impossible for them to bring the consumer to where they are.

So if your intent is to become a real contender, or even if your intent is to become a child platform (maybe a development platform, or a buyer demand data platform, or whatever) of the Real Estate Platform, you still have to think about capital > technology > inertia. And while you’re thinking of that, you have to figure out a way to offer the four core functions of a platform business:

- A large audience/network
- Matchmaking
- Core tools and services
- Rules and standards

The MLS Monopoly Gets Broken

Something for technology companies to consider is that the advent of the Platform likely results in the death of the monopoly that the MLS has over brokers and agents as well as over data.

The MLS will lose its monopoly power over real estate agents because of the emergence of non-traditional businesses post-Platform, the growth of importance of data from market makers (Bid/Ask, volume, real-time demand information, etc.), and superior core tools/services from the Platform.

Finally, when “market price” doesn’t mean the last sold price on the MLS, but the Bid/Ask of market makers, things are going to change.

The MLS will remain important for brokers and agents who remain in the traditional brokerage, as a substantial percentage of consumers will want or need to stay with that process. But I actually expect traditional brokerage deals to make up less than the majority of transactions in the post-Platform future because of how inconvenient that process is.

What does that mean for technology companies?

If you service only the MLS segment of the industry, it's time you start thinking about diversifying your customer base.

If your customers are mostly brokers and agents, and you have only needed to get data from the MLS, it's time to start architecting your system to take market makers and the Platform into account as data sources.

Opportunities in the Post-Platform World

While traditional brokerage will not die, it will be different, and likely a far smaller part of the real estate brokerage segment. But there will be new opportunities for technology companies as agents and brokers discover new ways to make money.

Two I have sketched out involve becoming more of a retail distribution channel for the Platform and its market makers, as well as a stronger emphasis on advisory skills and services.

Both of these will require technology partners who can provide systems and tools to make the business run.

Of particular interest, at least in my view, to technology providers is the prospect of a stronger focus on advisory services. Even the low-fee, high-volume business of referring leads to market makers is likely to require the agents to become (or at least appear to be) subject matter experts.

Today, because of the tension between independent contractor agents who guard their databases and insider knowledge jealously (since every other agent sitting in the office is a competitor) and the brokerage company, there is precious little demand for something that processes, analyzes, and distributes institutional knowledge. Agent teams and "teamerages" have such needs, but it's still a fraction of the market right now. I can see that changing in the post-Platform world. So think about how you might take advantage of such a shift.

Consumer Tools vs. Professional Tools

One of the issues that emerge as the Platform comes into being is the question of "core tools and services".

The Platform must provide them to the network: buyers, sellers, agents, and other real estate professionals (mortgage, title, escrow, etc., etc.) but the Platform only has to (and only should) provide the **core** tools. And if it is a true Platform, the company will provide development environments, data over feeds/API, business rules, etc. to allow others to build non-core tools for the marketplace. The most obvious segment is the professional market, where users need tools that the average consumer does not because they are using those tools to make money.

Today, the residential real estate industry is in a funny place where consumer technology tools are often superior to professional tools. It's difficult to deny that fact when agents will often use the Redfin app or Zillow mobile app to conduct business instead of "professional" tools provided by the MLS or by a vendor.

In contrast, look at industries like finance. What is available to day traders from consumer-oriented brokerage companies is different from what is available to a trader at Goldman Sachs… although the gap is closing as technology continues to advance.

A bigger gap exists between something like consumer-grade image manipulation and Adobe Photoshop. The question for the technology vendor—and the industry as a whole—to ask is where tools for real estate professionals fall on that spectrum.

Take as an example, Box Brownie, which works with some of the top real estate brokerage companies and agents. Earlier today, Box Brownie won the Pitch Battle at NAR's Real Estate Innovation, Opportunity & Investment Summit. Box Brownie does photo editing, virtual staging, rendering, etc. as a service.

While this is billed as a professional image tool/service, there's nothing about Box Brownie that says that a consumer could not easily use it directly. If this kind of image manipulation, photo editing, etc. becomes a core need, the Platform will find a way to provide it as a core tool—including buying Box Brownie as an infrastructure component.

The real professional tools here are whatever Box Brownie's people use to do what they do.

There's a lesson in that for technology vendors in real estate, and for their customers.

CONCLUSION

As I finished writing this report, I realized that I covered these themes in June, August, and now in September.

The reason is simple: this competition to become the Real Estate Platform is the biggest story in real estate today, and very few people truly understand what is happening.

Meanwhile, within the industry, we're still talking about the platform as if it were a series of software products connected to each other. Major national franchises are talking up a minor acquisition of a minor software company as the launch of a new platform. Major national figures are talking as if improving agent productivity—read, increasing their lead generation and lead conversion capabilities—is where the action is.

Because of that, thinly capitalized software vendors tout their solution as The Platform, and various thinly capitalized and relatively small MLSs talk about The Platform.

These are all strategic mistakes. I wrote this in the hopes that at least my subscribers would not mistake importance for urgency. No, the Platform issue is not one that will affect your future next quarter, or perhaps even next year. You have fires to put out today, and urgent matters demanding your attention right now. I understand and sympathize.

But the consumer does not care. As a strategist, neither should you.

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