

PAA Research

Z: Running Into a Wall

GROWTH IS SLOWING AND OTHER CRITICAL OBSERVATIONS FROM
OUR SURVEY OF 400 AGENTS

Zillow: The Short Thesis

1. Traffic growth is slowing, particularly for Trulia
2. The total addressable market (TAM) is significantly smaller than management's \$12B estimate, we think the market is closer to \$2-\$3B
3. Lead volume appears to be flattening out, or at the very least not improving materially
4. Lead quality has not improved and remains a persistent issue
5. Availability of ad inventory on for-sale listings continues to shrink due to growth in the premier agent program and broker level deals that block third party advertising next to listings
6. The lender co-marketing program has been a big contributor to overall ARPA growth for the past 12-18 months and will no longer serve as a tailwind

Zillow: The Short Thesis (cont'd)

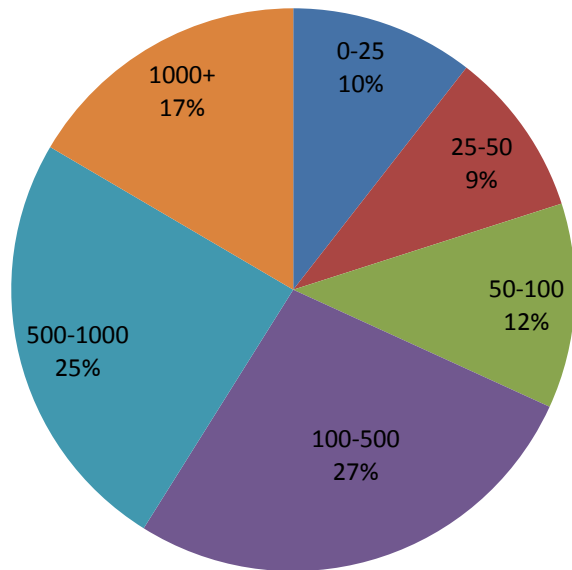
7. Trulia is dying on the vine in the absence of direct marketing support. Zillow could be forced to increase marketing spend meaningfully in 2016, which is not factored into estimates
8. Realtor.com is reinvigorated and appears to be gaining share under News Corp's ownership
9. Rentals will not prove to be an elixir to Zillow's growth woes given the intensity of competition from CSGP, Rentpath, Dominion Enterprises and others as well as the limited size of the end-market (\$2-\$2.5B)
10. **The Upstream/RPR platform backed by NAR and brokers accounting for more than 70% of listings in the country presents and EXISTENTIAL THREAT to Zillow's advertising model**
11. Estimates remain too high for 2H15 and 2016. Synergies from the Trulia deal could fall short of expectations as a result of slowing traffic growth
12. Valuation support is a long way off

About the Survey

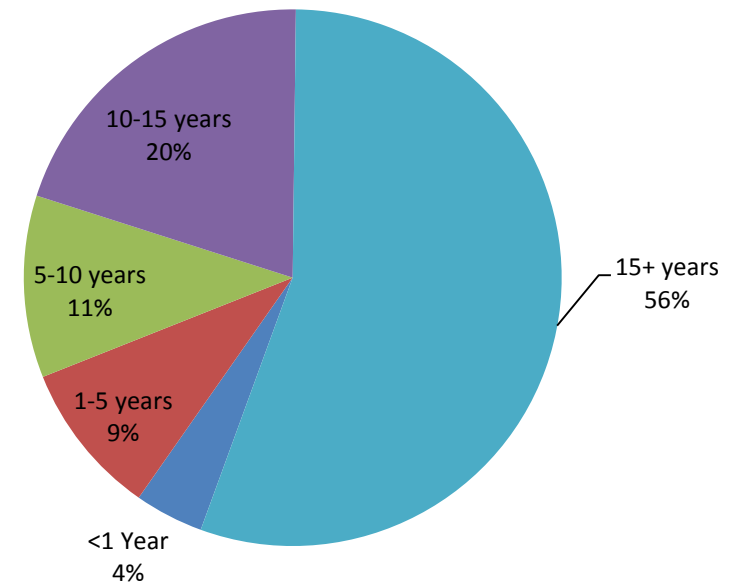
This is the 6th year of PAA Research's survey of residential real estate agents. PAA Research conducted the survey in 13 distinct geographic regions across the country. Overall, approximately 400 agents responded. The survey was conducted during the latter weeks of June and early July.

The Respondents

Size of Brokerage Firm Based on Number of Sides



Experience Level of Respondents



Key Findings From Our Survey – The Housing Market

Home prices have increased high single digits or low double digits in most markets

The “depth” and “strength” of the bid in the housing market has improved materially

- More multiple bid situations across most regions
- The discount to initial list price on average has declined; in many markets home sales close above list price

More than 70% of agents described inventory levels as “too low” in their local market

- 53% of agents indicated that more housing inventory would be a factor that would lead to the most rapid improvement in their local housing market

All cash buyers now play a much smaller role in the housing market

The majority of agents expect home prices to increase high single digits over the next 12-months

Distressed sellers have all but disappeared – 70% of agents indicated less than 10% of transactions in their local market came from non-traditional sellers

Key Findings From Our Survey - Zillow

Zillow appears to be running into a WALL:

- The percentage of agents that identified Zillow as a top three lead source only increased modestly compared to our 2014 survey
- Zillow trails broker websites, broker mobile apps, agent websites, search engine marketing, print advertising, and realtor.com in lead volume among the agents we surveyed

Zillow lead quality remains poor:

- The percentage of agents ranking Zillow as a top three online lead source was FLAT YOY
- The percentage of agents that identified Zillow as a lead source with high conversion DECLINED (13% 2014 vs. 11% 2015)
- 73% of agents that spend on Zillow characterize their ROI as “AVERAGE” or “POOR”
- 84% of agents that spend on Trulia characterize their ROI as “AVERAGE” or “POOR”

Only 10% of the agents we surveyed spend more than \$500/month out of pocket on advertising, which is more consistent with the NAR level data, 47% spend nothing out of pocket

- The true TAM for Zillow might be closer to 100-150,000 agents

Key Findings From Our Survey – Zillow (cont'd)

Online leads continue to make up a small percentage of overall transaction activity

- 50% of agents don't pay for online leads and another 35% get less than 10% of their transactions from internet inquiries
- 56% of respondents to our survey indicated that UNPAID online leads represent less than 10% of their closed sides
- Only 17% of respondents generate 50%+ of their sides from unpaid online leads
- Only 14% of agents indicated that PAID online leads

Facebook is increasingly becoming a major factor in residential real estate marketing

- **Facebook ranks as high from a lead volume perspective as Zillow among the agents we surveyed and ranks significantly better on lead quality**
- **Facebooks is positioned to take share from Zillow in PAID leads**

Realtor.com's rankings on lead volume, lead quality, and consumer mindshare improved relative to a year ago

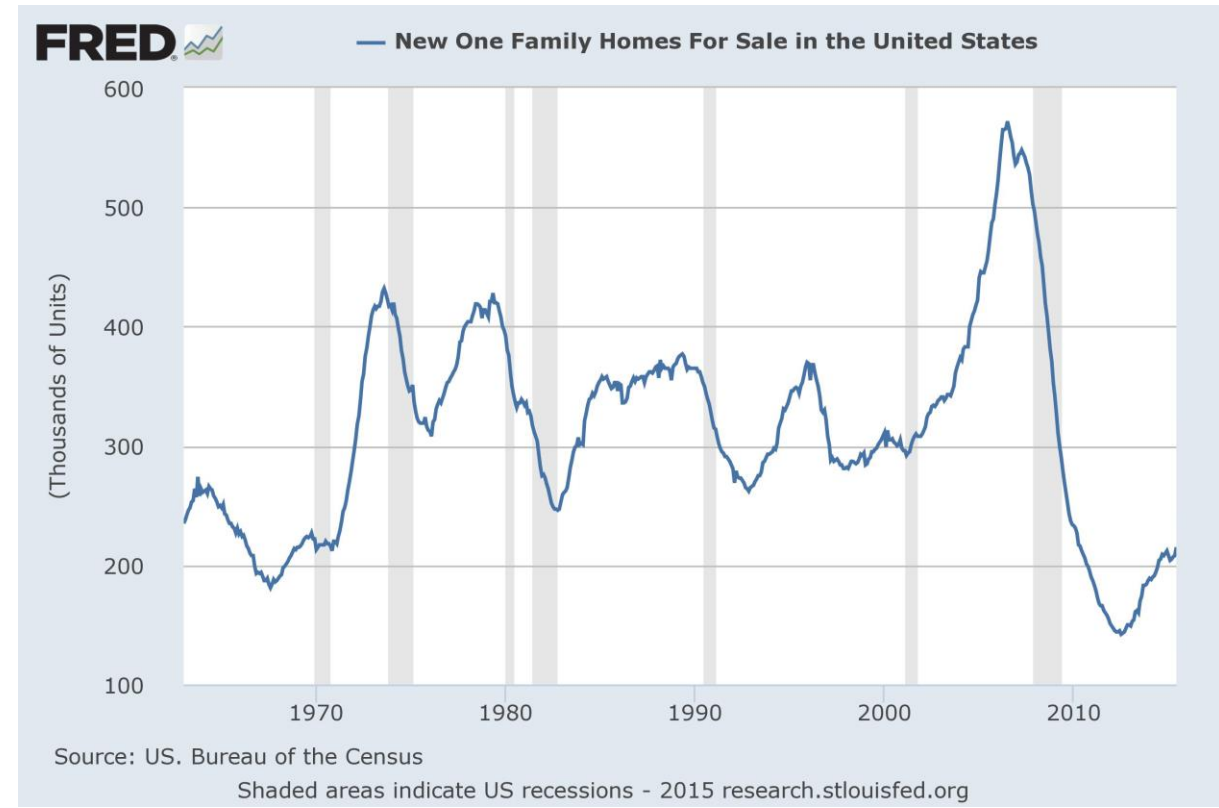
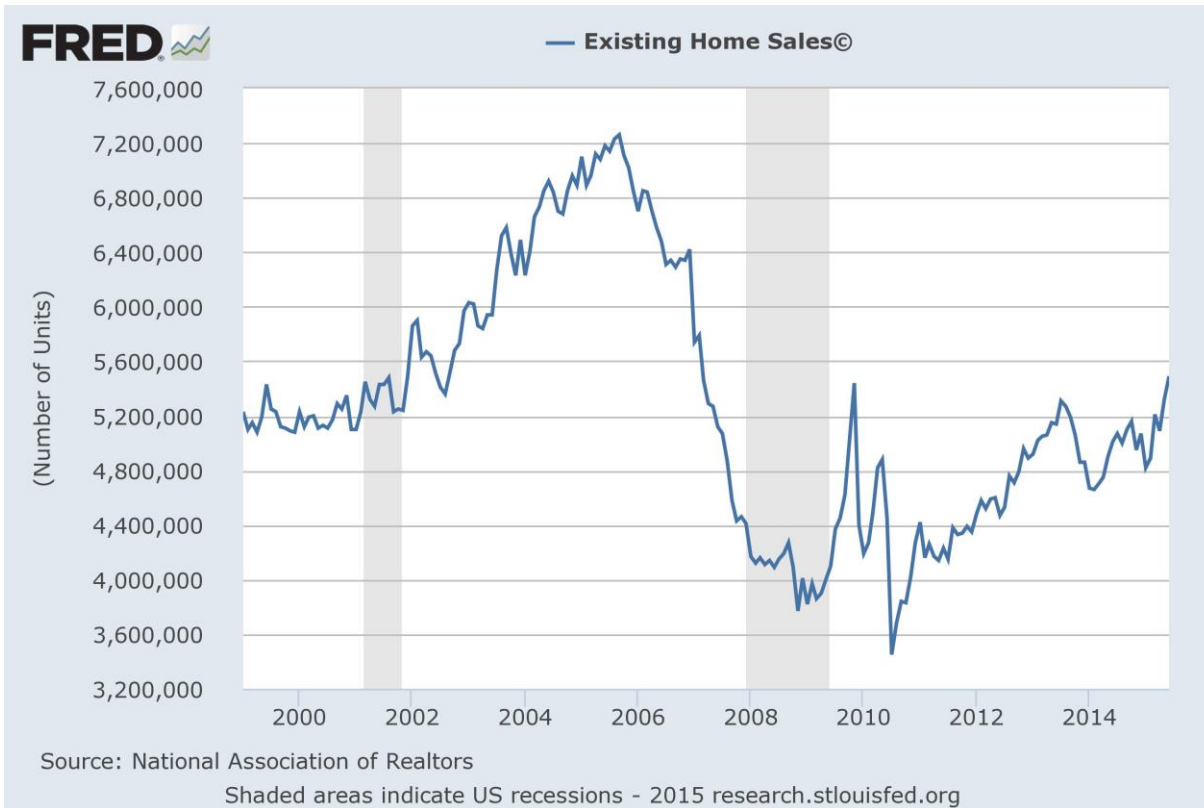
Redfin has gained critical traction with consumers in California and other markets on the West Coast according to the agents we surveyed

Upstream presents an existential threat to Zillow – only 50% of agents are actively aware of Upstream, but more than 40% of agents want to block third party agent advertising next to their listings

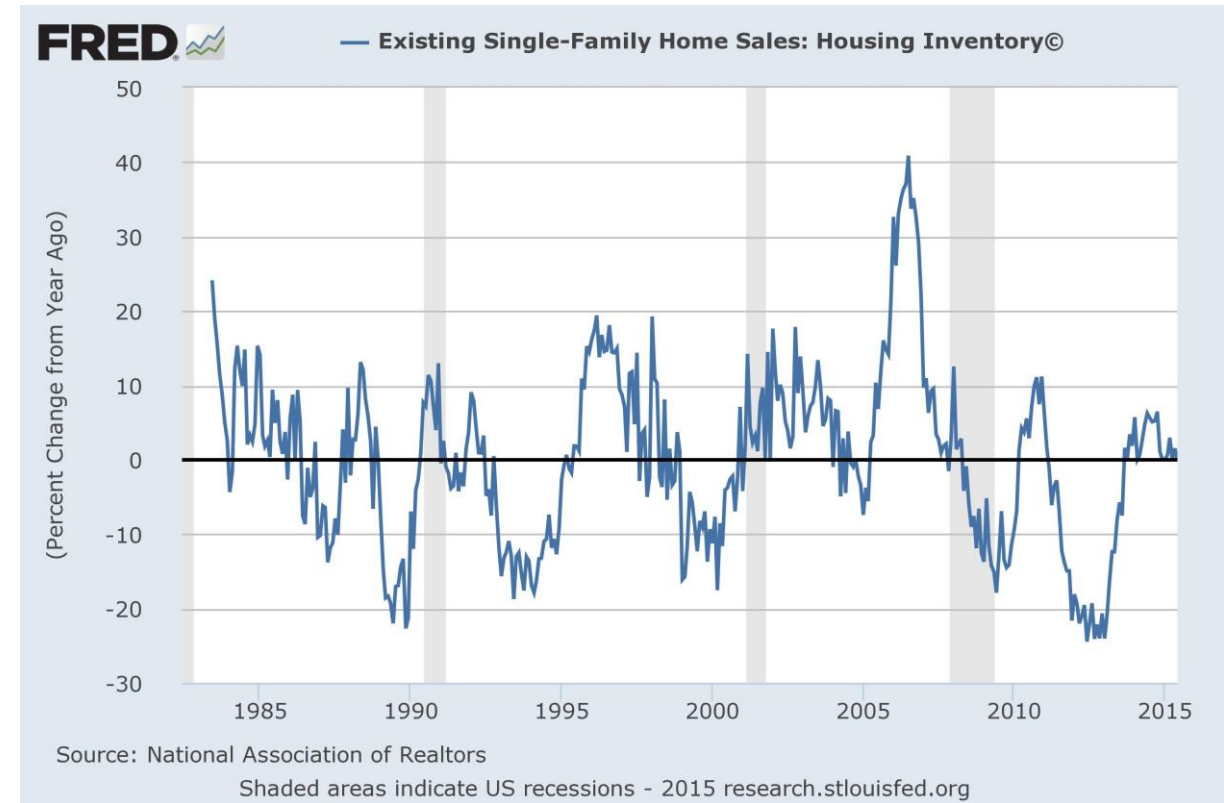
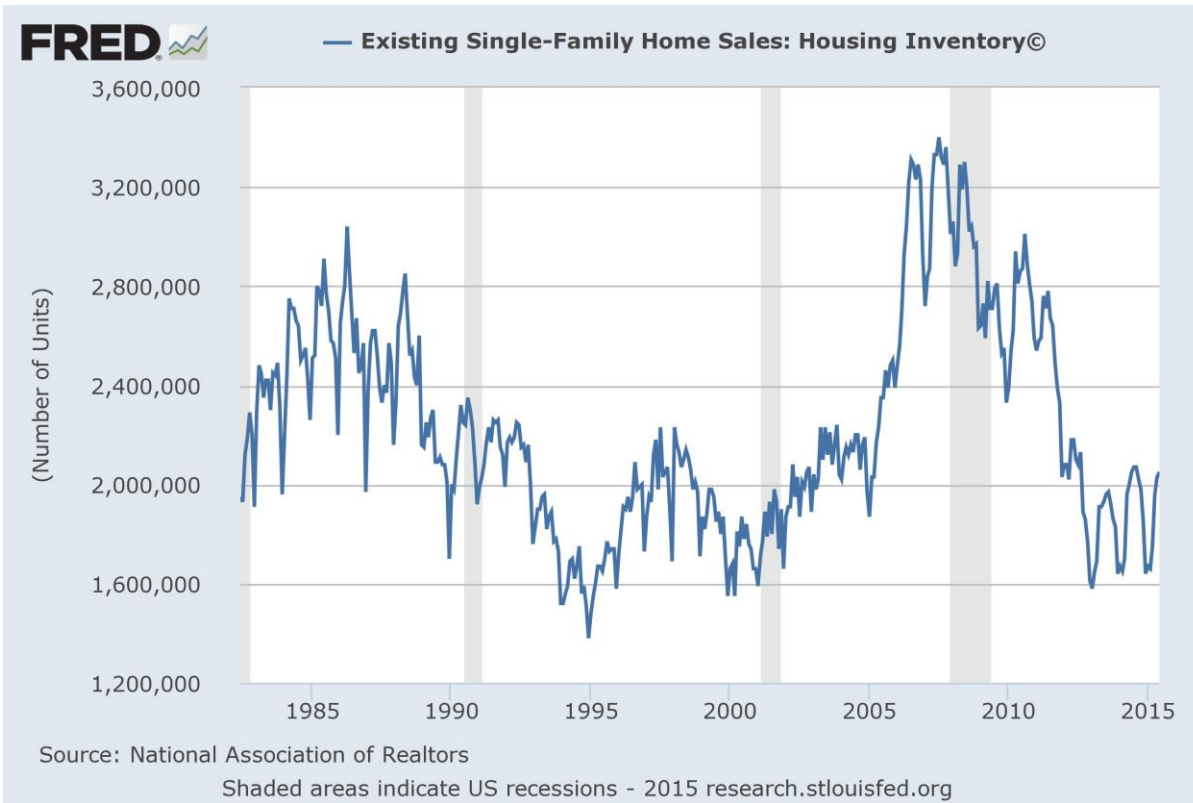
Key Observations

THE STATE OF THE HOUSING MARKET

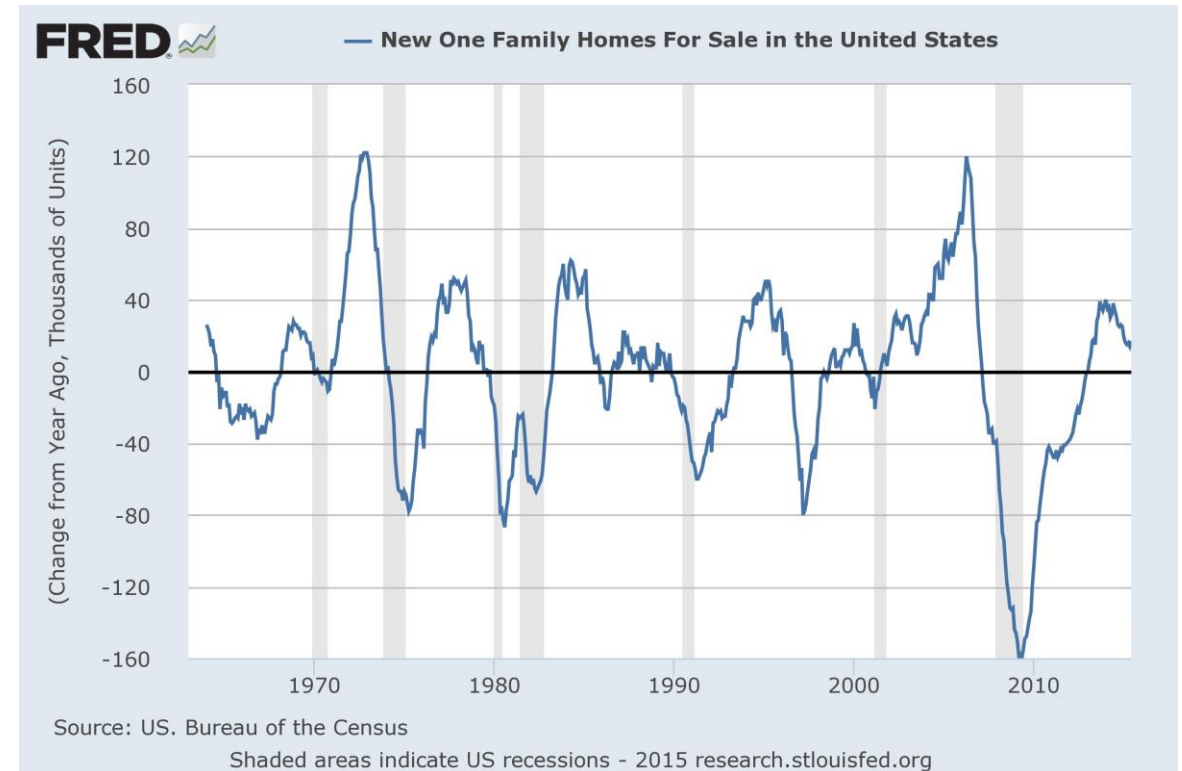
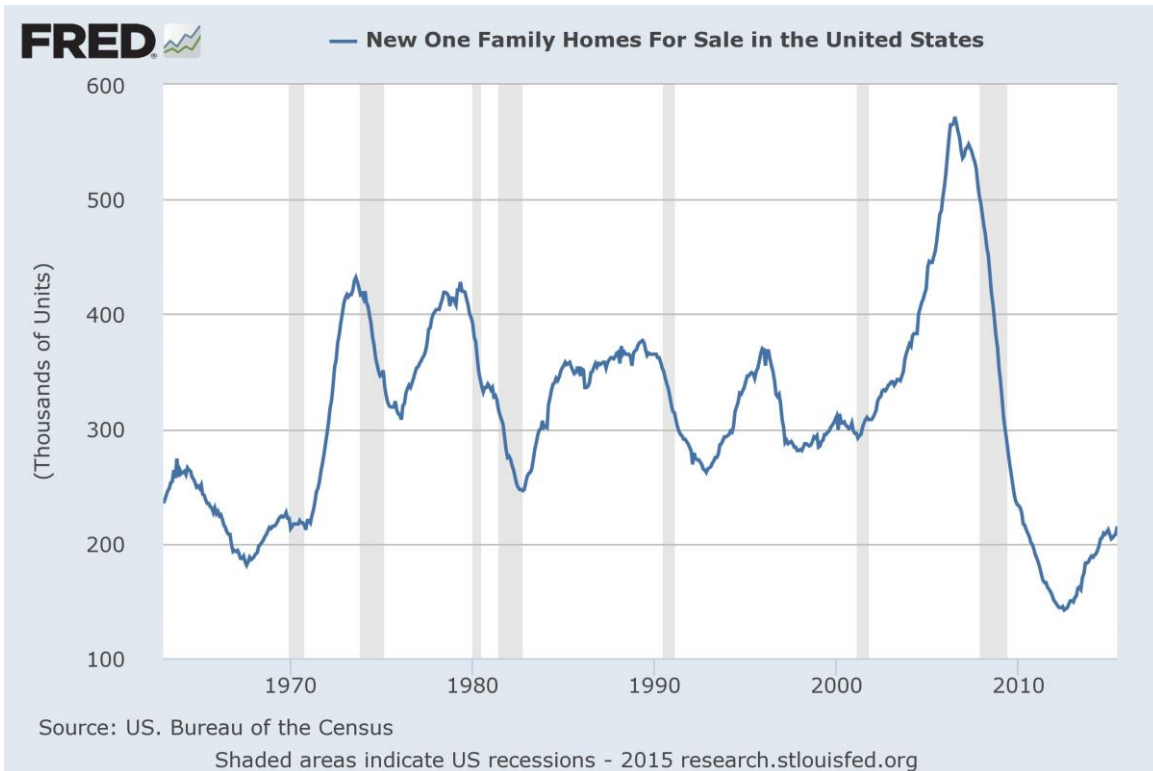
Existing Home Sales Have Normalized, New Home Sales Have Room to Grow



Existing Home Inventory Levels Nationally Are at the Lower Bound of the Historical Average

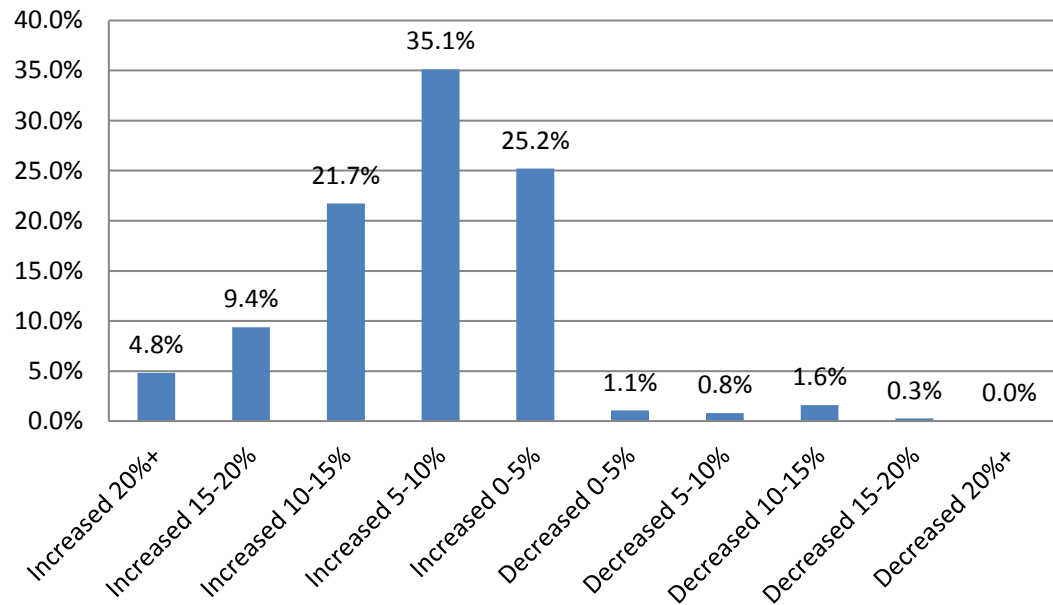


New Home Inventory Levels Remain at Historical Lows

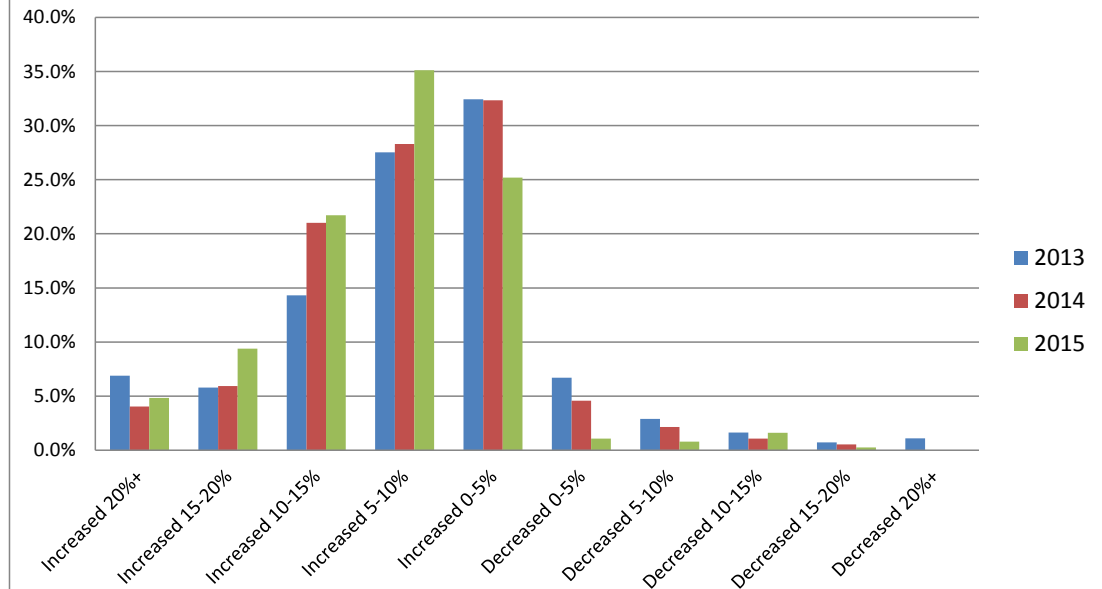


According to Agents Very Few Markets Are Experiencing YOY Declines in Home Prices

YOY Change in Prices in Local Market

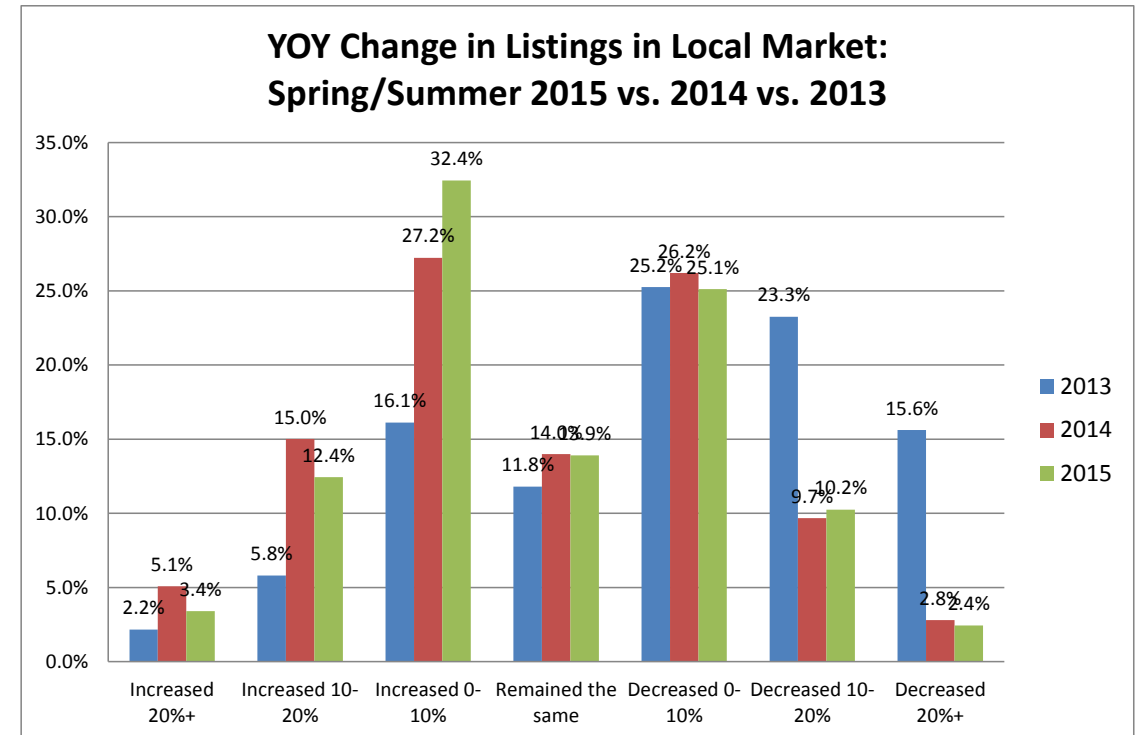
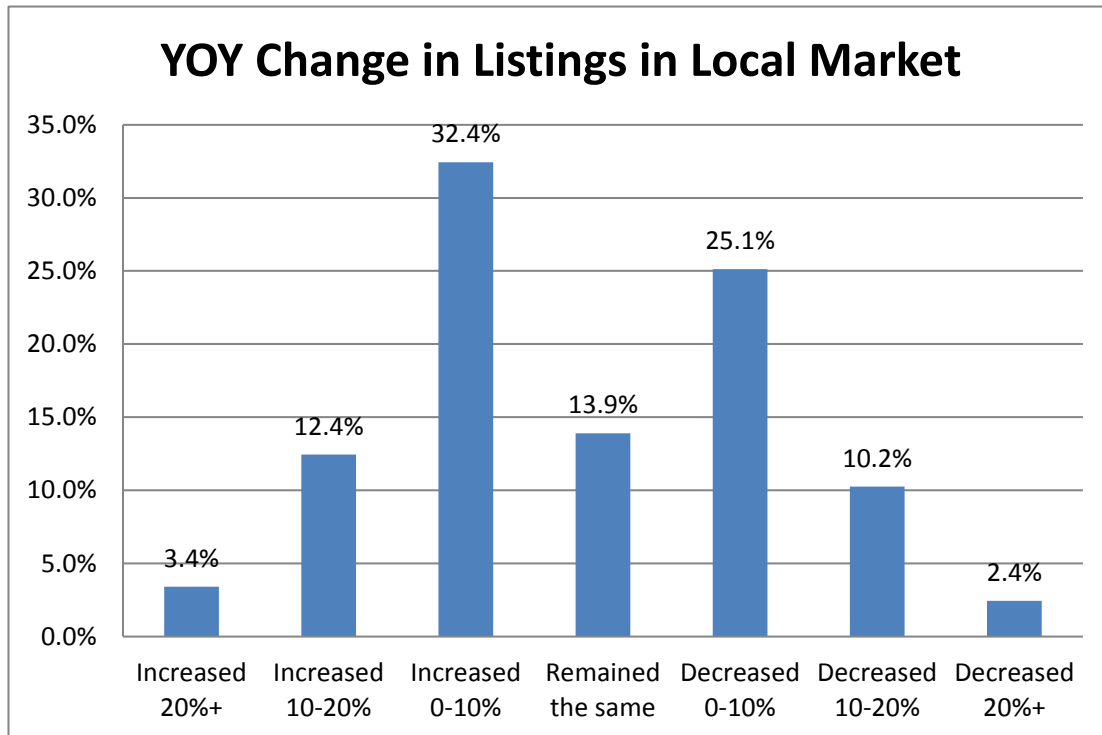


YOY Change in Home Prices in Local Market: Spring /Summer 2014 vs. 2013 vs. 2011



96% of respondents indicated that home prices in their local market are increasing on a YOY basis thus far in 2015, compared to 92% in 2014 and 87% in 2013

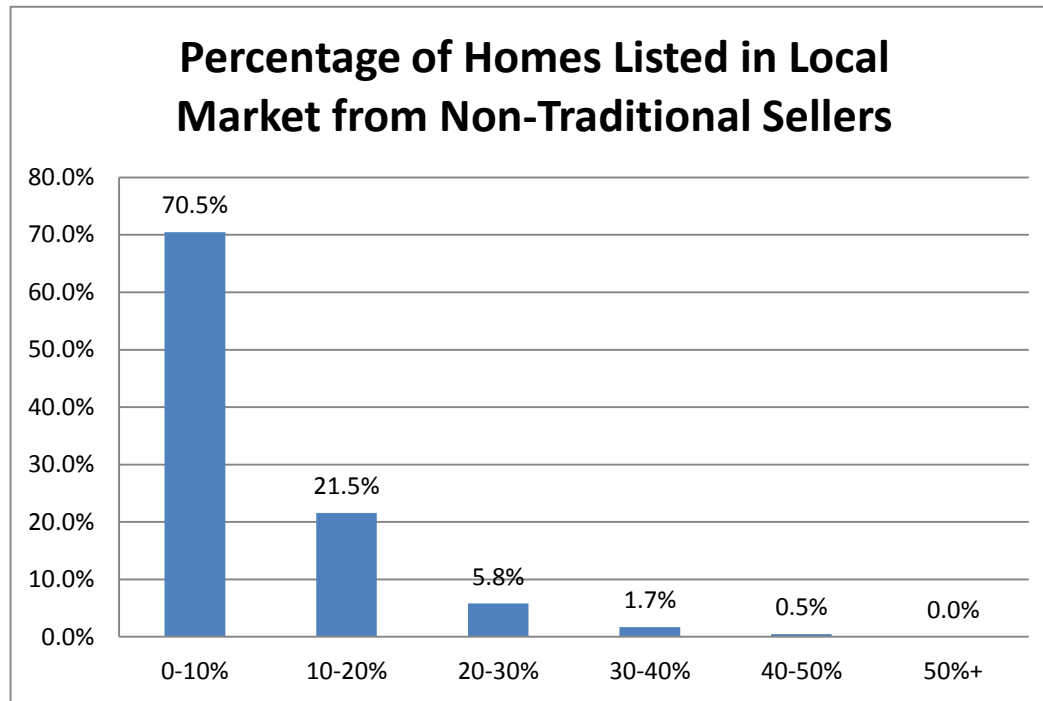
From a Listings Perspective Most Markets Are at Equilibrium



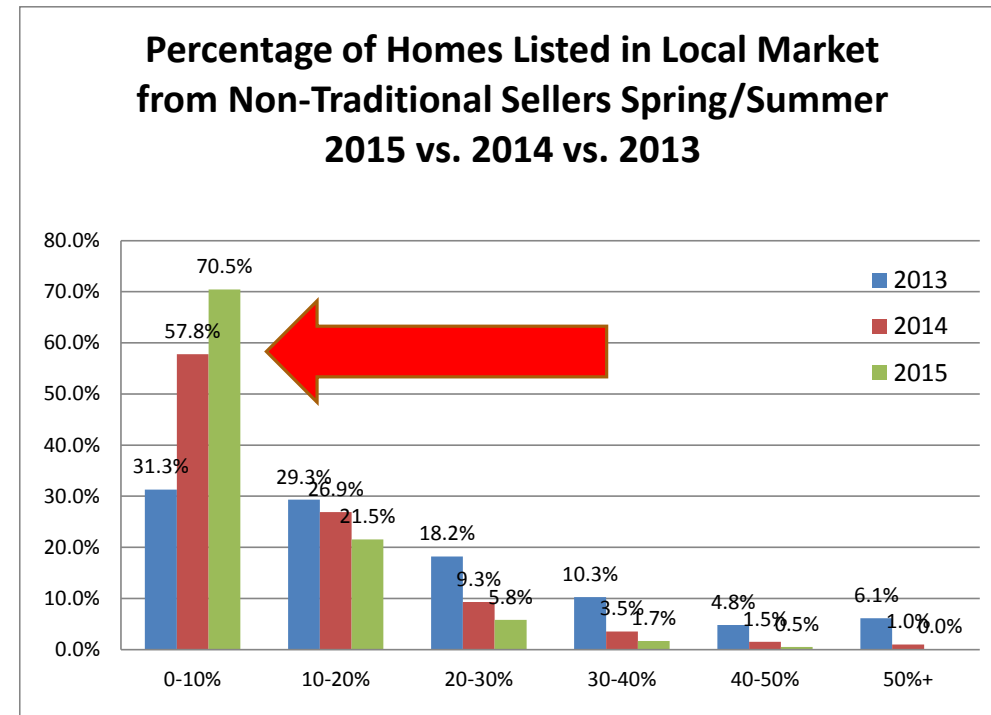
After a big reduction in listings in 2013, the number of markets witnessing a decline in listings has normalized for the past two years

Non-Traditional Sellers Have Disappeared from the Marketplace

2015 NON-TRADITIONAL SELLERS



PROGRESSION OF NON-TRADITIONAL SELLERS OVER THE PAST THREE YEARS



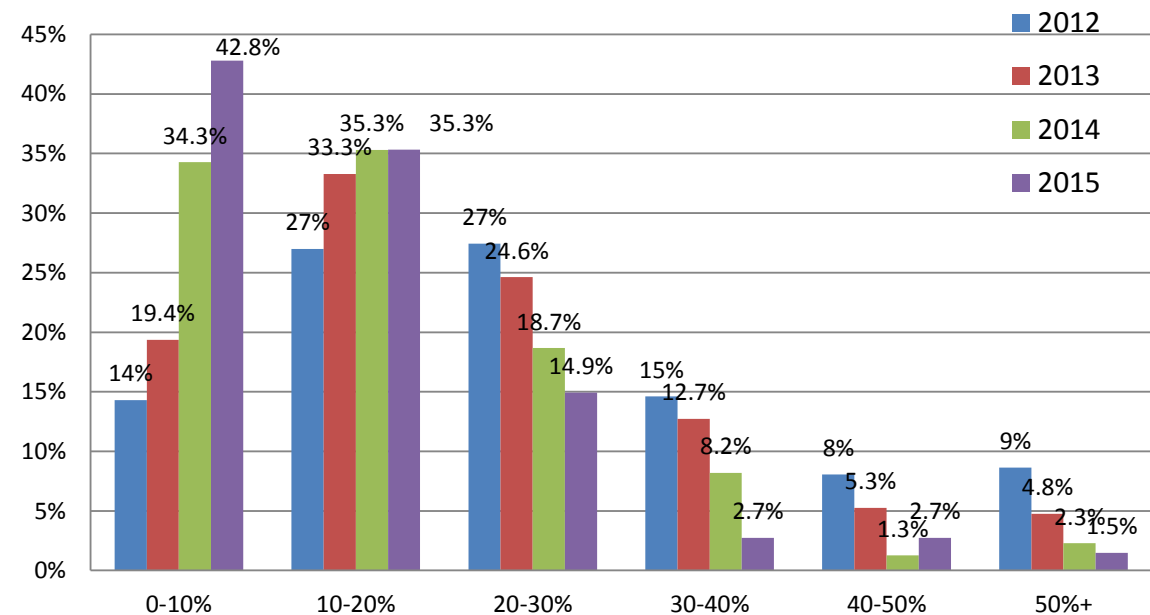
The Absence of Lingering Inventory Should Pave the Way for Further Price Gains

43% of respondents suggested less than 10% of homes listed in 2014 were not successfully sold

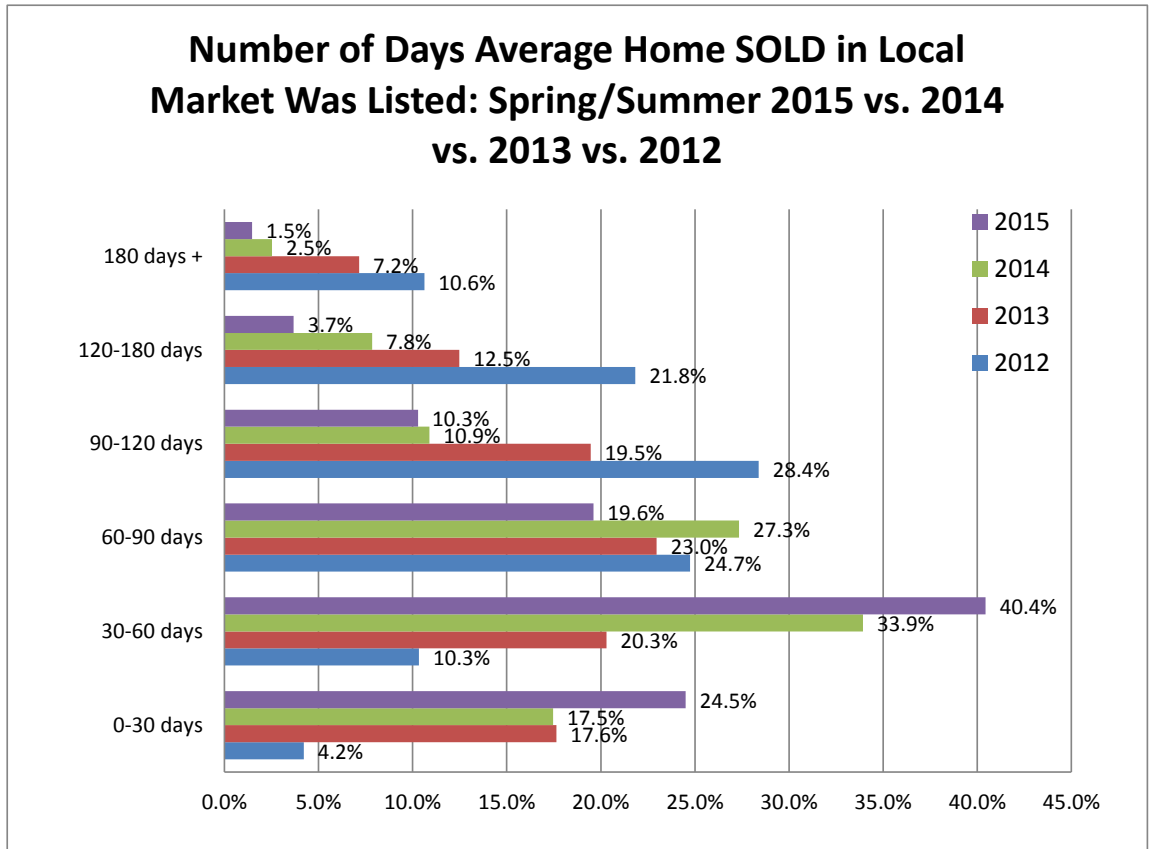
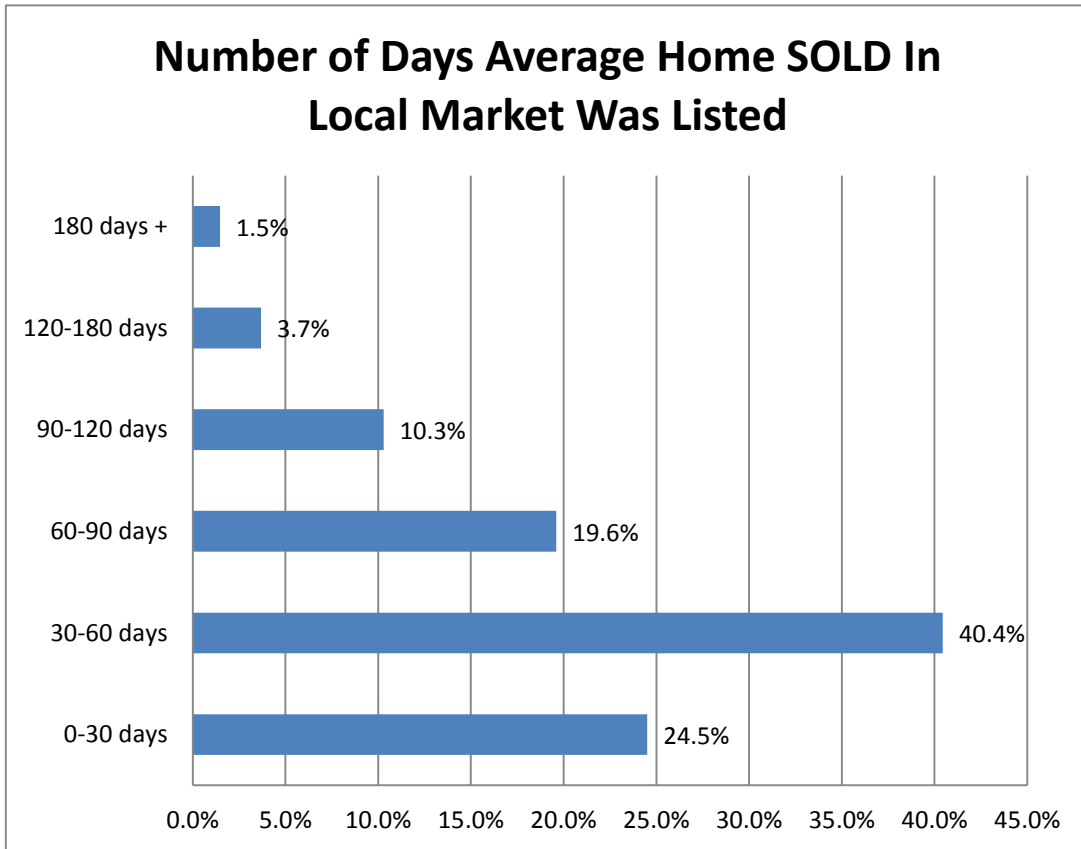
- This compares to 34% in 2014 and 19% in 2013

More than 90% of markets have less than 30% of homes that have been on the market since 2014

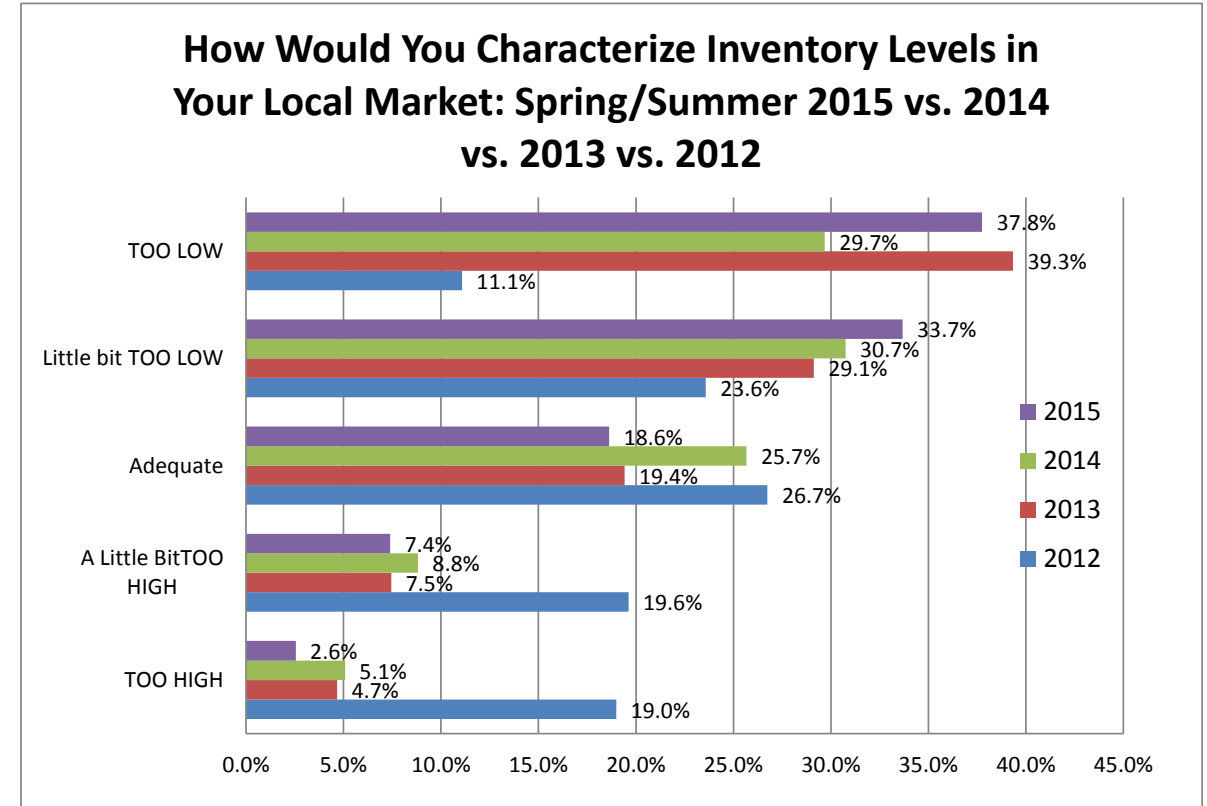
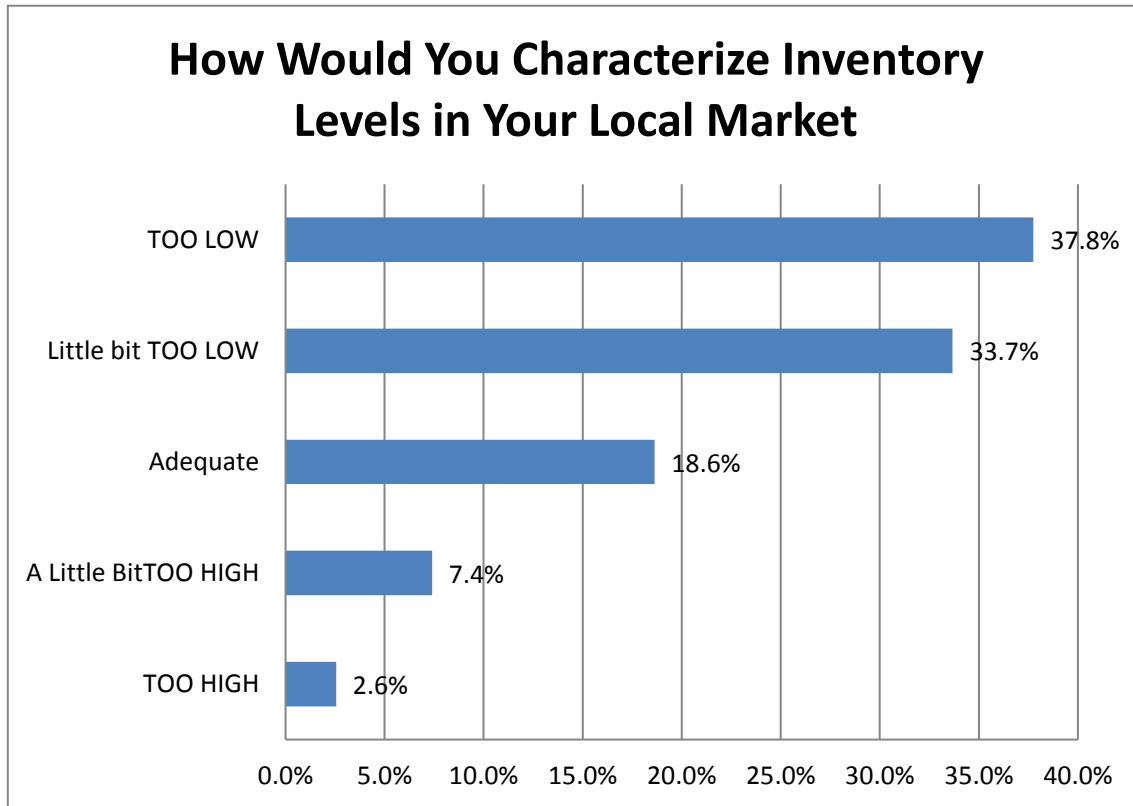
Percentage of Homes That Were Listed in Prior Year and NOT Successfully Sold: 2015 vs. 2014 vs. 2013 vs. 2012



In 2015, Most Homes Are Sold Within 60 Days of Being Listed

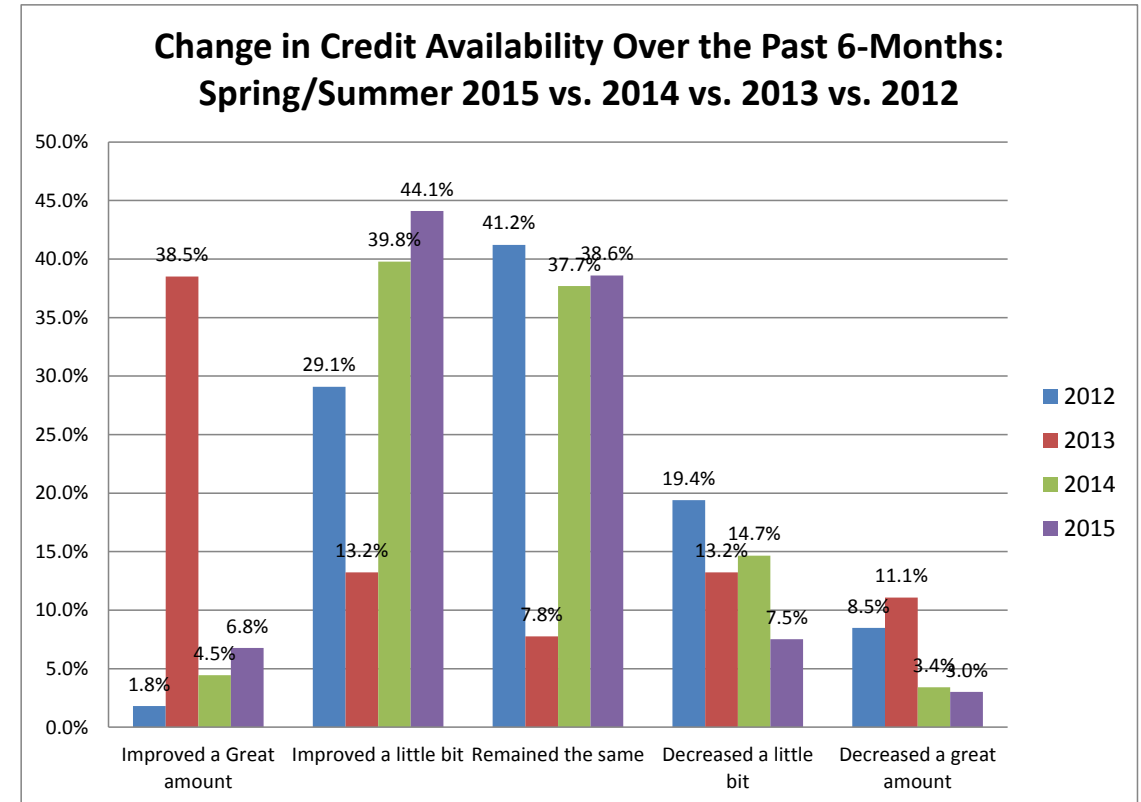
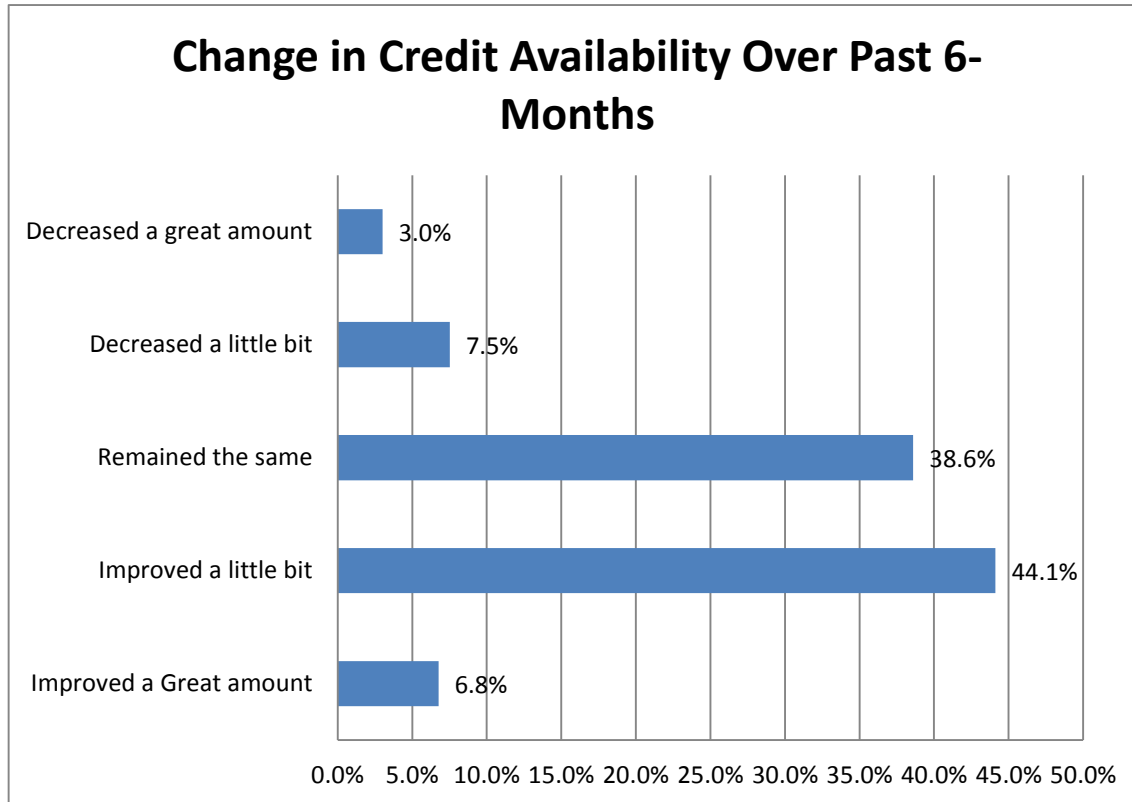


Agents Think That Inventory Levels Are Too Low



More than one-third of agents feel that their market is in acute need of more homes for sale

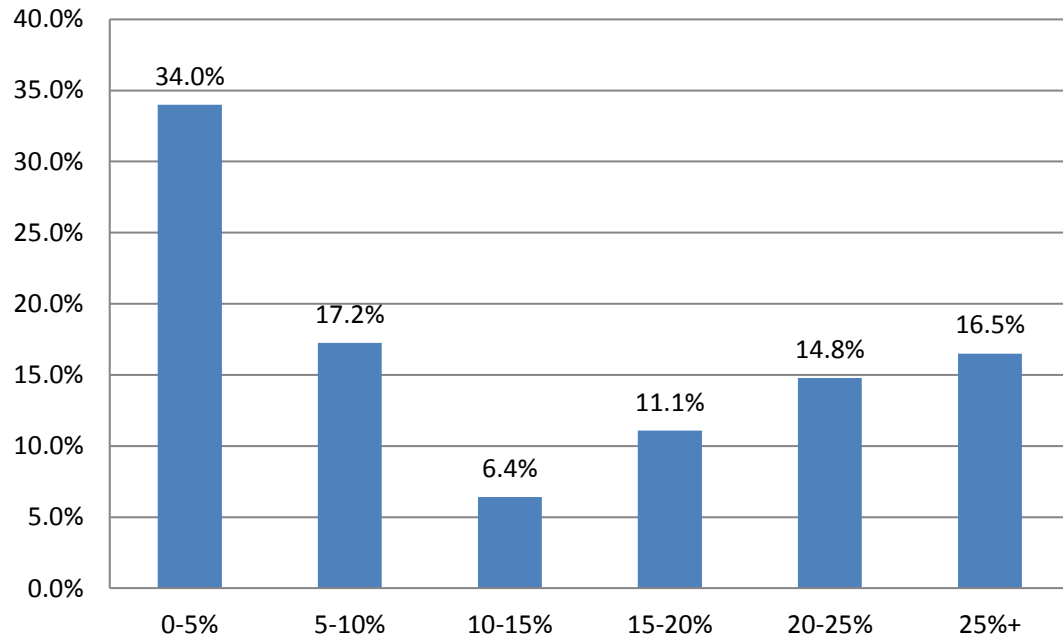
Credit Availability Has Finally Started to Become a Tailwind for the Housing Market



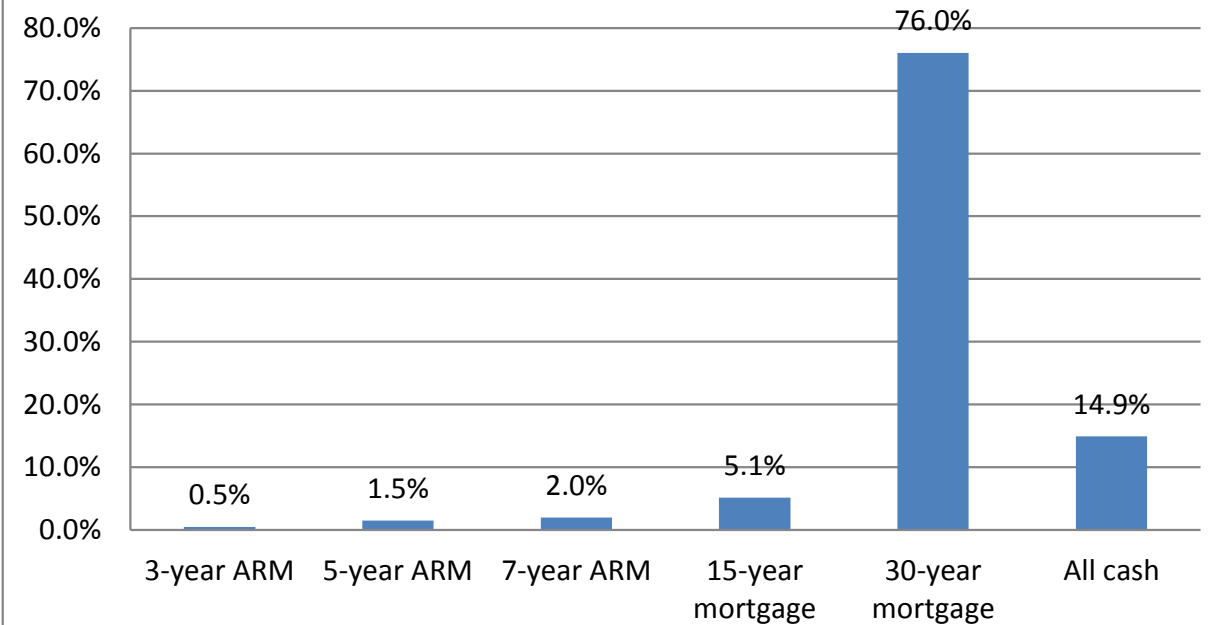
51% of respondent suggested that credit availability had improved in their local market over the past 6-months, more importantly only 11% indicated that credit availability had DECREASED in the past 6-months

From a Financing Perspective the Housing Market Looks Increasingly “Normal”

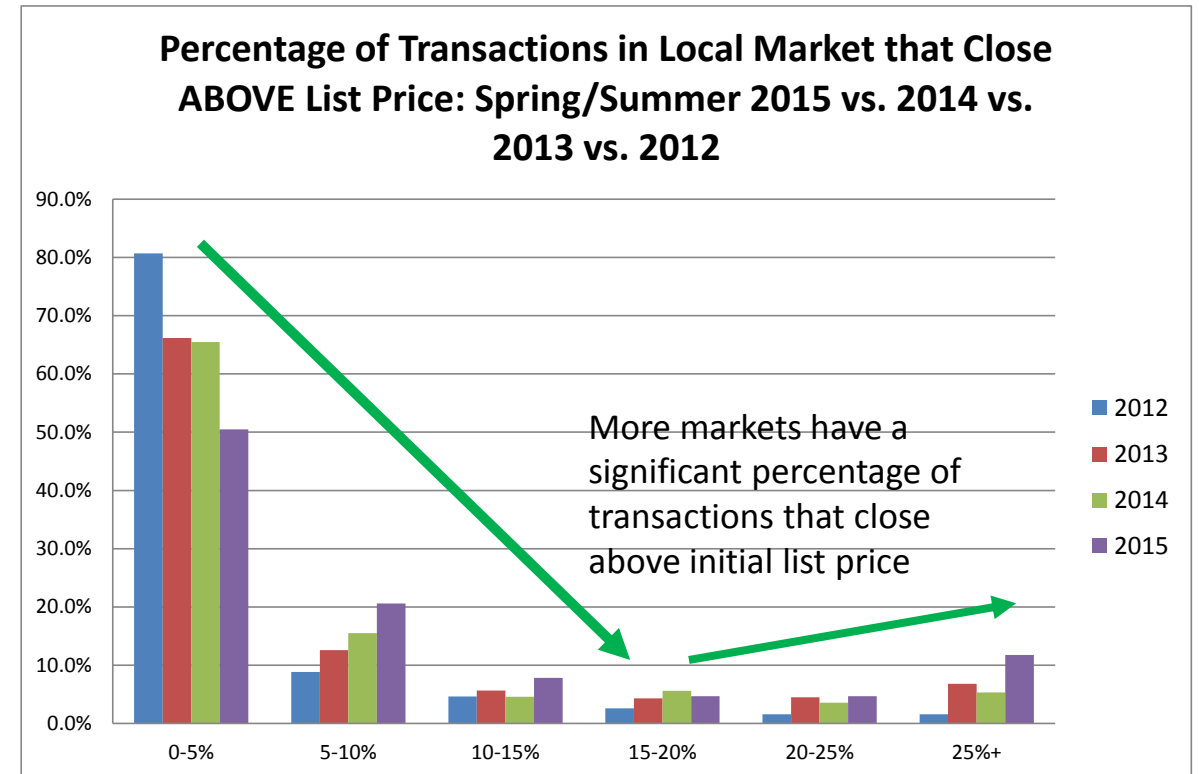
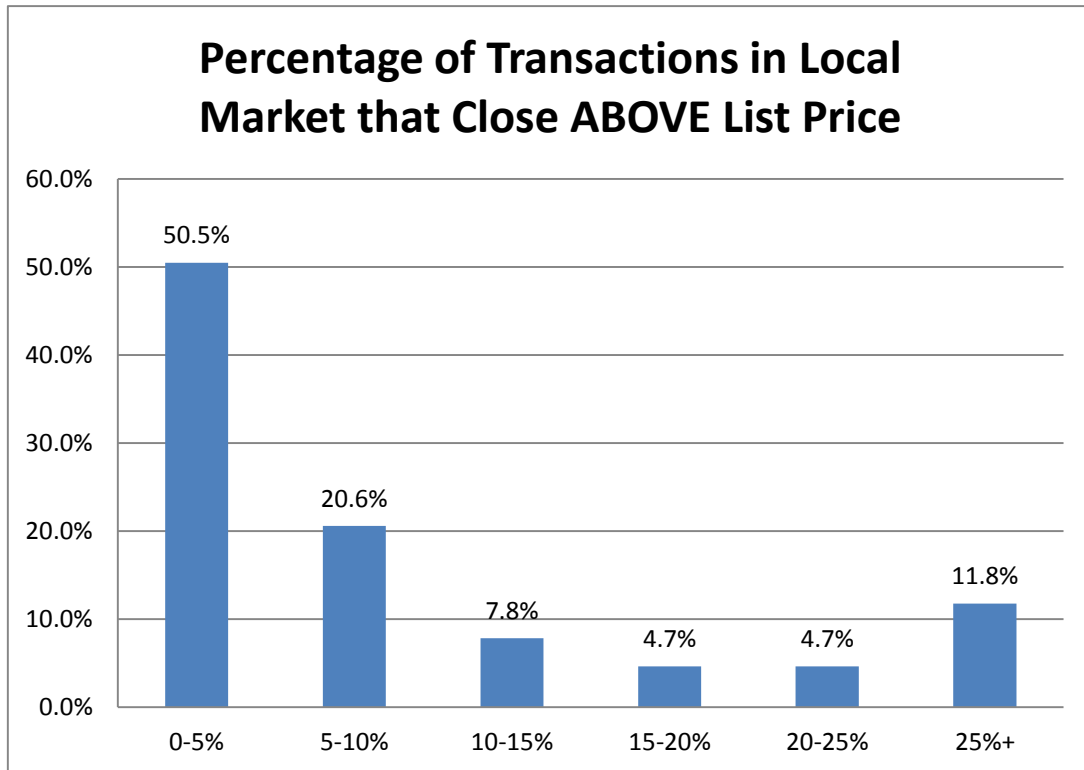
Down Payment Percentage from Buyer on Most Recent Transaction



Nature of Financing on Most Recent Transaction

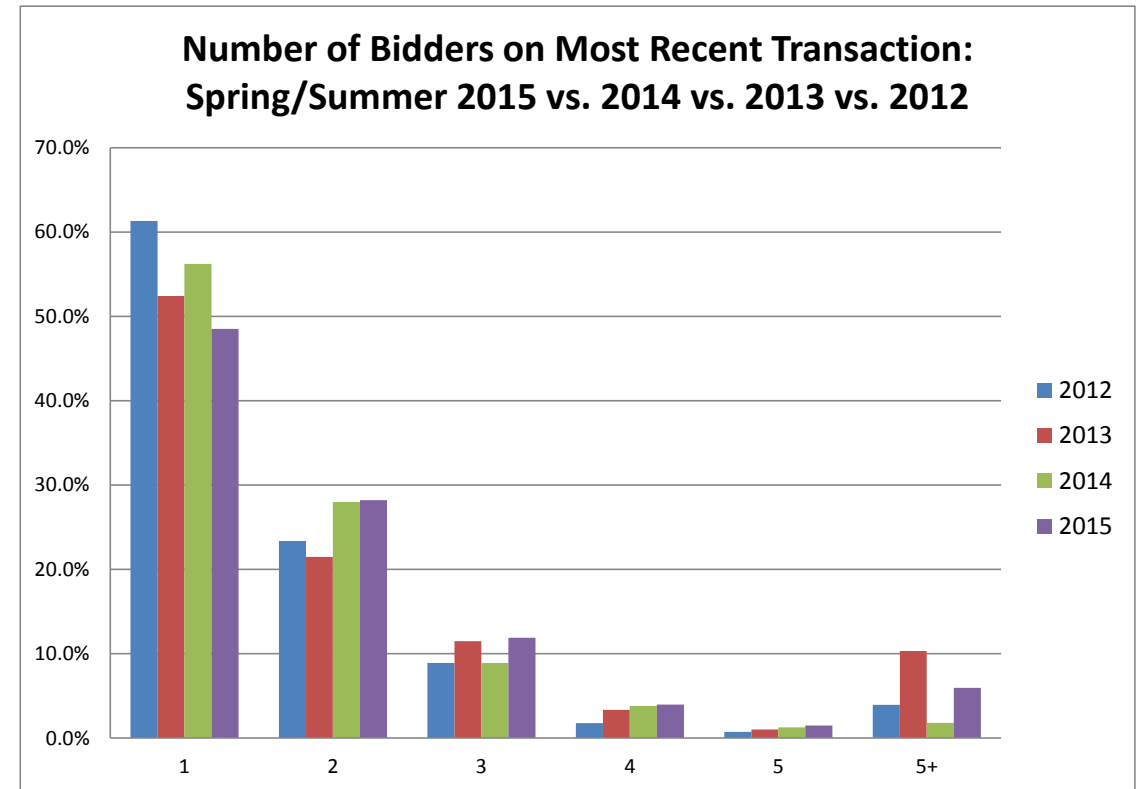
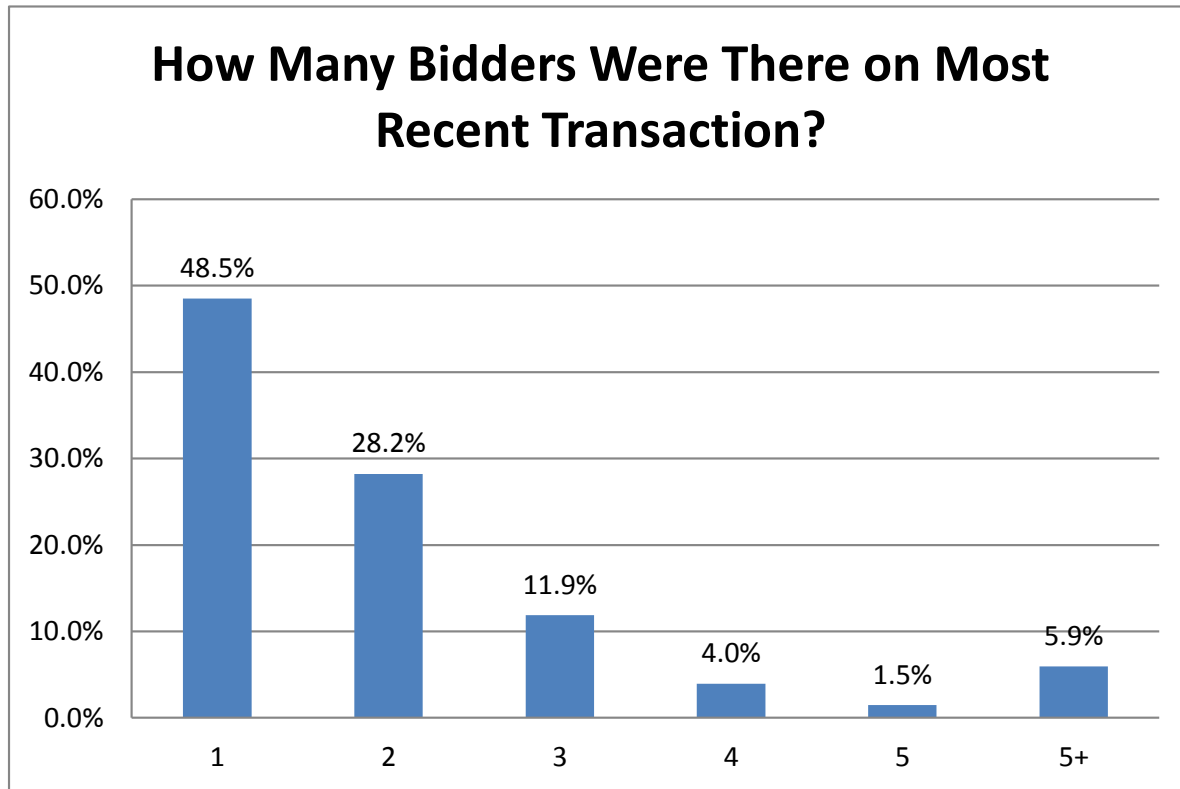


The “Strength” and “Depth” of the Bid in the Housing Market Has Improved Meaningfully



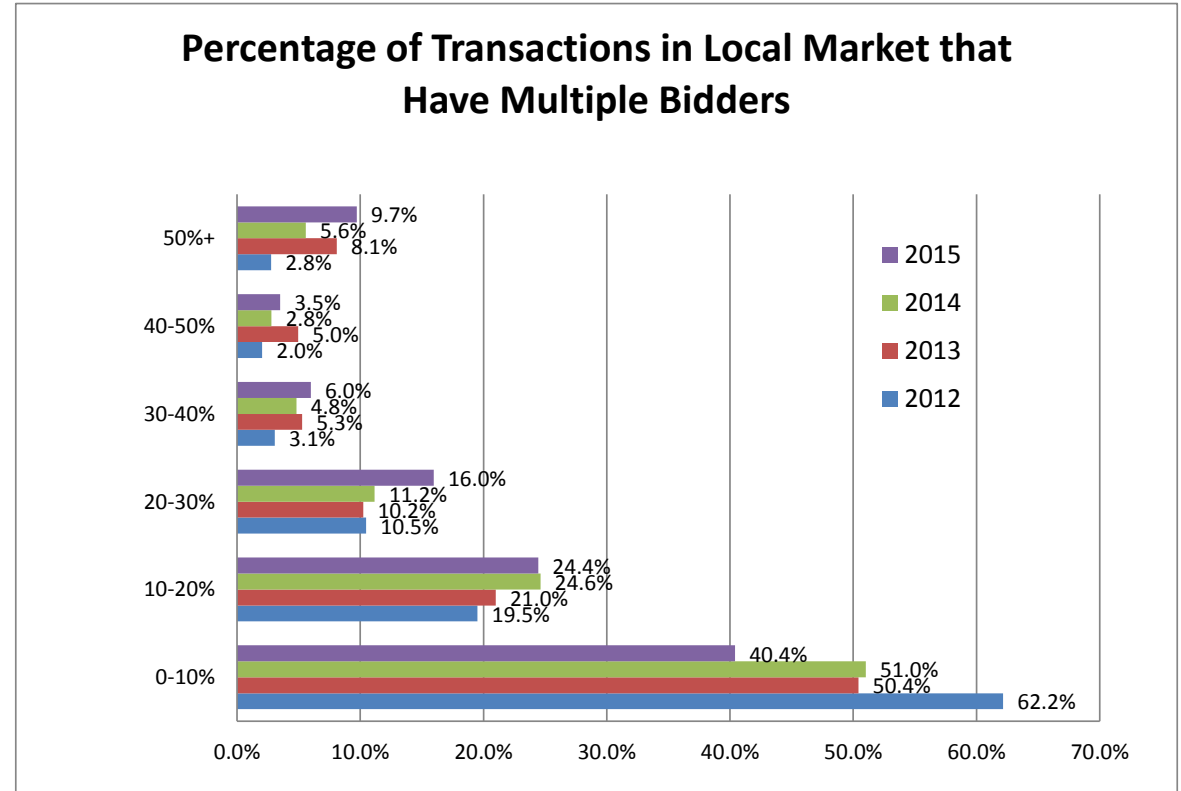
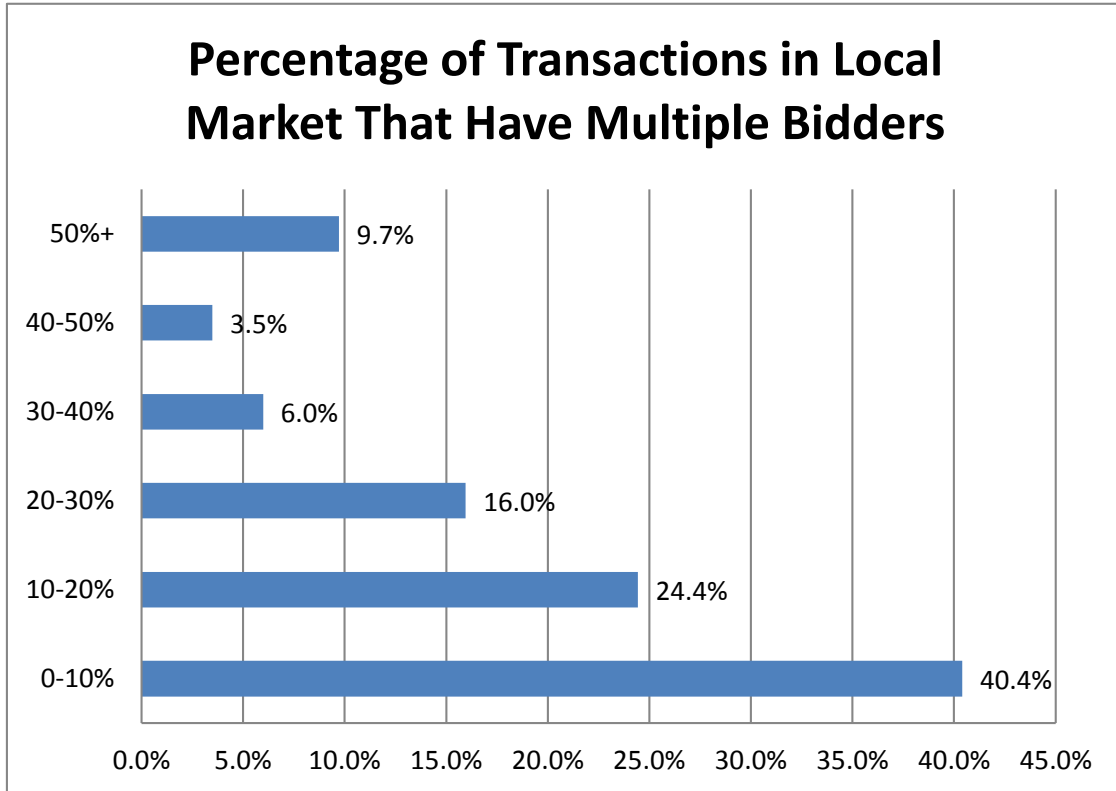
We measure the strength and depth of the bid in housing based on the percentage of transactions that close above list price, the average discount to list price, and the number of bidders per home sold

Homes for Sale with Multiple Bids Have Become More Common



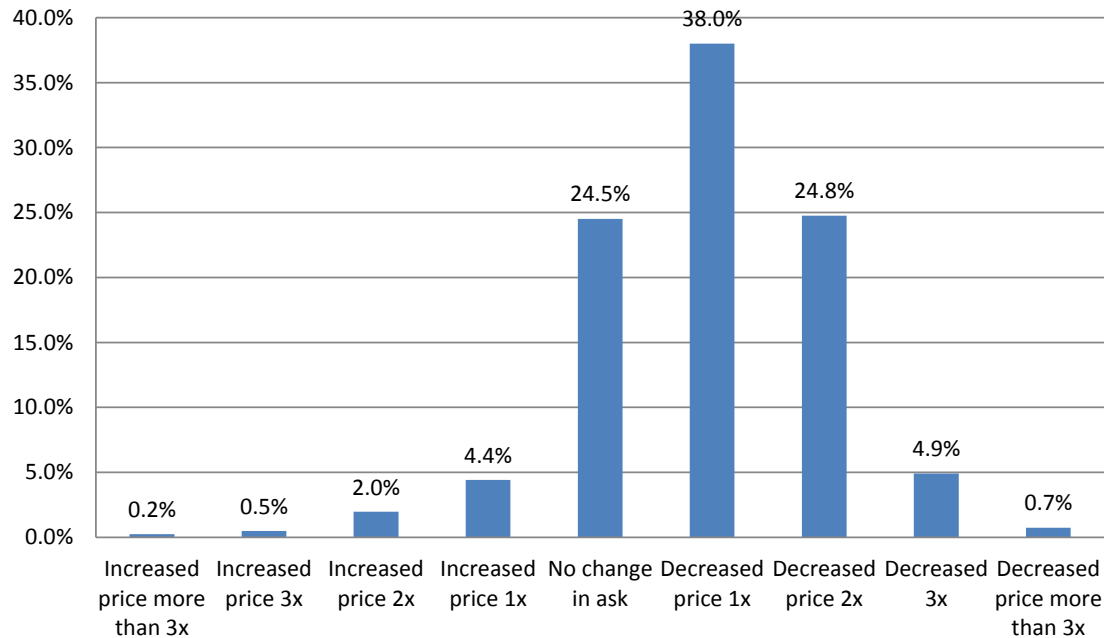
In California, the majority of homes for sale receive multiple bids.

Multiple Bid Situations Have Become the Norm In Many Markets

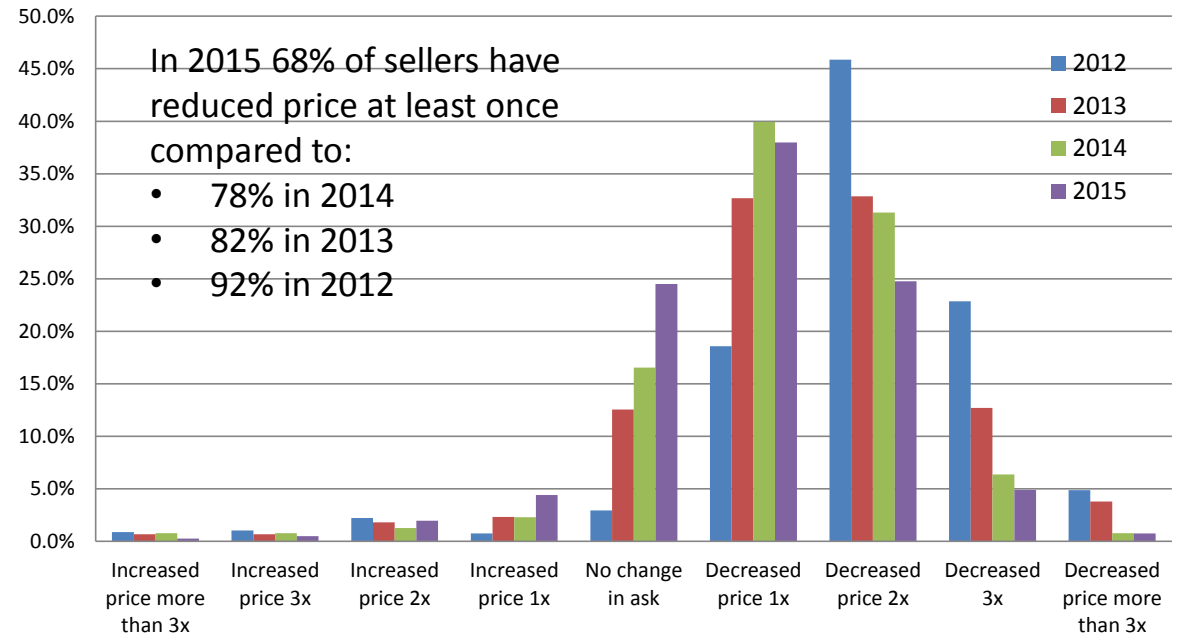


Seller Reductions to List Price Have Moderated

Number of Times Successful Sellers Have Modified Their Sales Price



Number of Times Successful Sellers Have Modified Their Sales Price: Spring/Summer 2014 vs. 2013 vs. 2012 vs. 2011

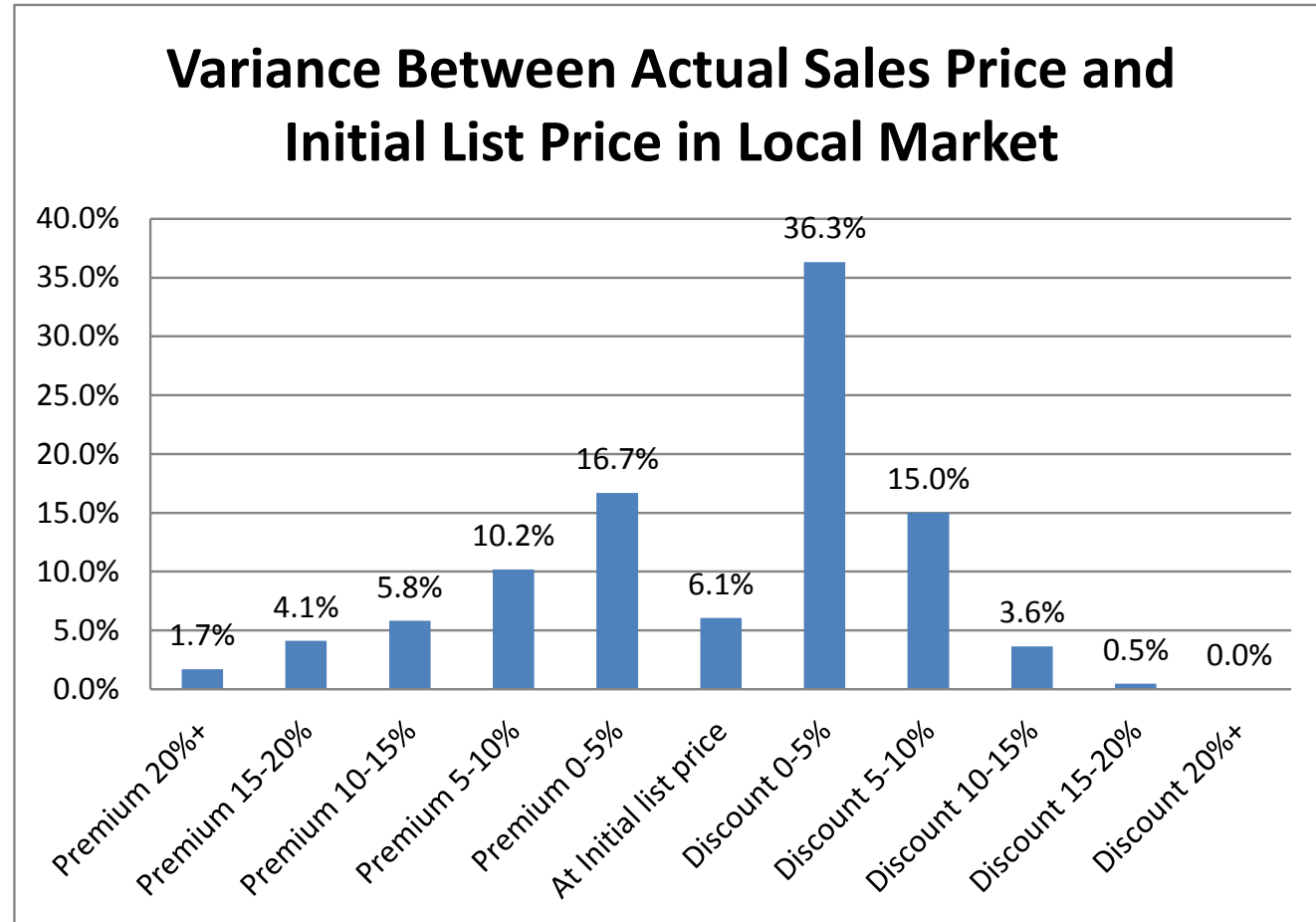


The Majority of Homes Sell Within 5% of Initial List Price

Overall thus far in 2015, 38% of homes closed above list price compared to:

- 28% in 2014
- 31% in 2013
- 18% in 2012

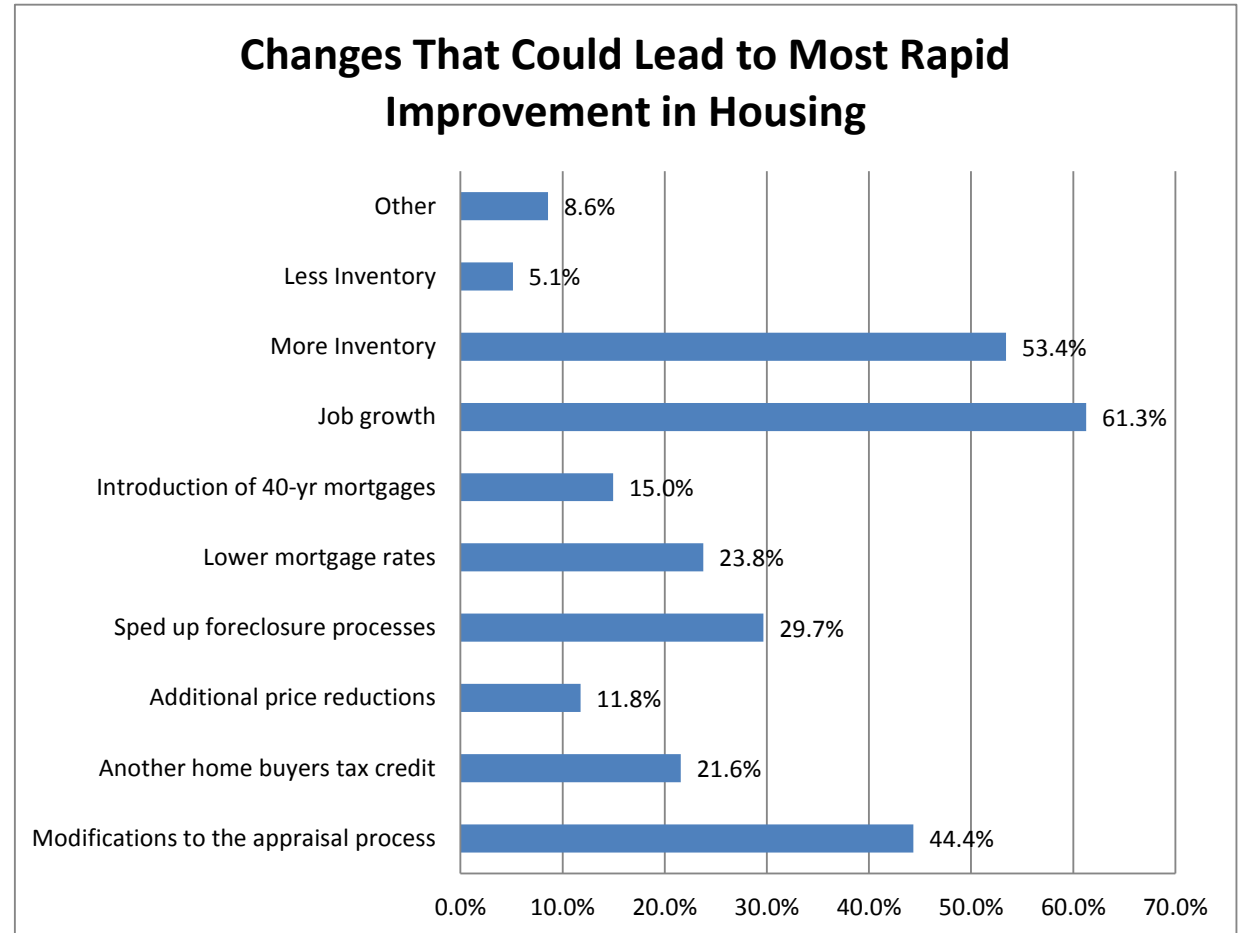
Sales at double digit discounts have declined meaningfully



Agents Think Jobs and More Inventory Would Spark an Improvement in Housing – Not Lower Rates

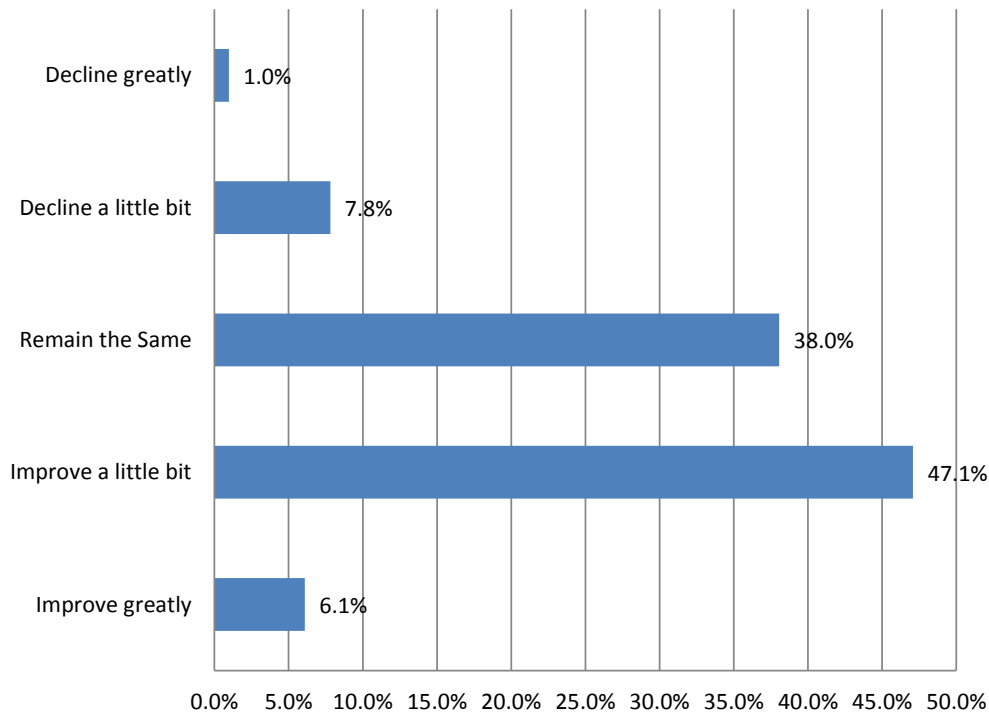
Compared to a year ago, the only factor that a higher percentage of agents expect would lead to an improvement in the housing market is **MORE INVENTORY**.

The job market has been the one factor most consistently identified as leading to an improvement in housing, but in 2014 and 2013 68% and 73% of agents pointed out job growth as the key factor driving housing

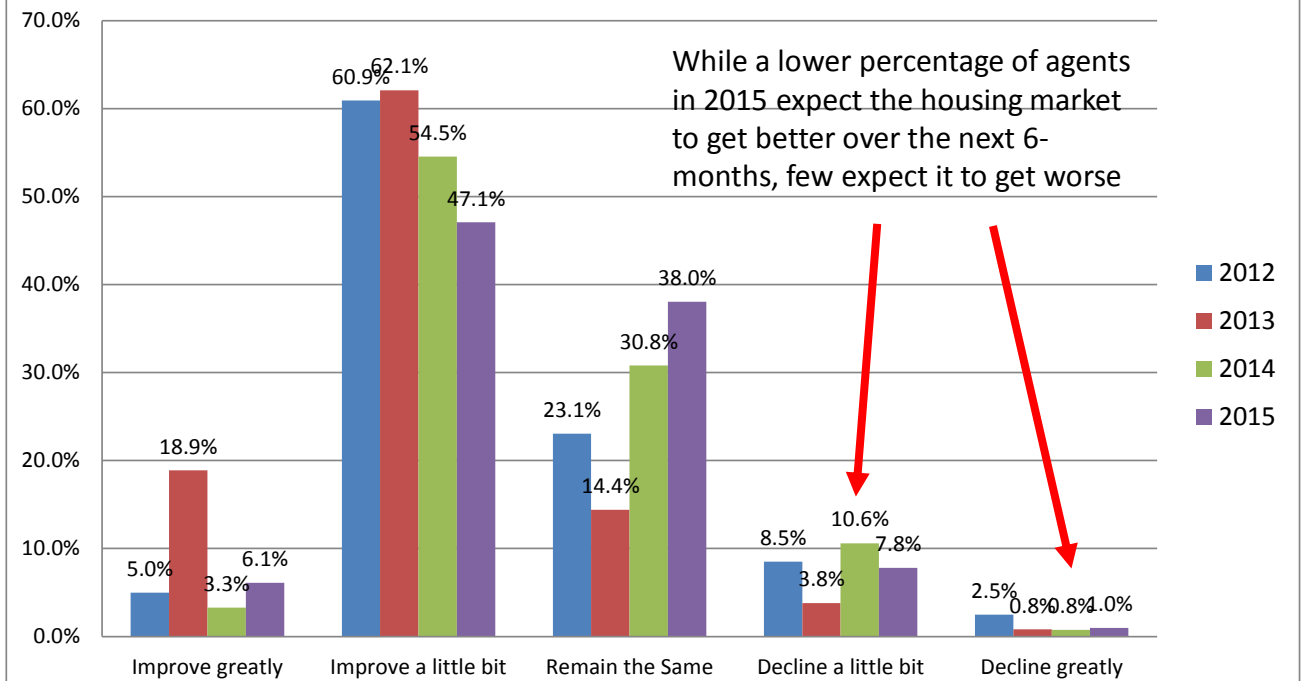


Agents Remain Optimistic About the Health of the Housing Market

Expectations for the Health of the Housing Market Over the Next 6-Months

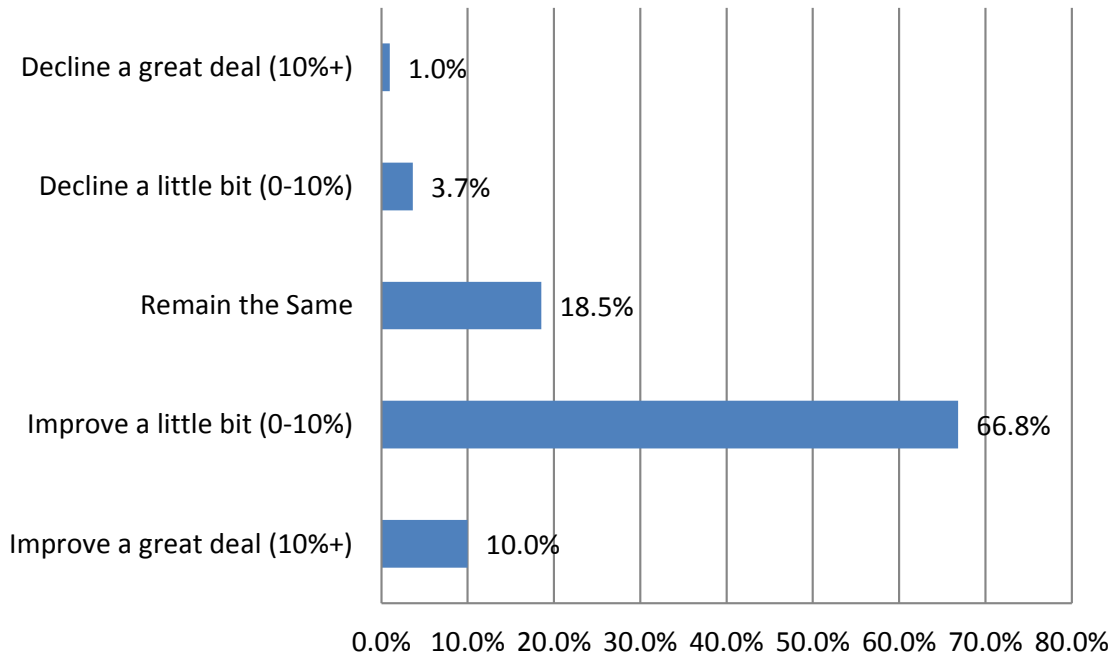


Expectations for the Health of the Housing Market Over the Next 6-Months: Spring/Summer 2015 vs. 2014 vs. 2013 vs. 2012

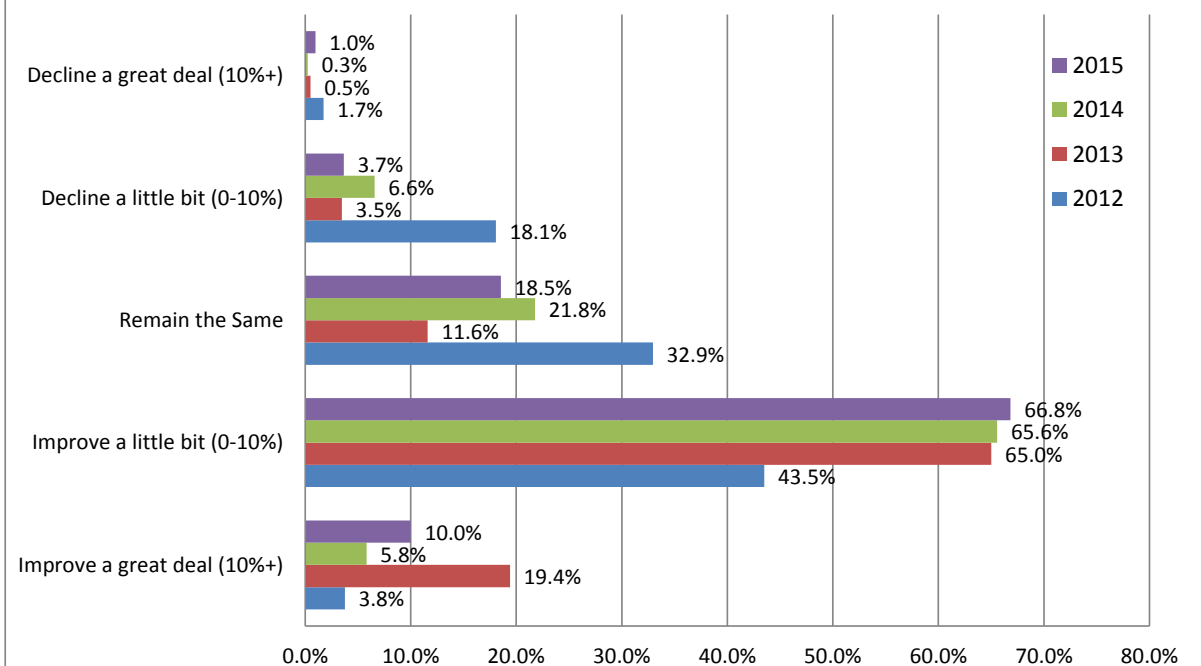


Most Agents Expect Home Prices to Increase Mid-to-High Single Digits Over the Next 12-Months

Expectations for Home Prices Over the Next 12-Months in Local Market



Expectations for Home Prices Over the Next 12-Months in Local Market Spring/Summer 2015 vs. 2014 vs. 2013 vs. 2012



Real Estate Agent Marketing and Technology Practices

ZILLOW'S SUPPOSED ASCENSION TO DOMINANCE APPEARS TO HAVE
HIT A WALL

The Good News – From an Agent Perspective Zillow Remains the Go to Site for Consumers

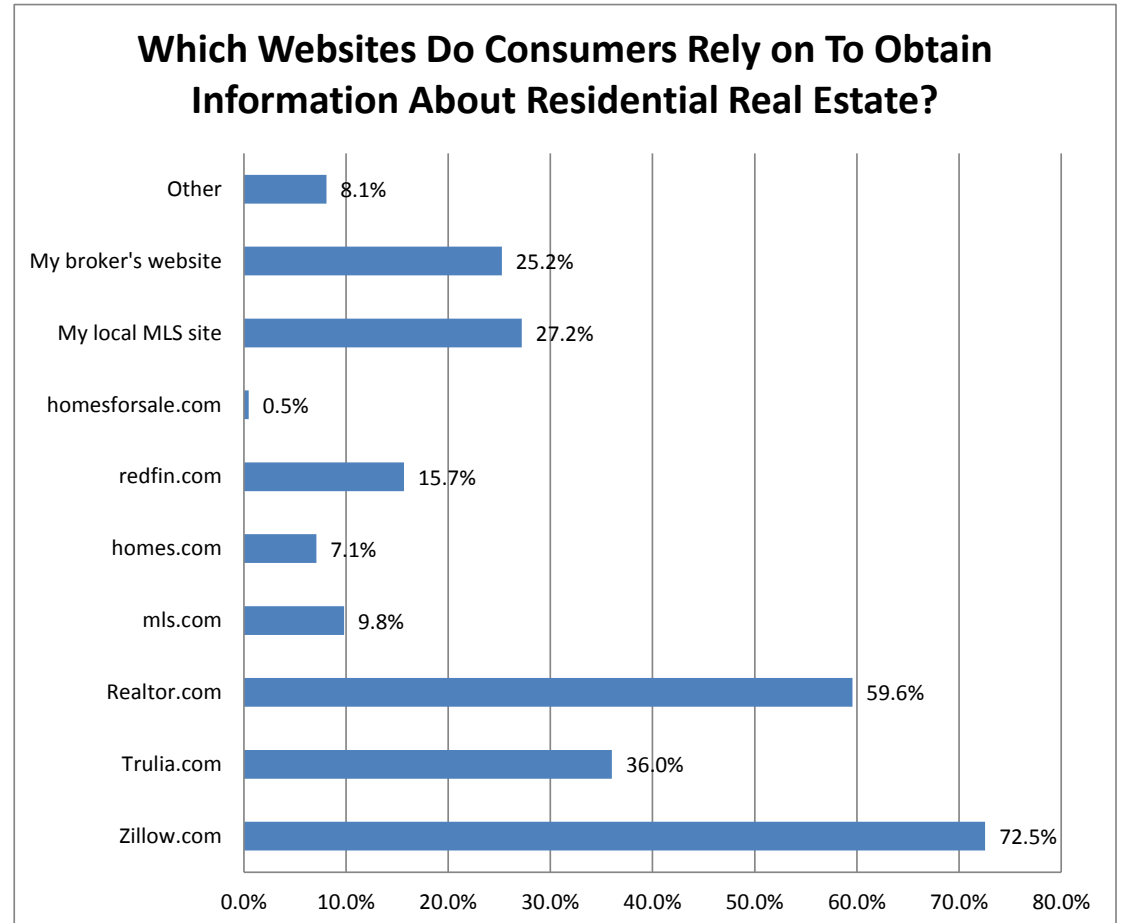
72% of the agents we surveyed indicated that Zillow was the site that consumers rely on most

At 36%, Trulia is increasingly viewed as an “also ran” among agents

The picture for brokers remains problematic

- Only 25% of respondents suggested their broker’s site was the “go to” for consumers
- Realty’s homesforsale.com as of now has not gained much attention

Redfin has started to demonstrate strength in certain markets



Zillow Has Been Steadily Gaining Consumer Mindshare, Realtor.com Bounces Back

Over the past 4-years, Zillow has been steadily gaining consumer mindshare

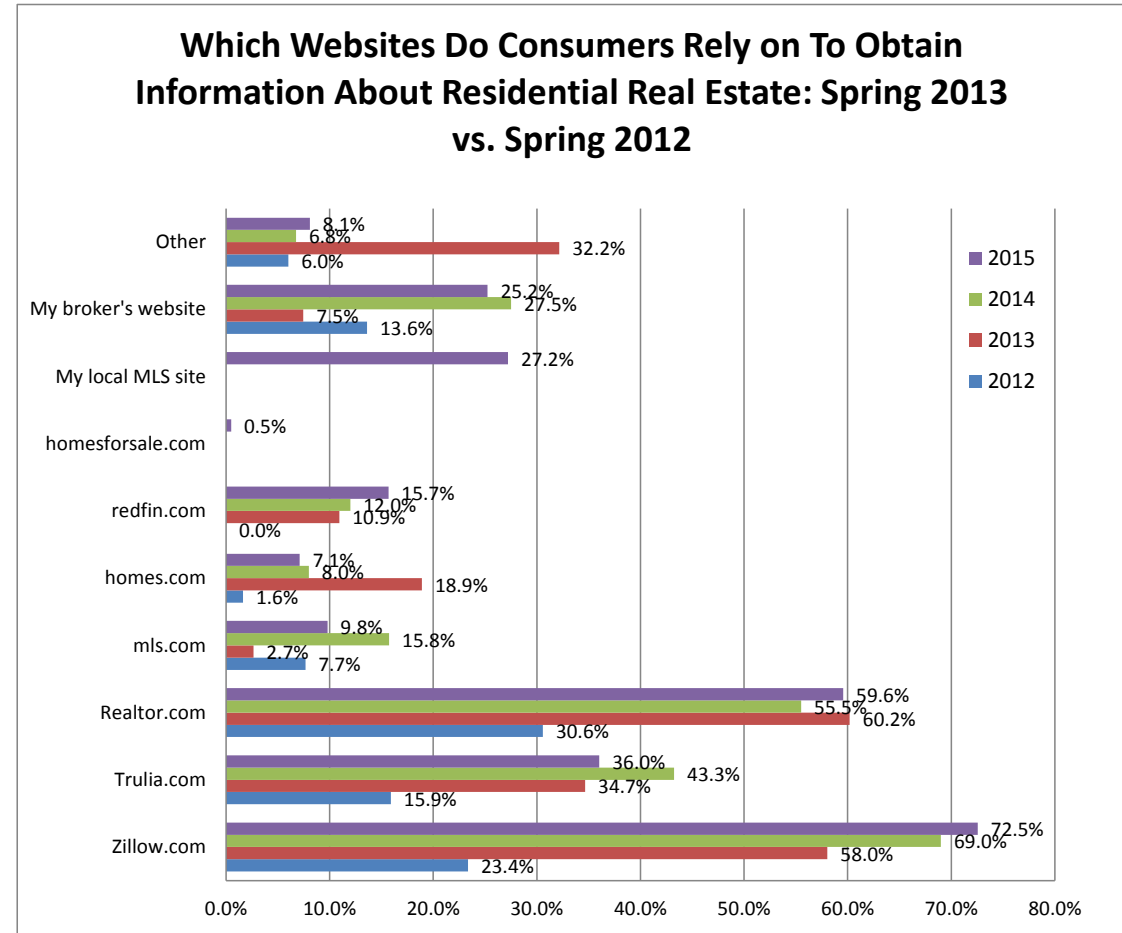
Trulia's consumer mindshare retrenched meaningfully in the past 12-months

Ad spend from NWS has started to make a difference for Realtor.com

Redfin has been gaining share steadily

- In California, Redfin's consumer mindshare exceeds that of Trulia and is on par with Realtor.com

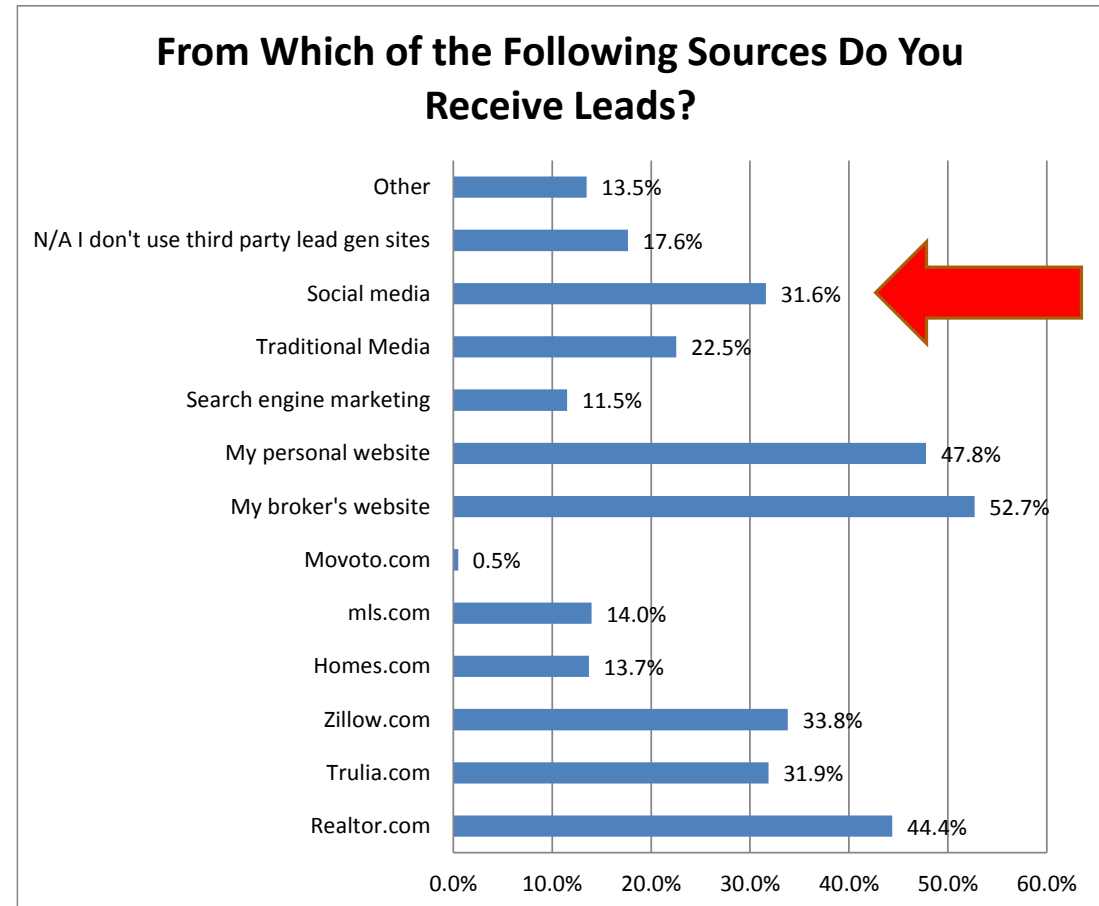
Local MLS sites remain an important channel for consumers



From Which Online Platforms Do Agents Generate Leads?

A few critical observations:

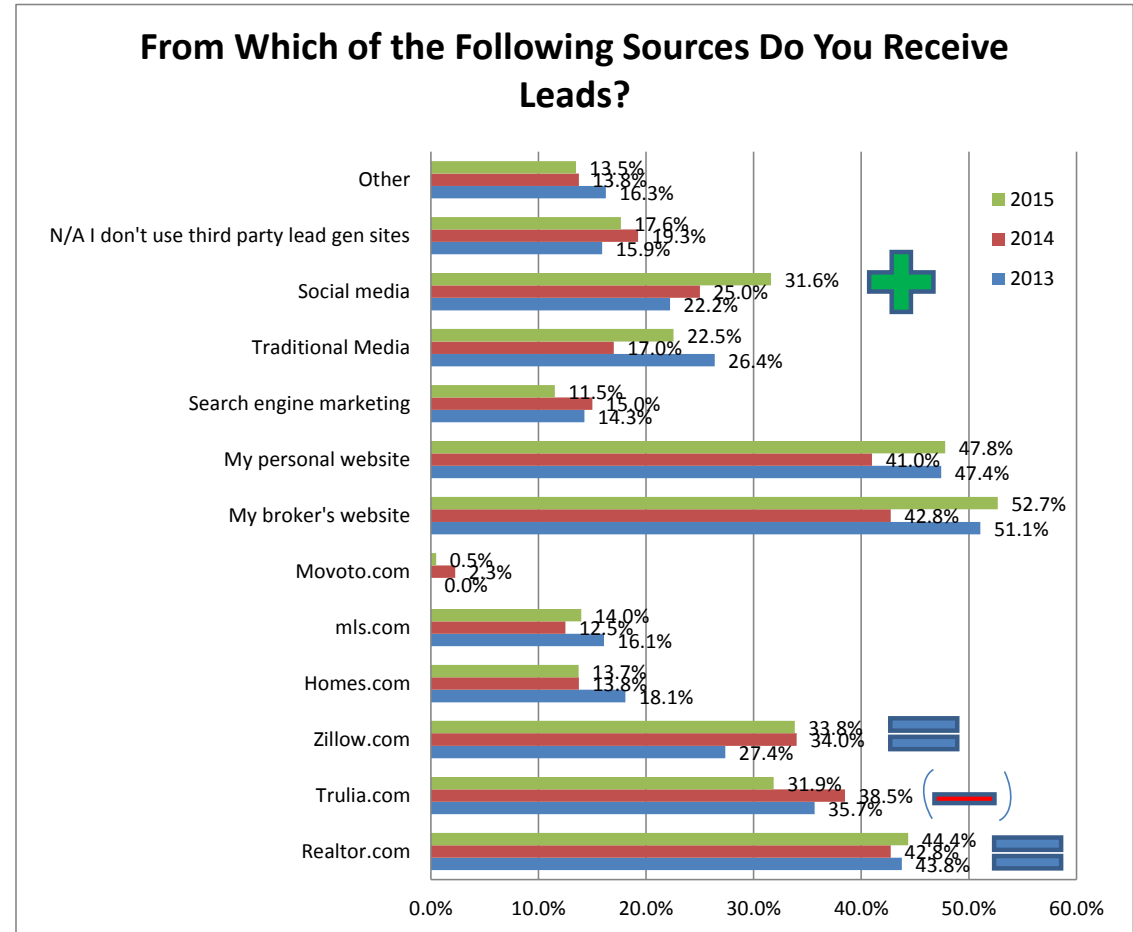
- This captures both PAID and UNPAID leads
- It should not come as a surprise that broker websites is most frequently identified as a lead source
- Realtor.com among the agents we surveyed has a significant lead over other lead aggregation platforms
- Social media has quickly become a critical lead generation platform



From Which Platforms Do Agents Generate Leads? Zillow and Trulia Still Haven't Closed the Gap on Realtor.com as Social Media/Facebook Gains Share

We asked the same question in each of our surveys over the past three years

- Zillow – After a big increase a year ago, the same percentage of agents in 2015 indicated they are receiving leads from Zillow as in 2014 – STALLED MOMENTUM?
- Trulia – Among the agents we surveyed fewer now receive leads from Trulia
- Realtor.com – Steady
- Facebook/social media – Gaining share in real estate agent lead generation



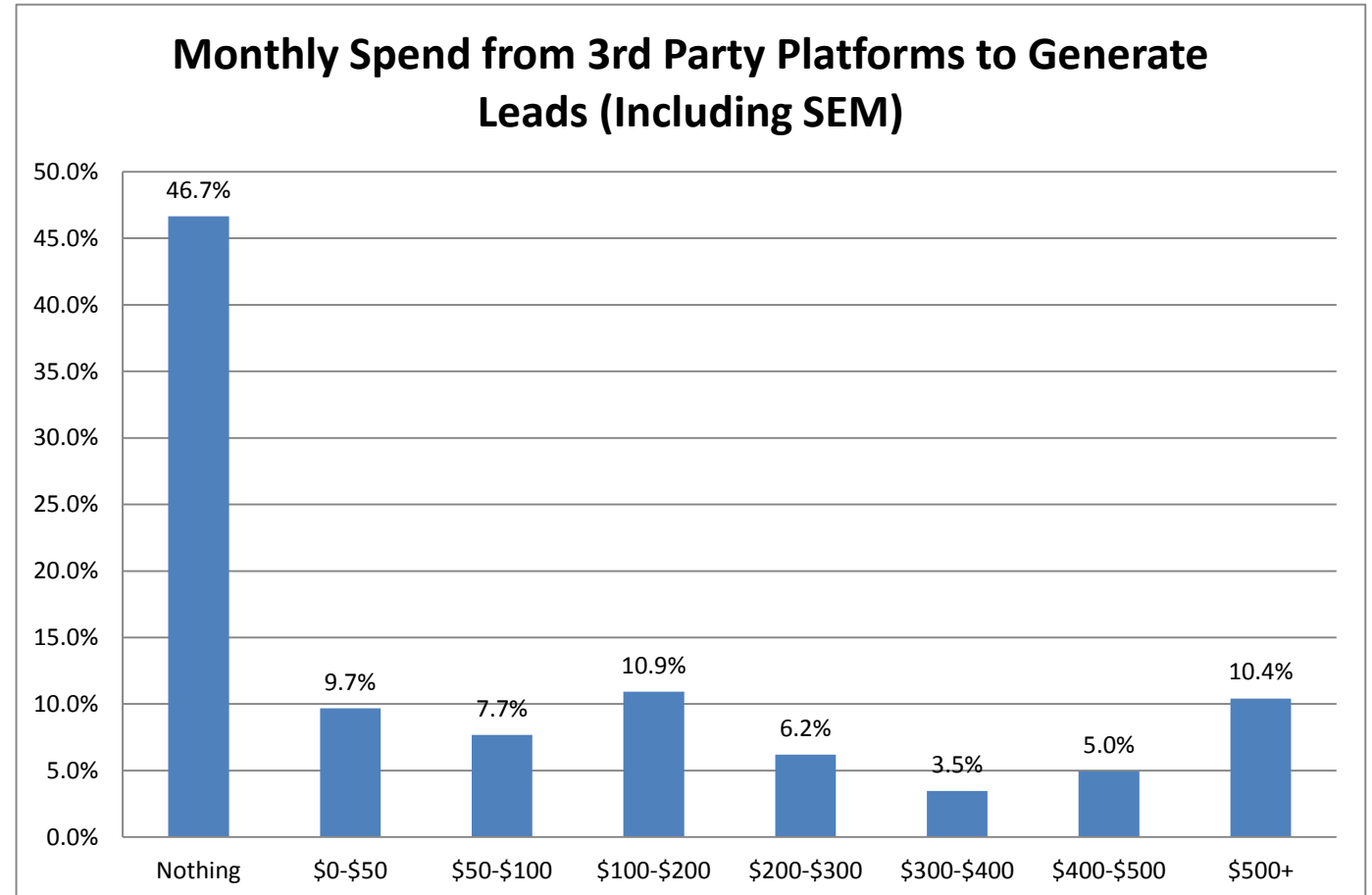
Assessing the TAM – How Much Do Agents Spend on Advertising?

More than 45% of agents we surveyed spend NO money out of pocket on advertising

Only 10% of agents we surveyed spend more than \$500 on 3rd party advertising

The feedback from our survey is consistent with NAR national surveys

The Total Addressable Market for Zillow's core advertising solution might only be \$2-\$3B

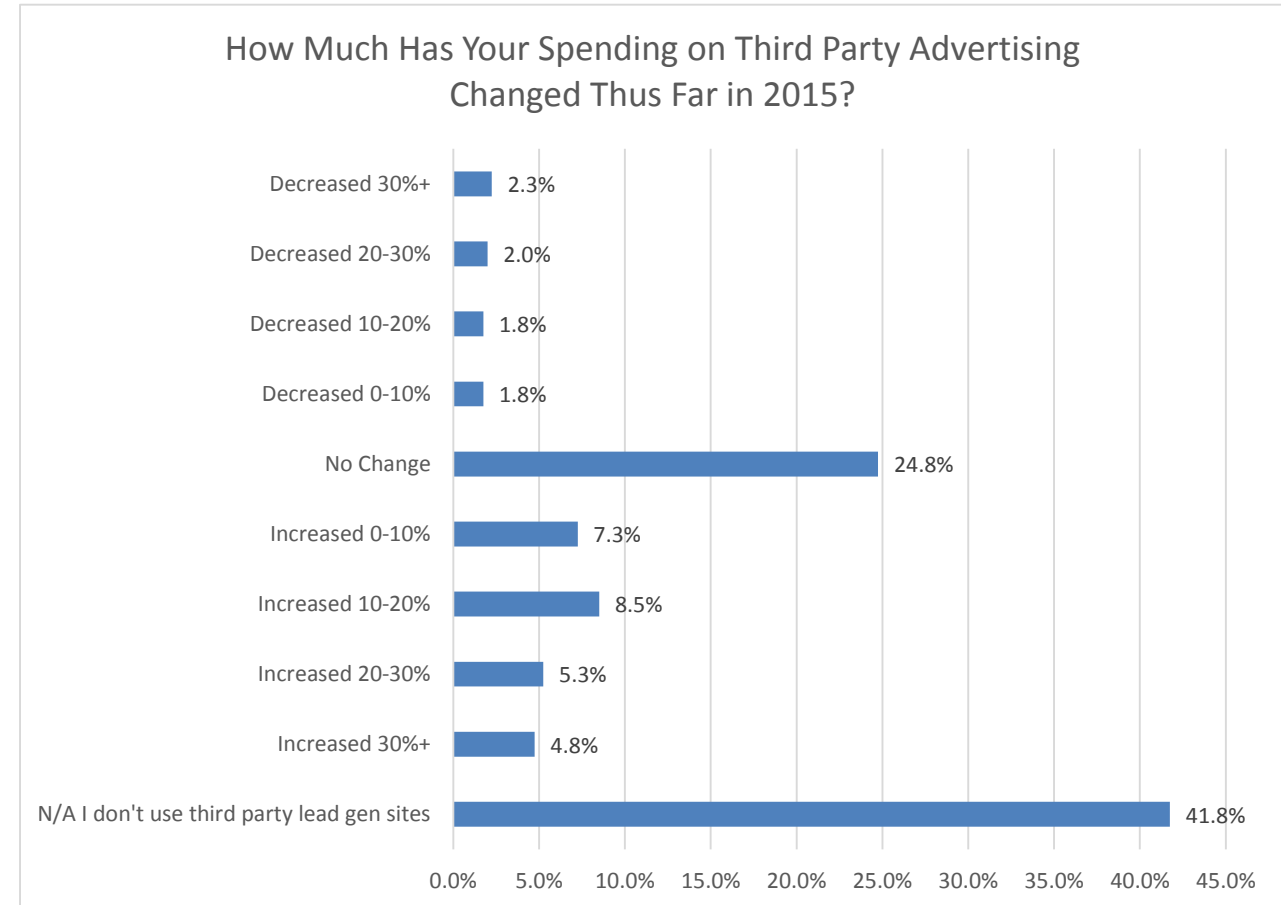


Assessing the TAM - Agents Appear to be Spending Slightly More on 3rd Party Ads in 2015

Overall there's an upward bias to agent advertising spend in 2015

Of those agents that spend, a significant percentage are not changing their budgets overall

Agent ad budgets in general tend to be static both in terms of dollars and platform allocation



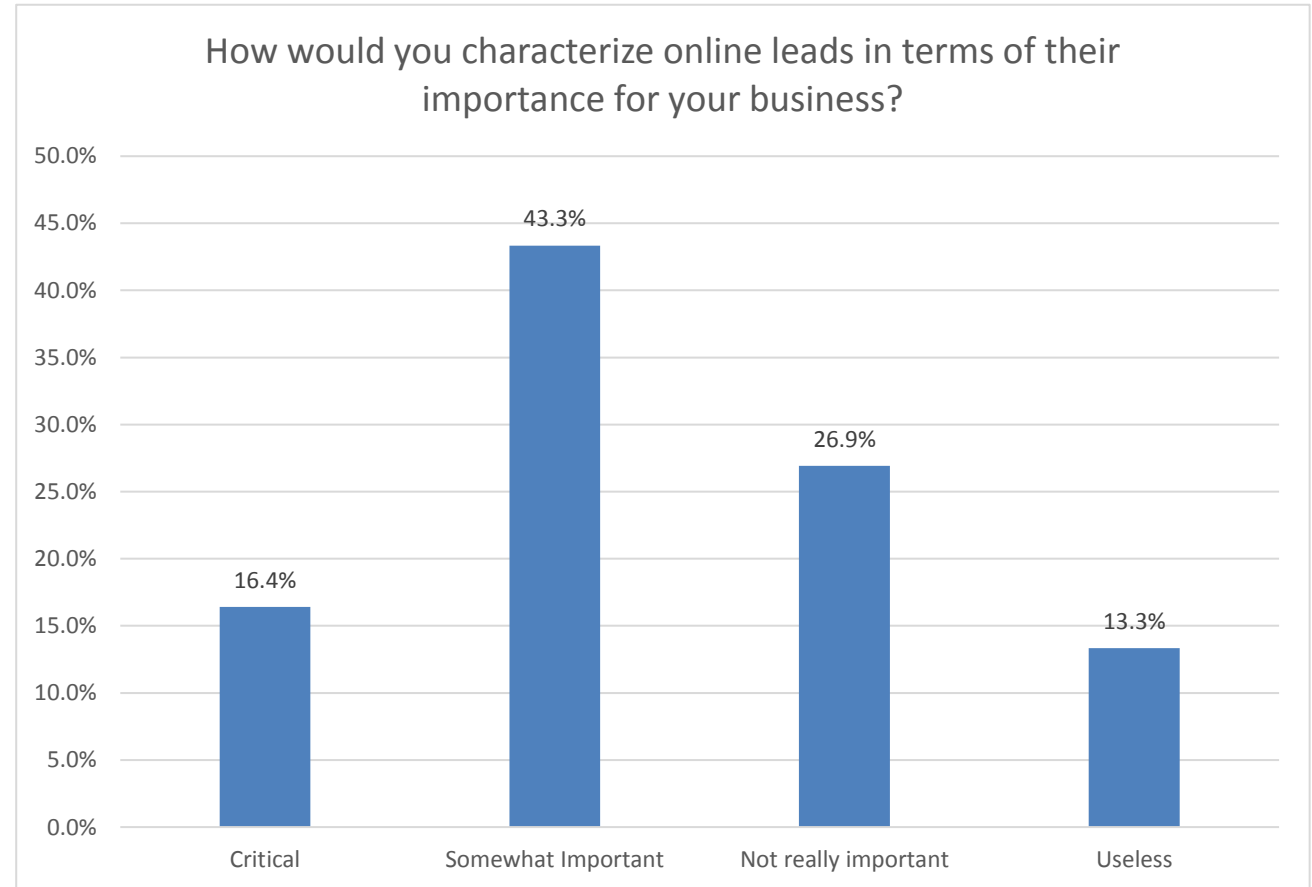
Assessing the TAM - Internet Leads Are Not As Important to Agents As You Think

The search for a home has moved entirely online, but agent selection has not

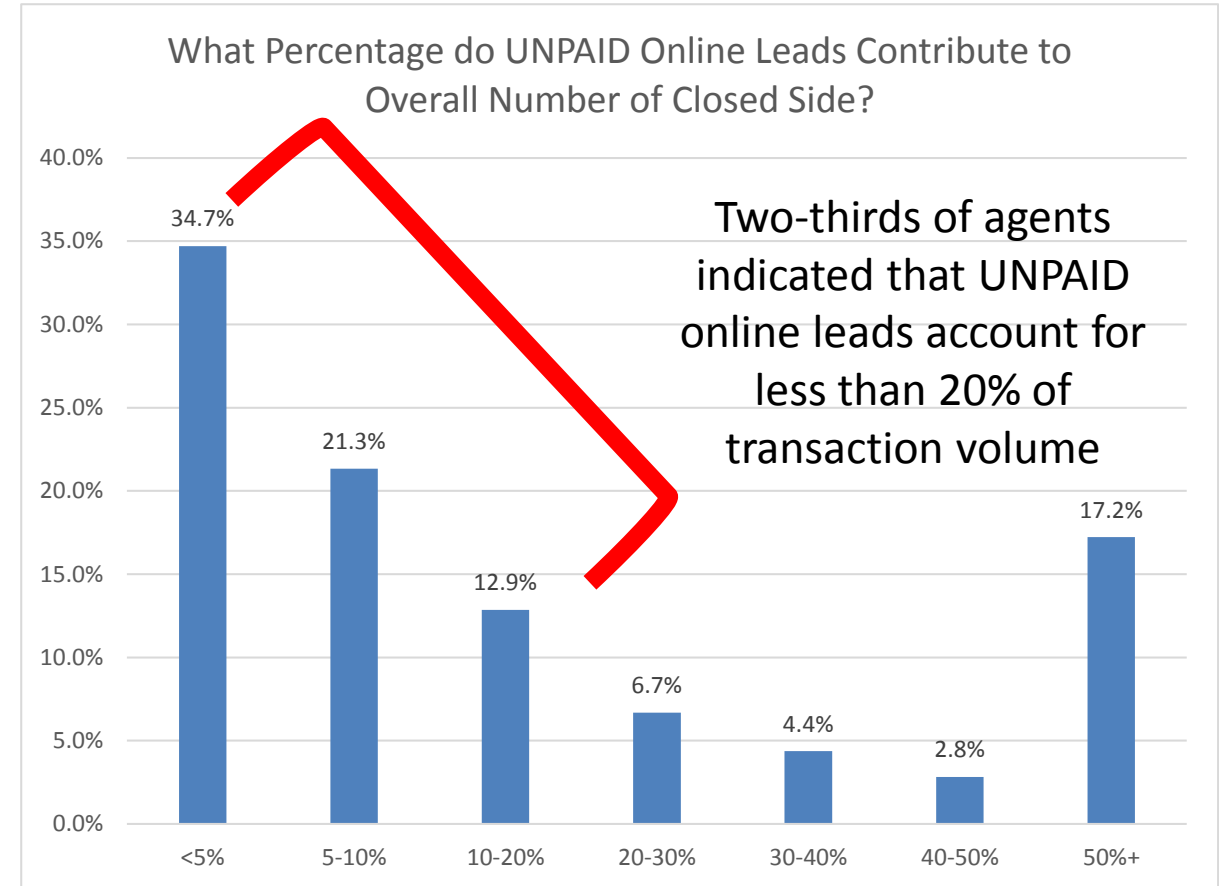
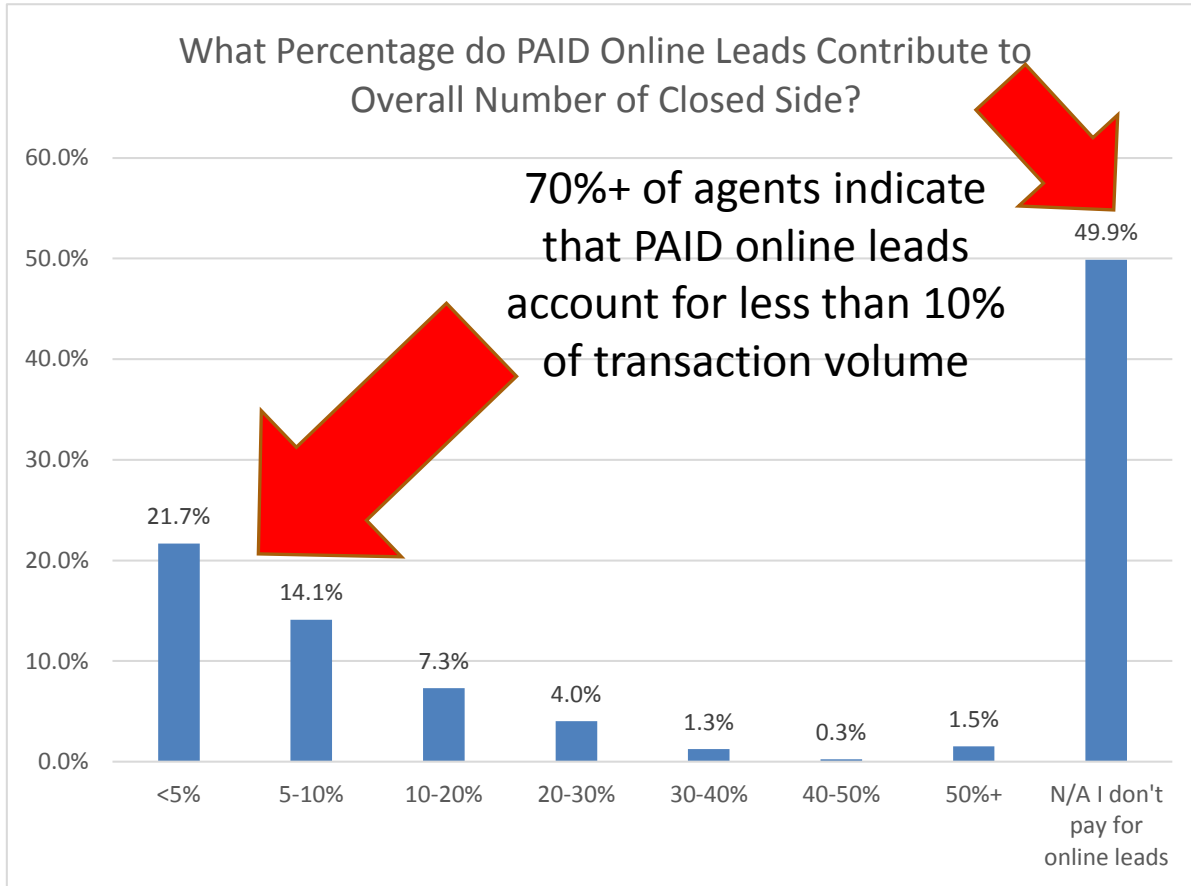
Most agents rely first on their “Sphere Of Influence” (SOI)

There are online-centric agents that aggressively pursue internet leads:

- Agent team model
- Active buys across multiple platforms
- 10-days of pain approach to conversion
- Large social media presence
- Relies on reviews for leads



Assessing the TAM – Online Leads Account for a Small Percentage of Transaction Volume



Zillow and Trulia Rank Well Behind Other Platforms In Lead Volume

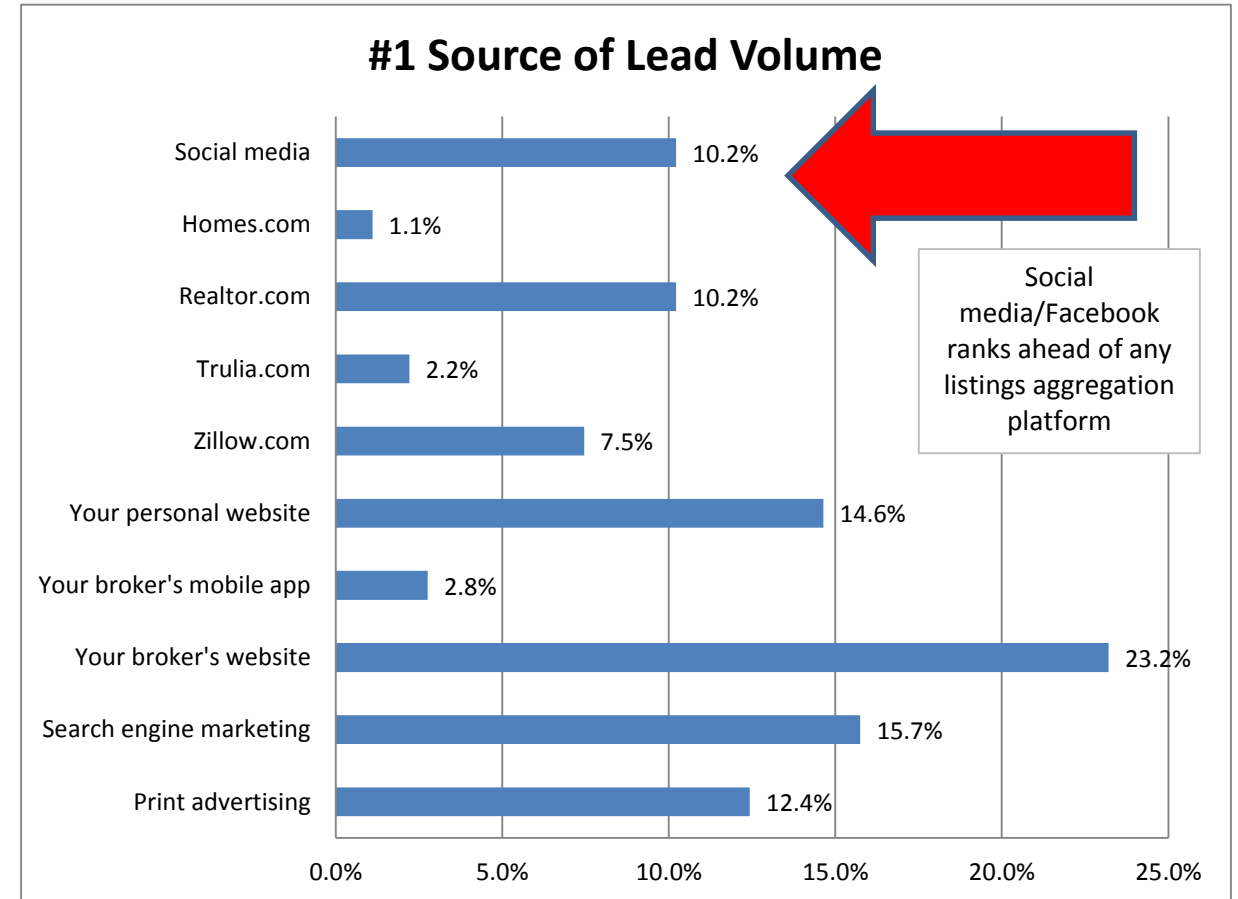
Brokers need to do more to drive lead volume to agents

- Only 23% of agents identified their broker website as the number one source of leads

Search remains a powerful source of leads for agents

The complete demise of print advertising has not yet been seen

Zillow and Trulia rank behind Social media and realtor.com as a top source of lead volume



Platforms Gaining/Losing Share In the Past Year As TOP Source of Lead Volume for Agents

Gaining share as top source of lead volume in the past year:

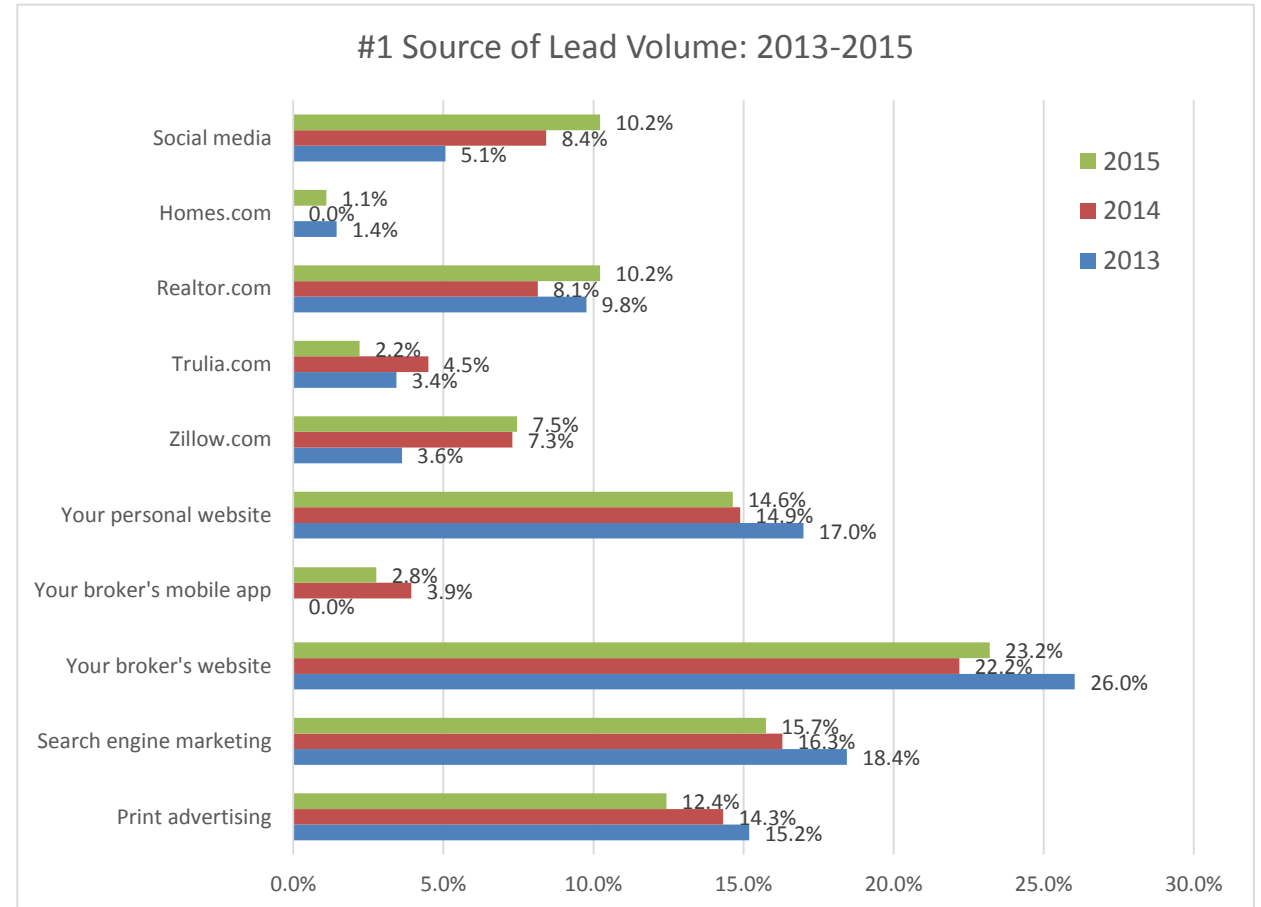
- Social media
- Realtor.com

HOLDING share as a top source of lead volume:

- Zillow

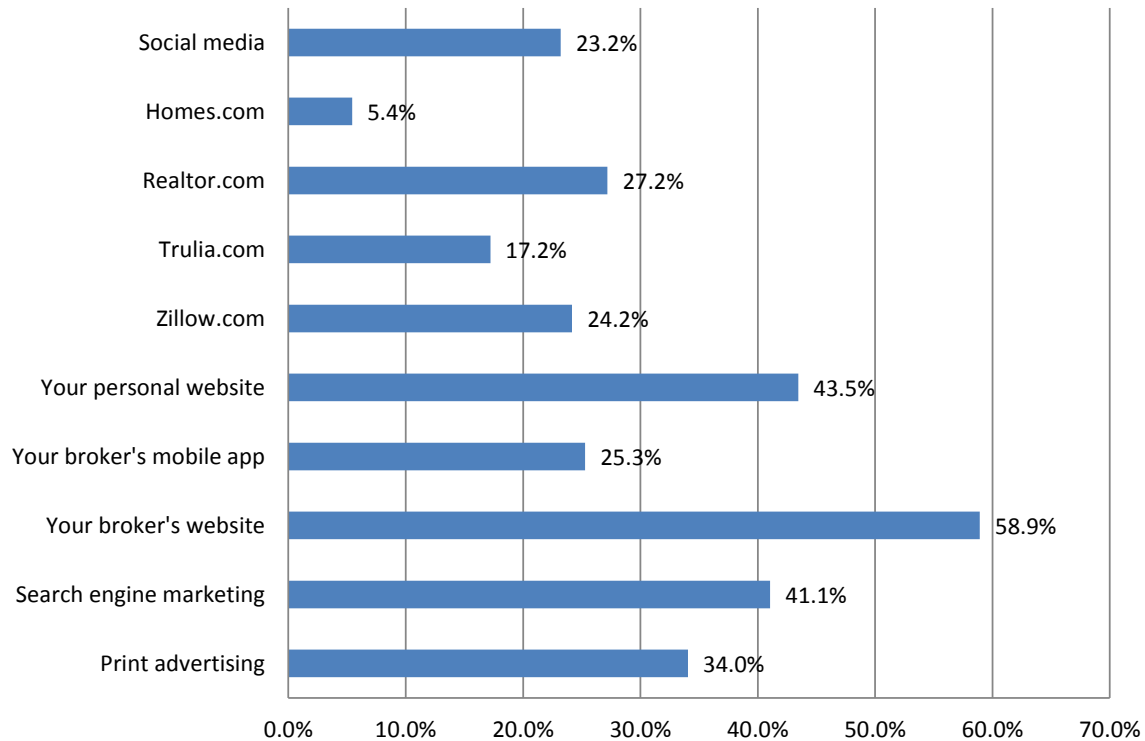
LOSING share as a top source of lead volume:

- Trulia
- Search
- Print
- Broker websites
- Agent websites

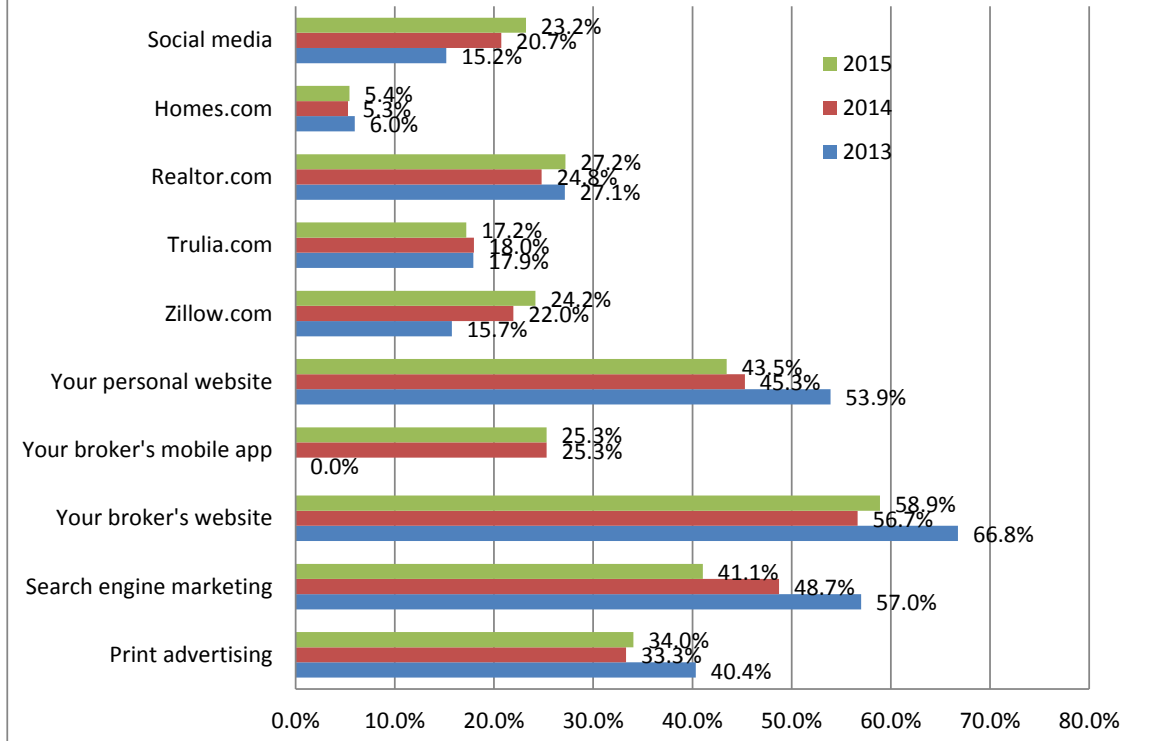


From a Lead Volume Perspective, Zillow Is Not Gaining Meaningful Share

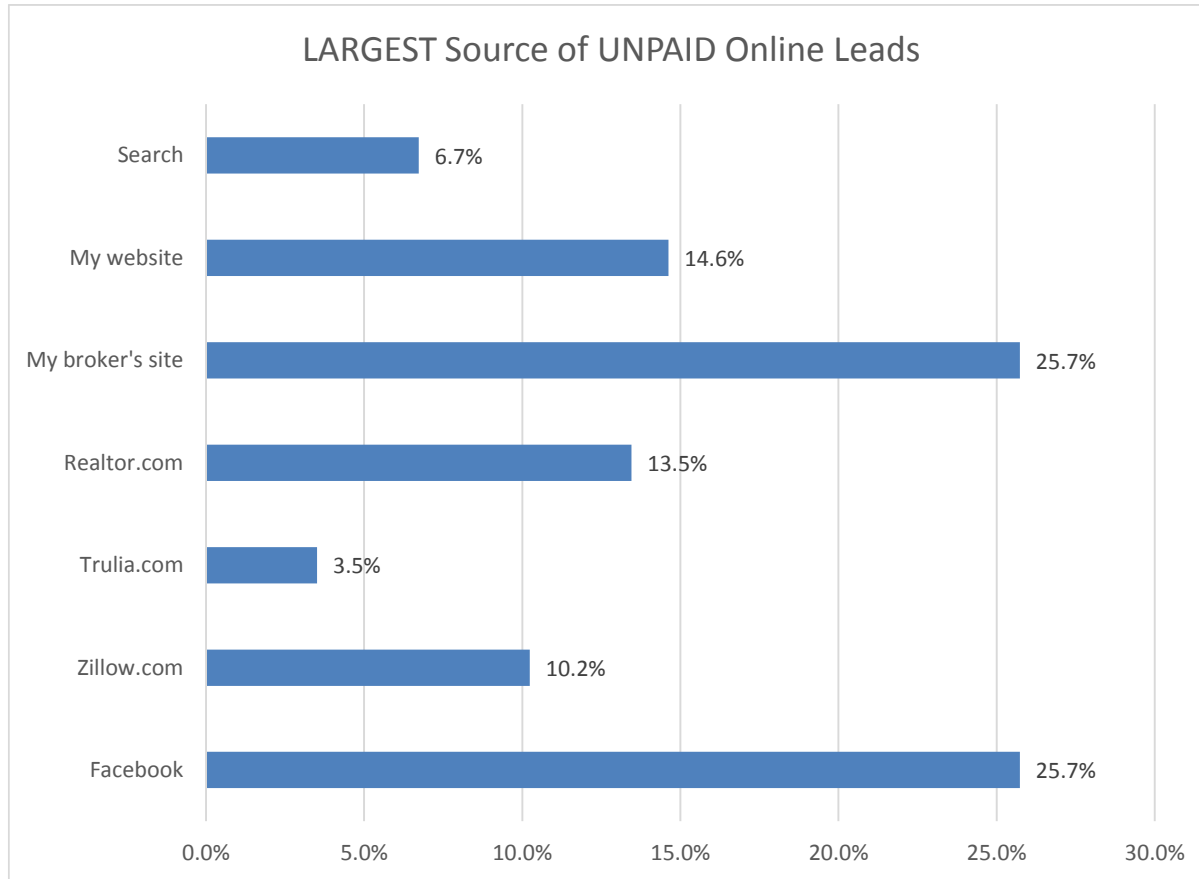
Percentage of Agents Identifying as a Top Three Source of Lead Volume



Percentage Identifying as a Top Three Source of Lead Volume - 2013-2015



Facebook Has Become a Huge Unpaid Lead Volume Generator for Agents



Facebook has become as important as a broker's website for agent in terms of lead generation:

- Facebook is a form of "sphere of influence" marketing
- Agent ROI on Facebook is higher than almost any other channel
- In many respects it is the perfect platform through which to harvest leads

Among listings aggregation sites, Zillow trails Realtor.com and Trulia.com is a distant third

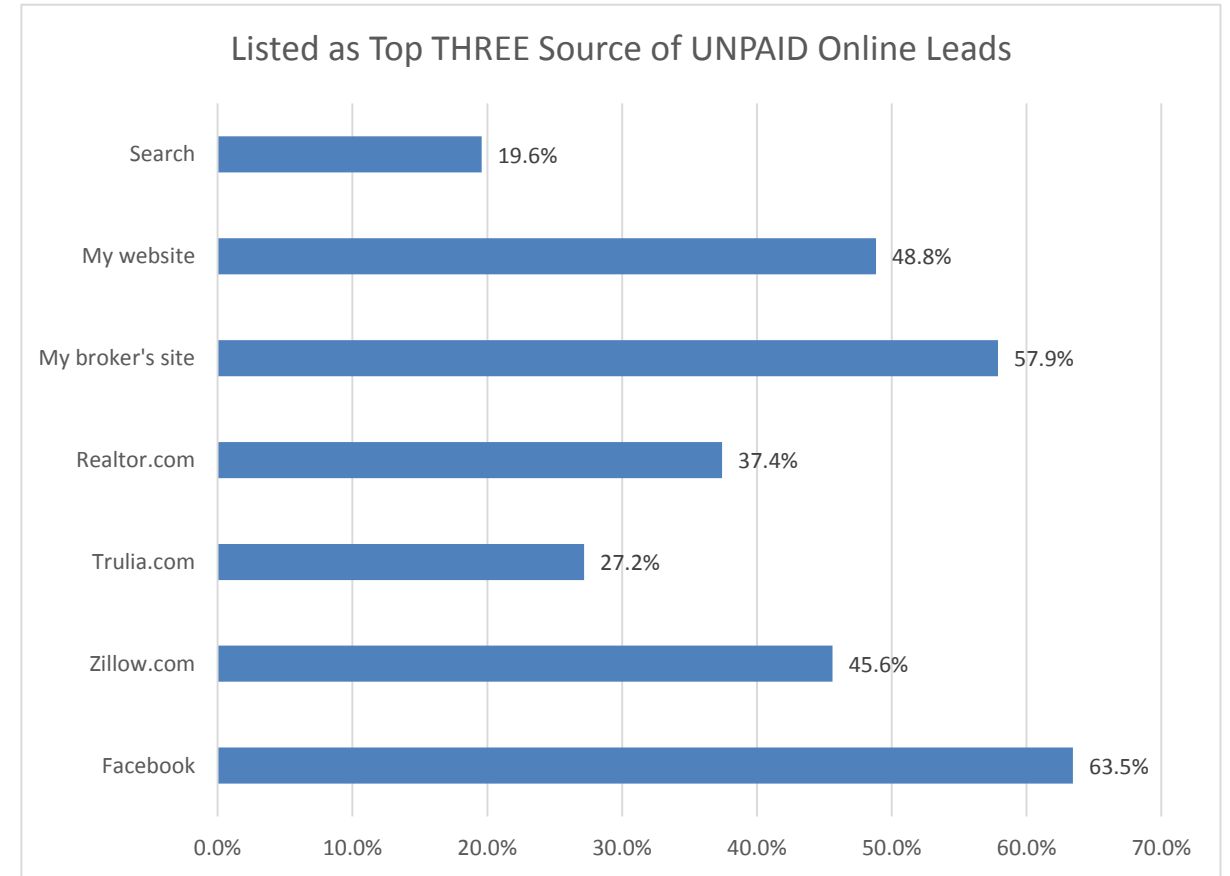
Facebook Has Become the Single Largest Source of Unpaid Leads Online

“Zillow may be the 800-pound gorilla in the real estate advertising space right now, but Facebook is the elephant in the room. They’re the company that never really gets mentioned in the same breath as Zillow or Realtor.com.”

But Facebook is where the smart agents and brokers are spending their money right now. And it’s where I believe the lion’s share of that \$10 billion will be spent in the future.”

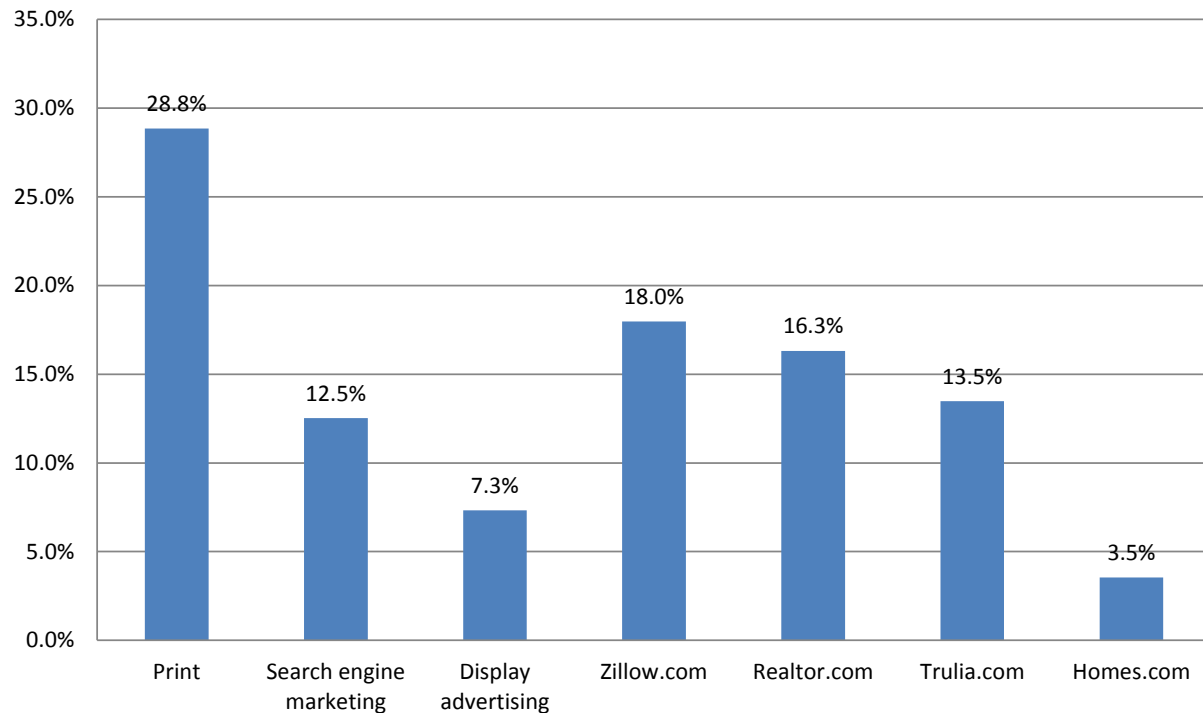
- 1000 Watt Consulting

It’s inevitable that Facebook will start taking share from Zillow in the paid online lead channel in the near future, in our view.

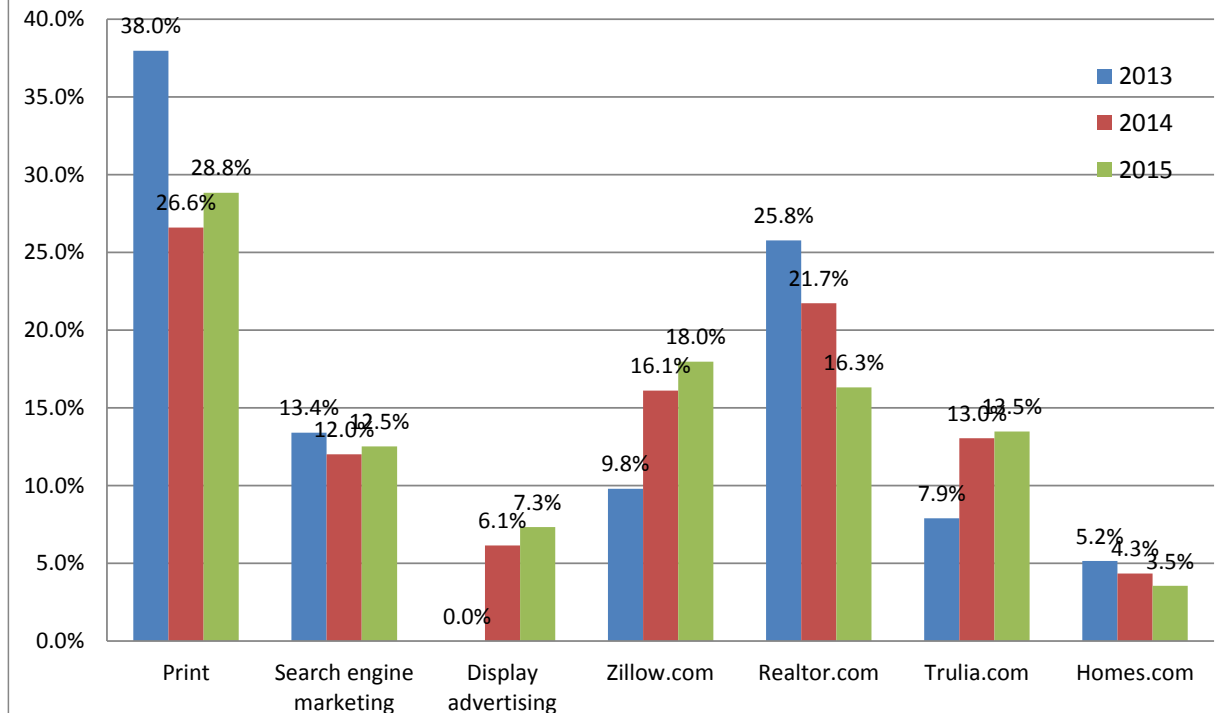


More Agents are Spending on Zillow, Print Allocation Remains Stubbornly High

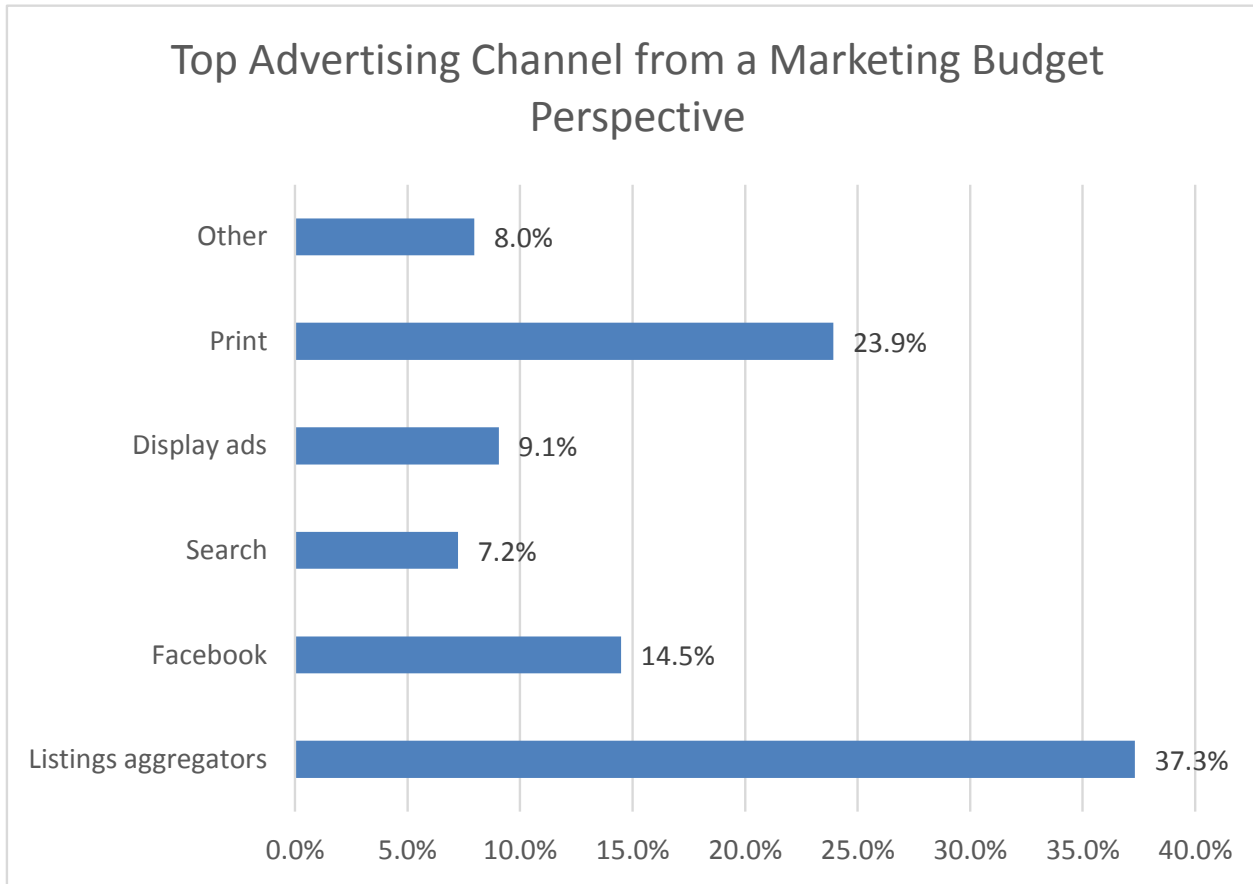
Third Party Sources That Agents Pay to Generate Leads



Third Party Sources That Agents Pay to Generate Leads



Listings Aggregators Now Get the Greatest Wallet Share, but is the ROI Compelling?



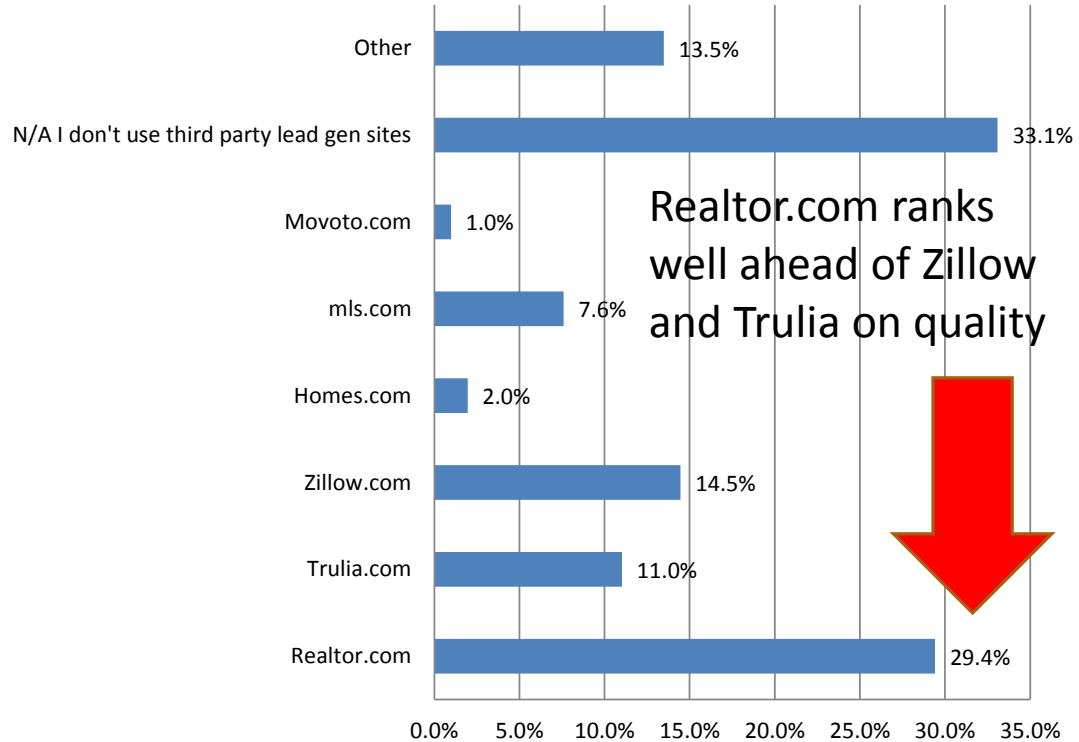
Listings aggregators combined now receive the greatest amount of third party advertising spend

Facebook's wallet share has been growing

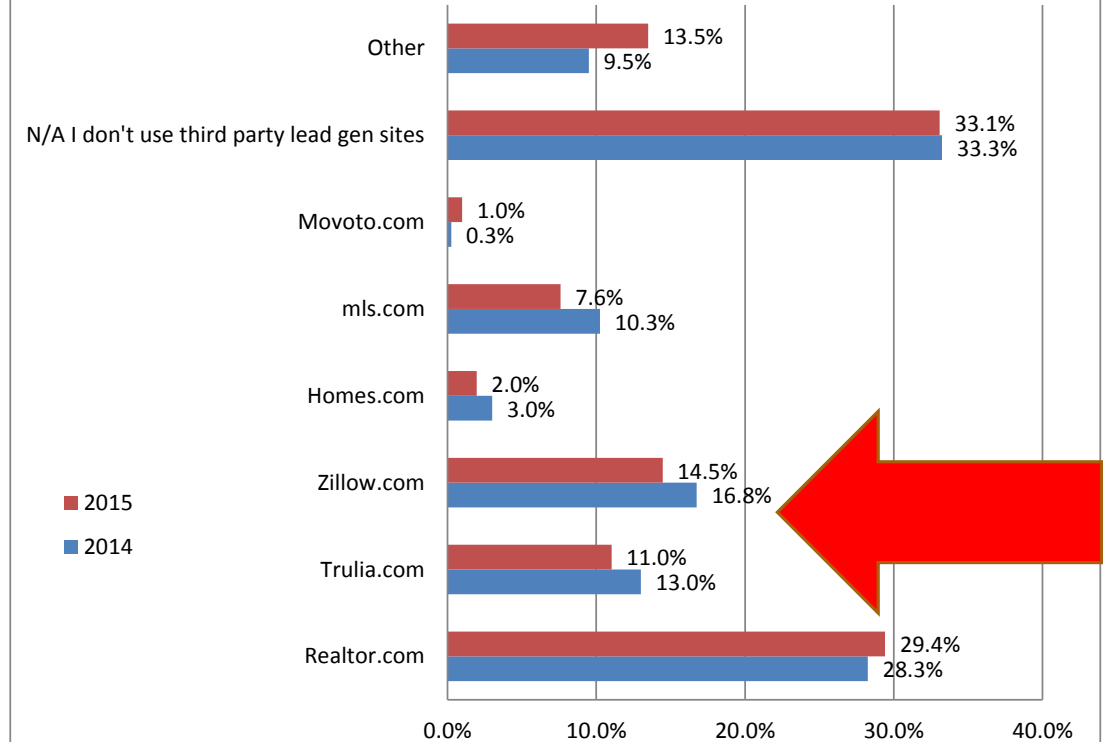
Print still hasn't declined at the rate most would expect

Despite Higher Spend from Agents, Few Agents Identify Zillow as a High Conversion Lead Channel, Conversion Rates Don't Appear to Be Improving

Which Lead Source Offers the Highest Conversion Rate?

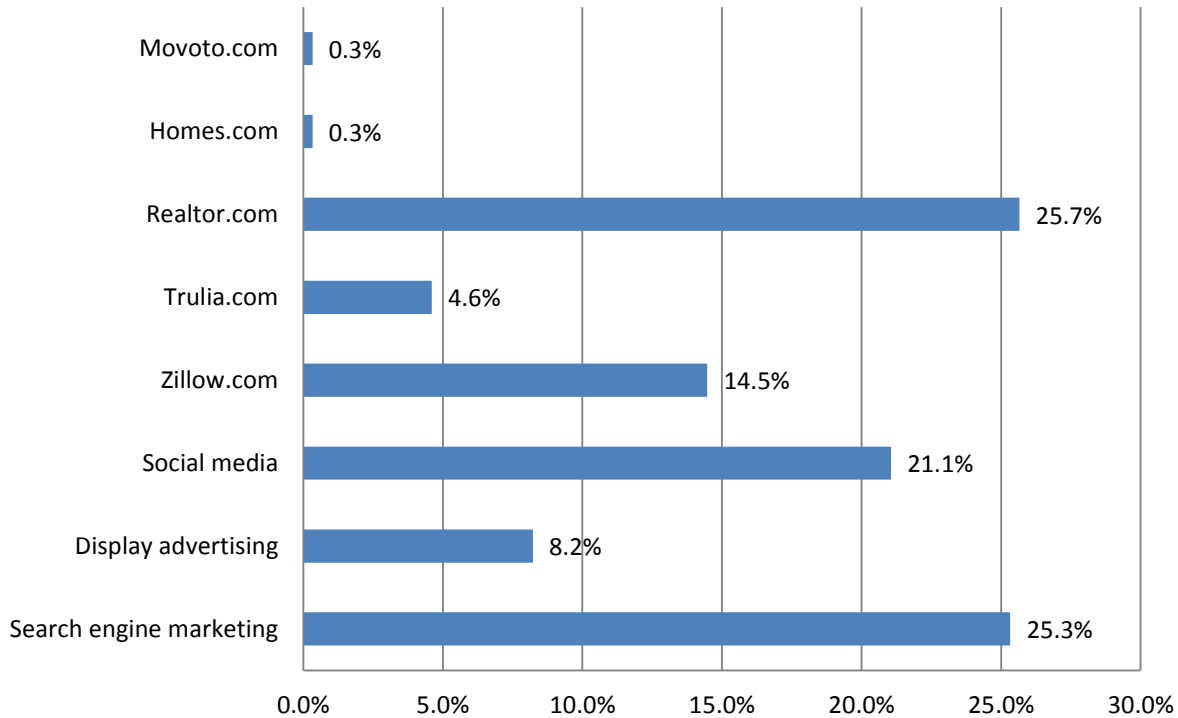


Which Lead Source Offers the Highest Conversion Rate?

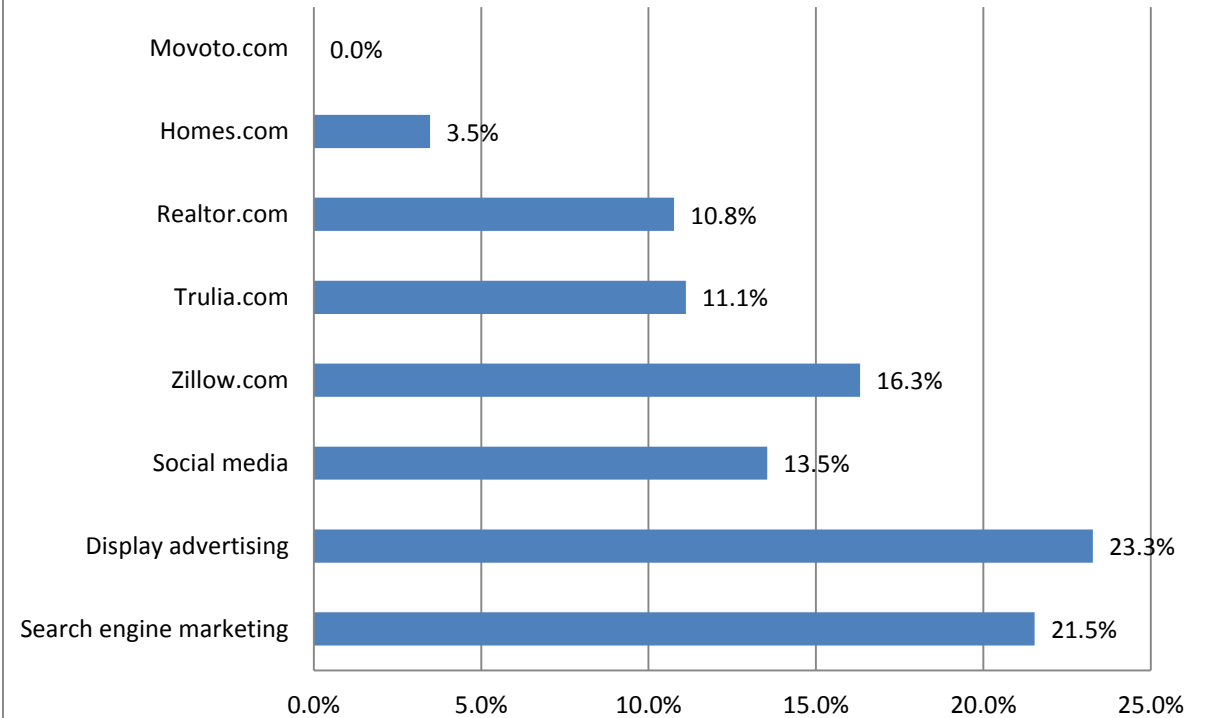


Agents Rank Zillow Behind Realtor.com, Facebook, and SEM in Lead Quality by a Wide Margin

#1 For Lead Quality Among Internet Advertising Sources

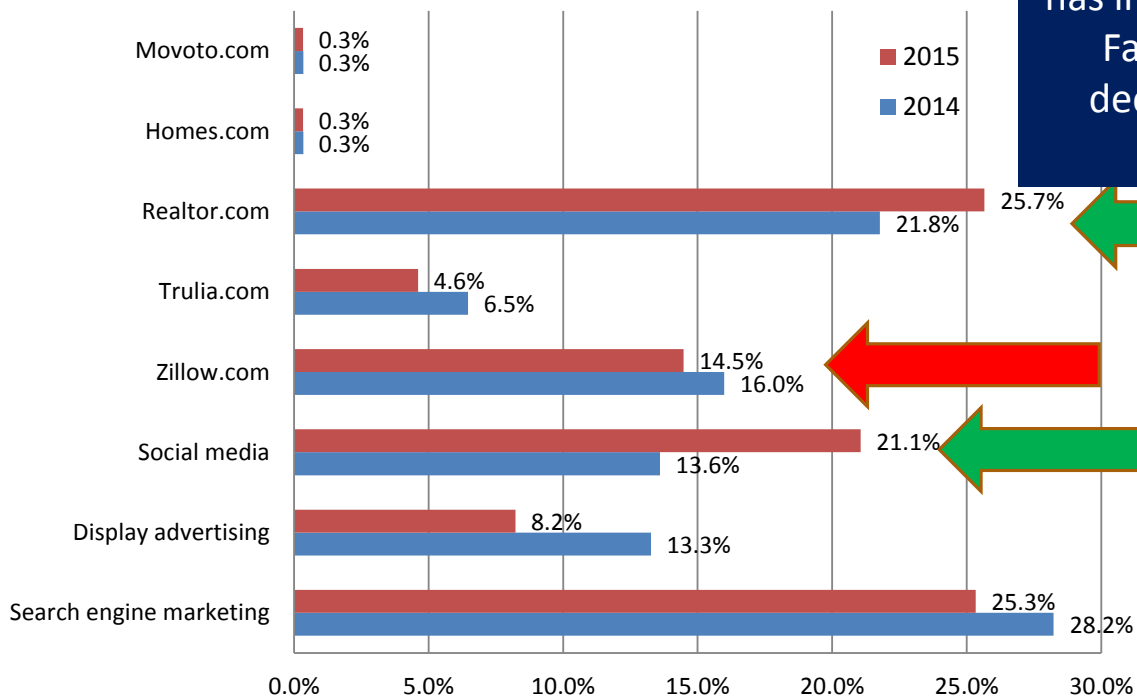


#2 For Lead Quality Among Internet Advertising Sources



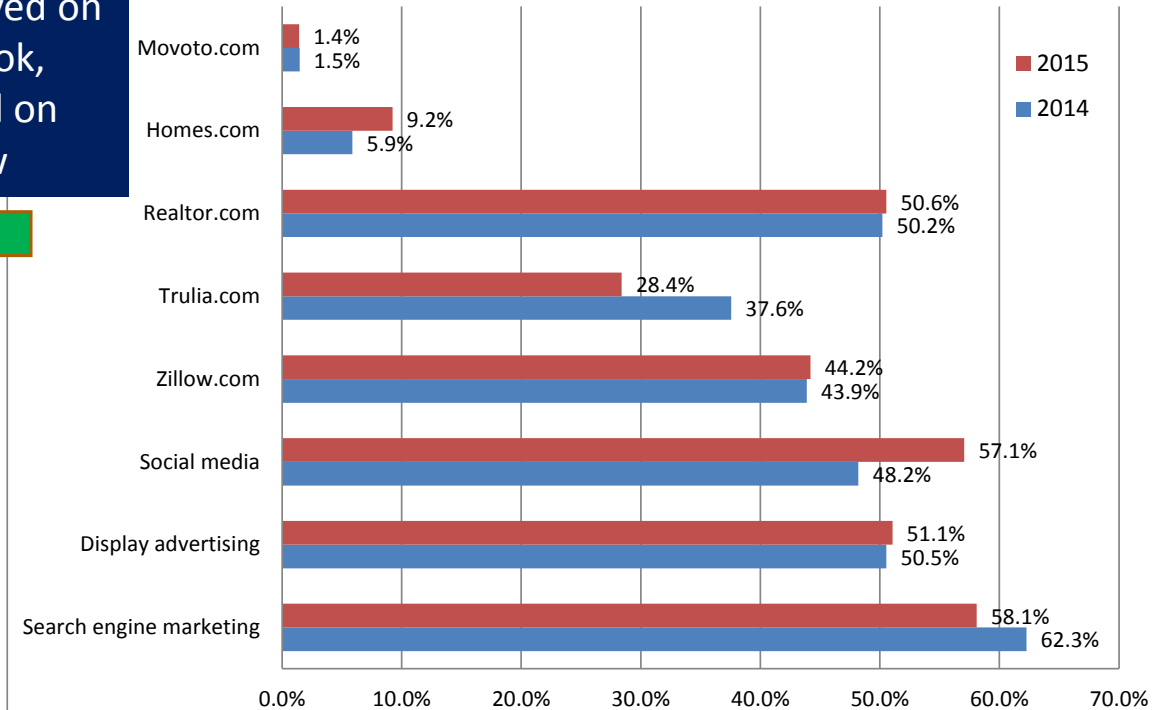
According to Agents Lead Conversion at Zillow Has Not Improved Relative to Other Internet Platforms

#1 For Lead Quality Among Internet Advertising Sources: 2015 vs. 2014



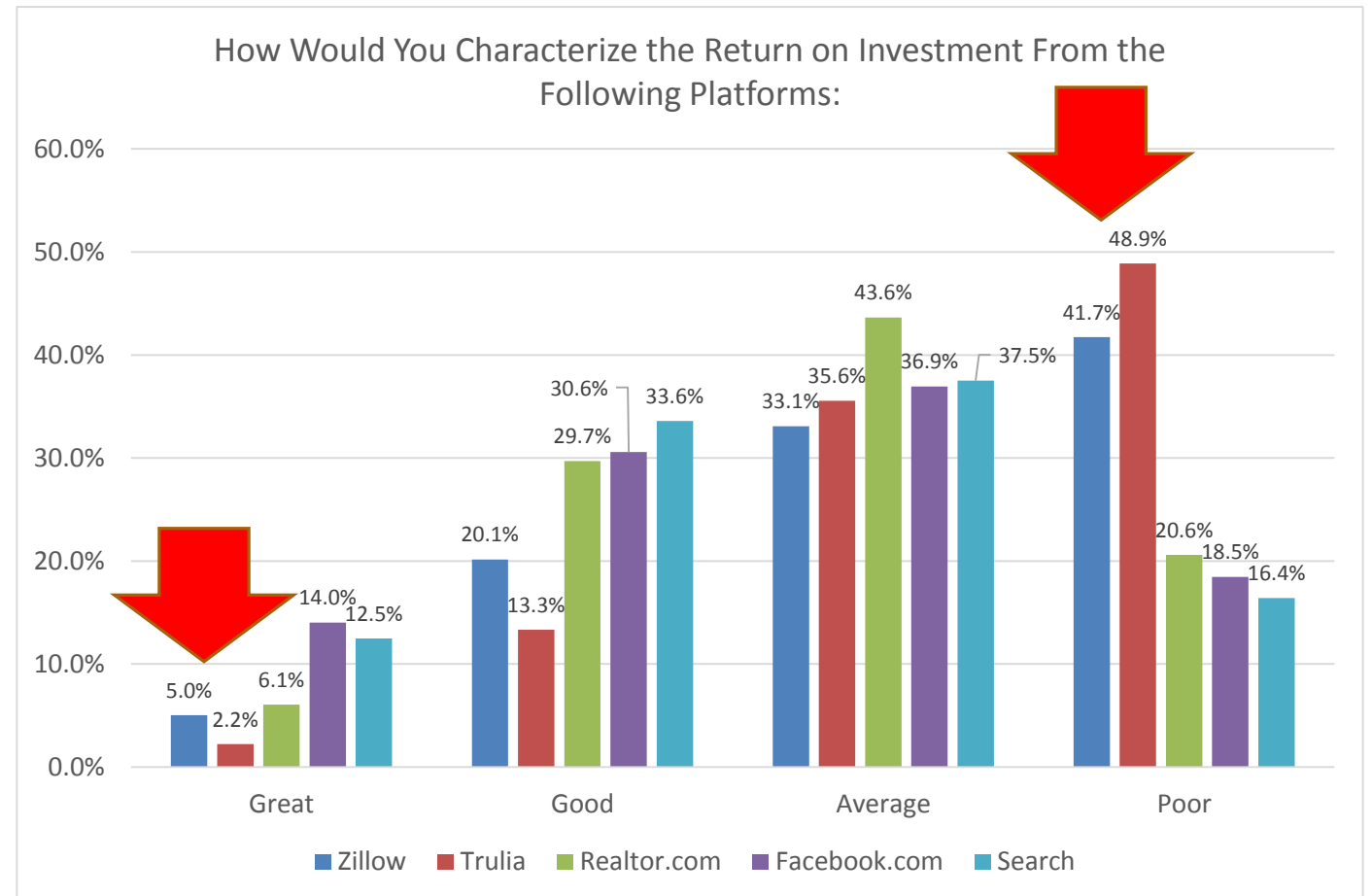
Lead conversion has improved on Facebook, declined on Zillow

Percentage of Agents Identifying in the Top Three for LEAD QUALITY Among Internet Advertising Channels



Qualitatively Agents Have Hurtful Words for Zillow When It Comes to ROI

- **42% and 49% of Agents that PAY (or have paid) for leads on Zillow and Trulia describe the ROI as “Poor”**
- Conversely only 5% and 2.2% of paying agents on Zillow and Trulia describe the ROI on ad spend as great
- Zillow and Trulia rank below every other meaningful internet advertising platform on advertising ROI
- Search and Facebook/social media generate favorable ROI relative to listings aggregators



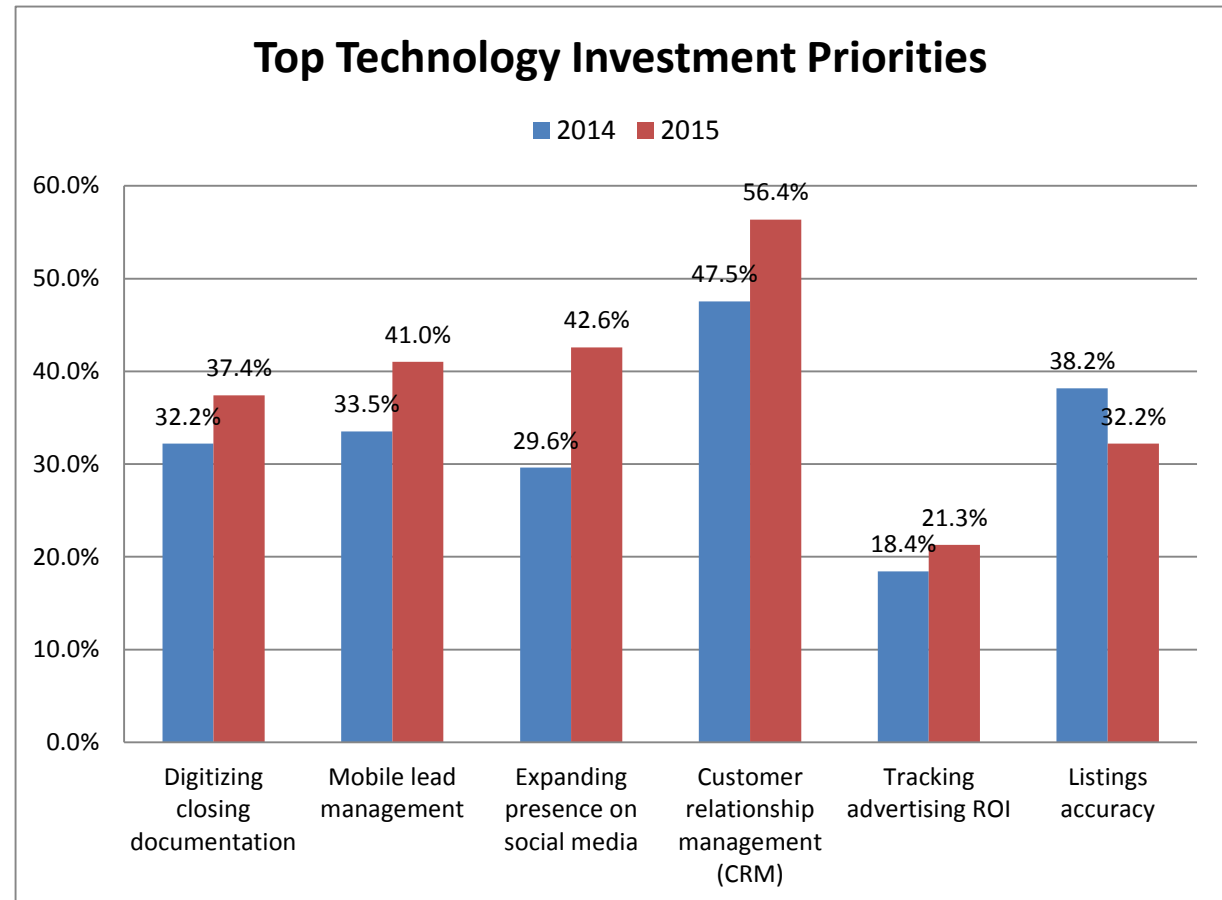
Technology Priorities for Agents – CRM, Mobile Lead Management, and Social Media

CRM remains the top investment priority for agents

- There's a huge variance between agents and how they harvest leads
- There's a lot of CRM software out there for agents, but no clear industry leader(s)

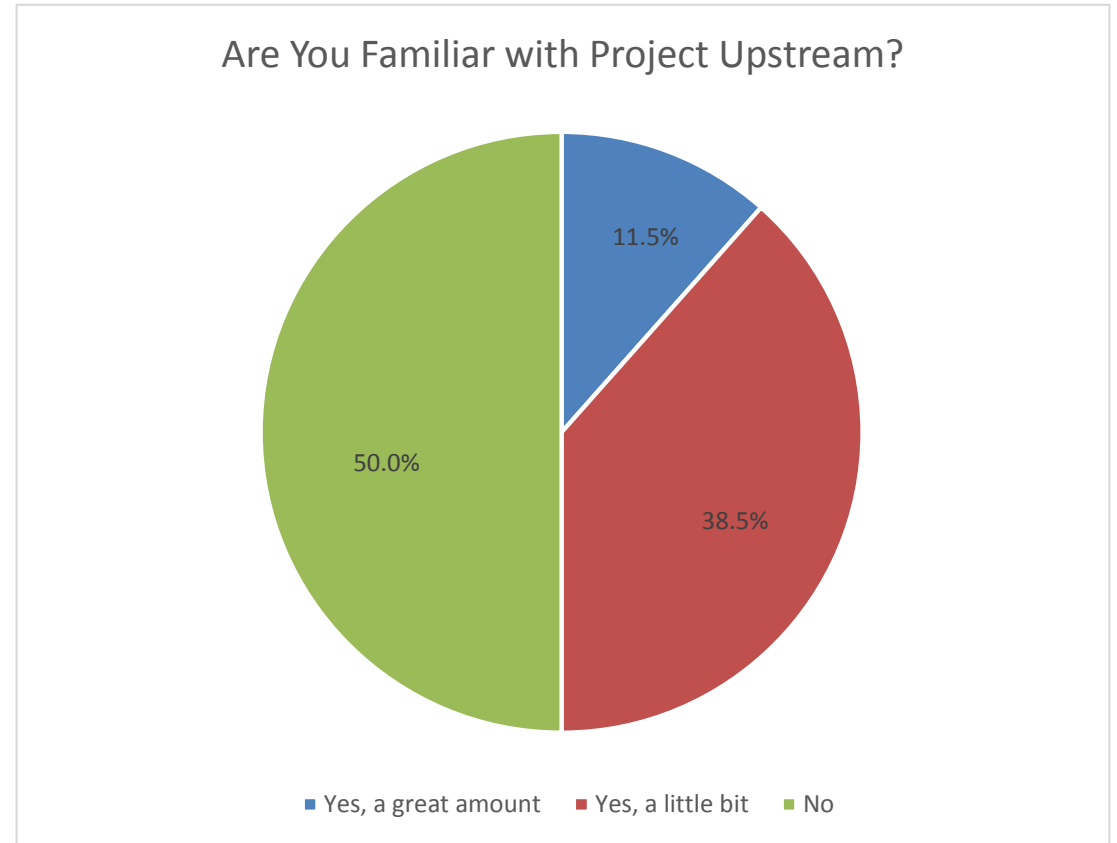
Once again, Facebook remains a high priority for agents

Listings accuracy is not as important to agents as it was a year ago



Much Like Investors, Many Agents Remain Unfamiliar with Project Upstream

In May, it was announced that Project Upstream, the technology initiative to create a quasi-National MLS spearheaded by the Realty Alliance and other large brokerage firms, will launch in the very near future. Upstream will work with NAR's subsidiary Realtors Property Resource to create a technology platform that will drastically enhance the quality of listings data realtors have access to and enable brokers to assert direct control over the dissemination of their listings to third parties such as Zillow.



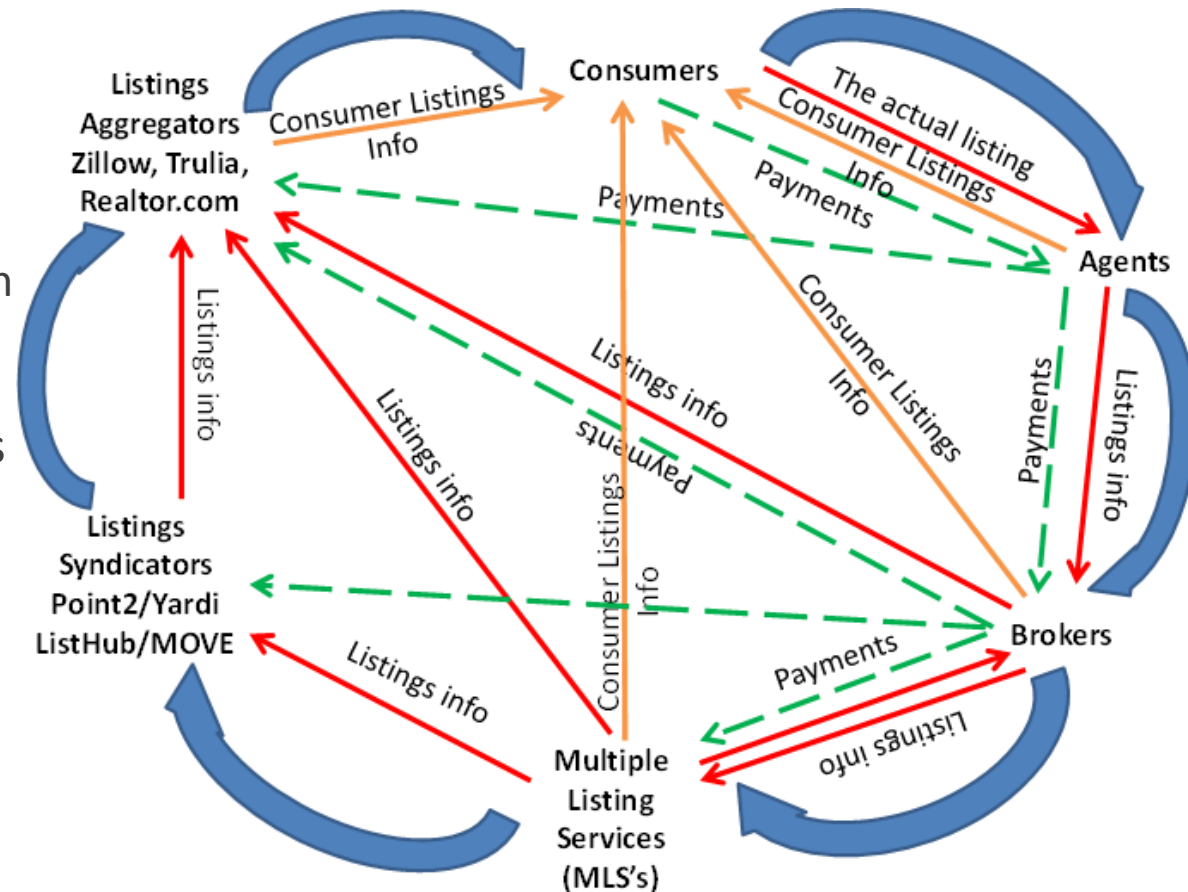
The Current Listings Distribution Ecosystem

Currently, listings data are fed to more than 800 multiple listings services (MLS's) across the country

- Many brokers/agents don't have direct control over what happens to their listings information
- Data quality is a persistent issue

Listings aggregators rely on feeds from MLS's and listings syndicators

The current infrastructure DILUTES the value proposition of brokerages whose primary mandate is to provide leads to agents



Listings Distribution in a Post-Upstream World

The listings syndicators would no longer play a meaningful role in the distribution ecosystem. This has already happened more or less when Zillow elected not to move forward with Listhub. Many brokers/agents don't have direct control over what happens to their listings information

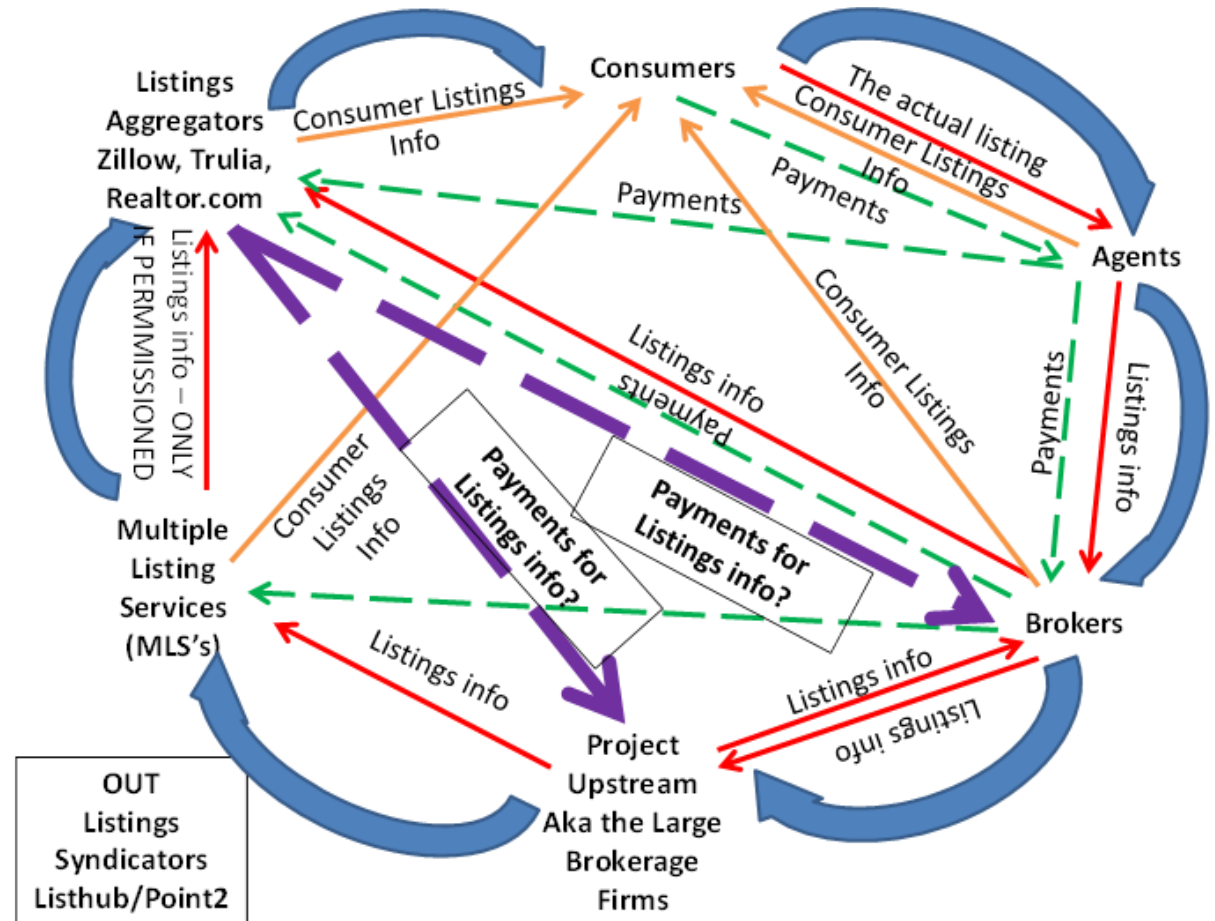
Brokers would upload listings information to the Upstream FIRST

Then the listings information would be distributed to the MLS's (simultaneously for all intents and purposes)

The MLS's would no longer be allowed to syndicate listings to third parties without consent from the brokerage firms

The brokers could pursue any of the following changes with the portals such as Zillow

- Delay the distribution of listings
- Ask for "featured" status for their listings at below market rates, if not free (similar to the deal that Realogy and Keller Williams have) which would reduce advertising inventory for Zillow further
- Demand payment for listings information – the purple lines – aka the nuclear option



Project Upstream Represents an Existential Threat to Zillow In Our View

Improved listings accuracy remains a top priority for agents in a potential post Upstream world

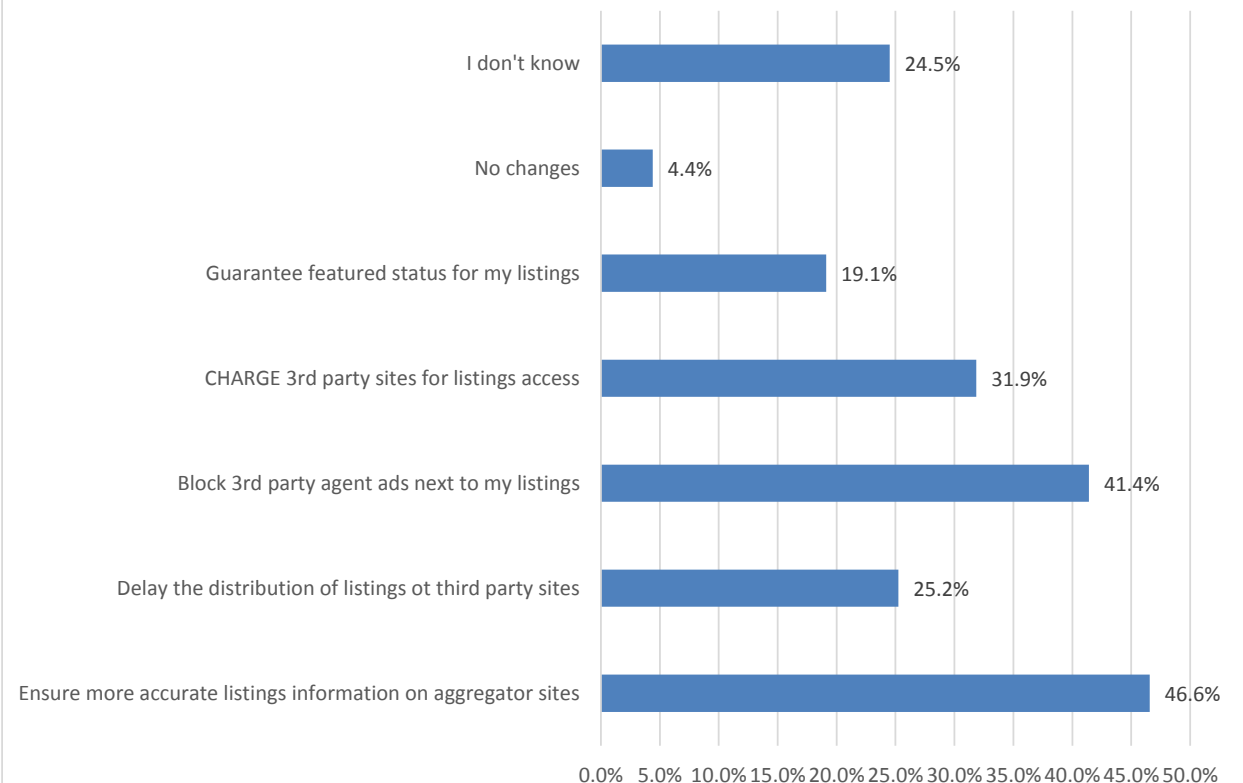
However, a significant percentage of agents want to see the following:

- Block 3rd party agent ads next to their listings
- Charge listings aggregators for access to data

Brokers will have the option to ask Zillow for terms

Upstream could lead to further reductions of Zillow's ad inventory and/or DRASTIC changes to the company's cost structure

Which of the Following Changes Do You Want to Occur to Listings Syndication With the Introduction of Project Upstream?



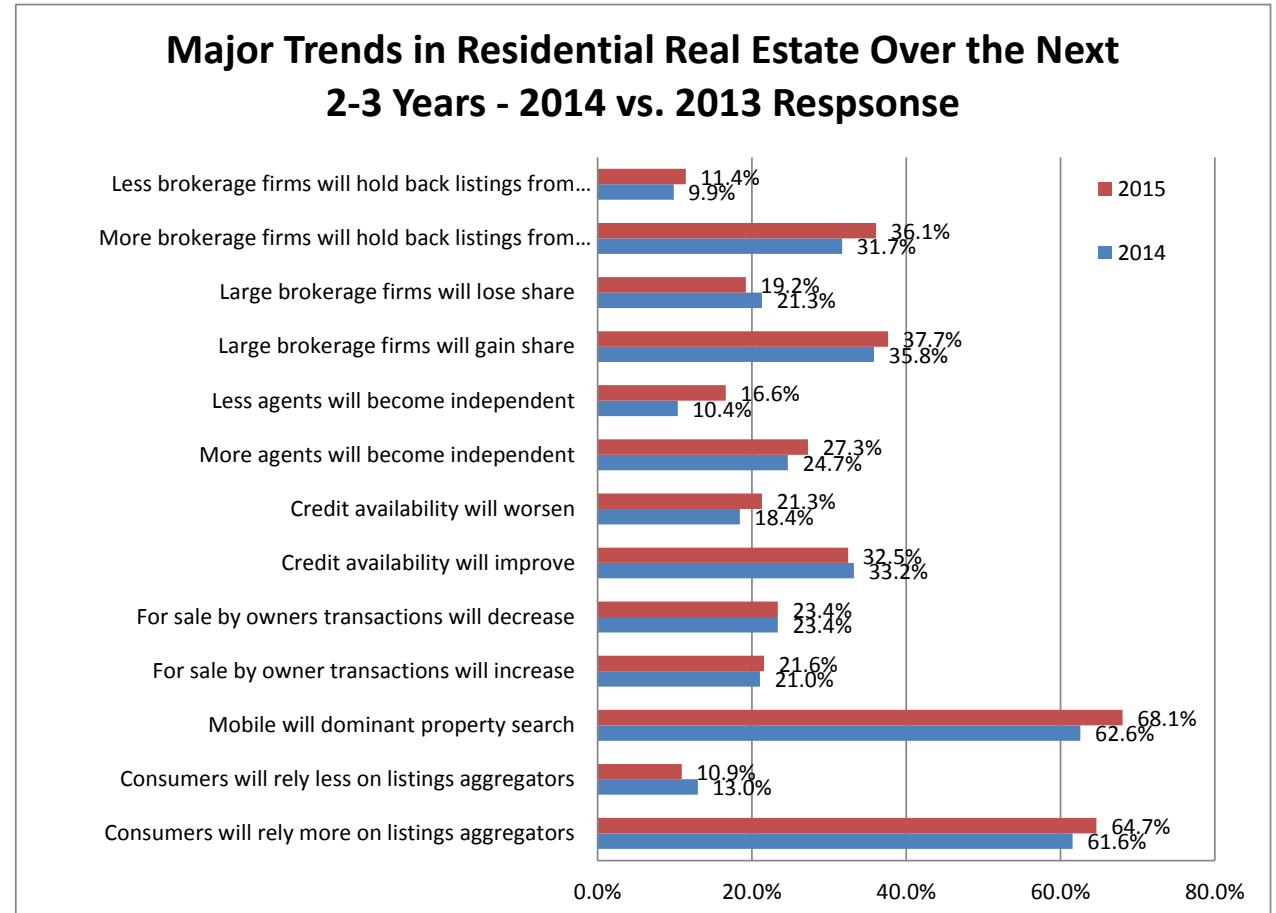
Agent Views on Key Trends in Residential Real Estate

Agents expect the following that could be negative for Zillow:

- Large brokerage firms to gain share
- More brokerage firms could hold back listings

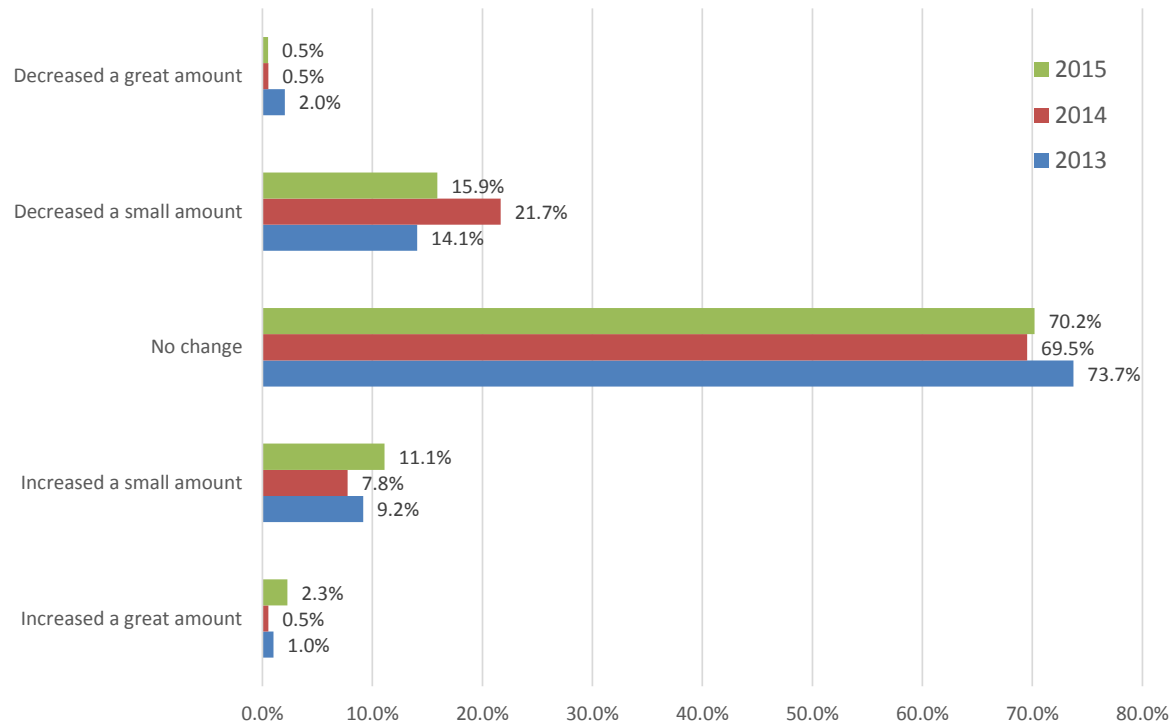
Agents expect the following that could be POSITIVE for Zillow:

- Slightly more agents could become independent
- Mobile will continue to dominant property search
- Consumers will rely more on listings aggregators

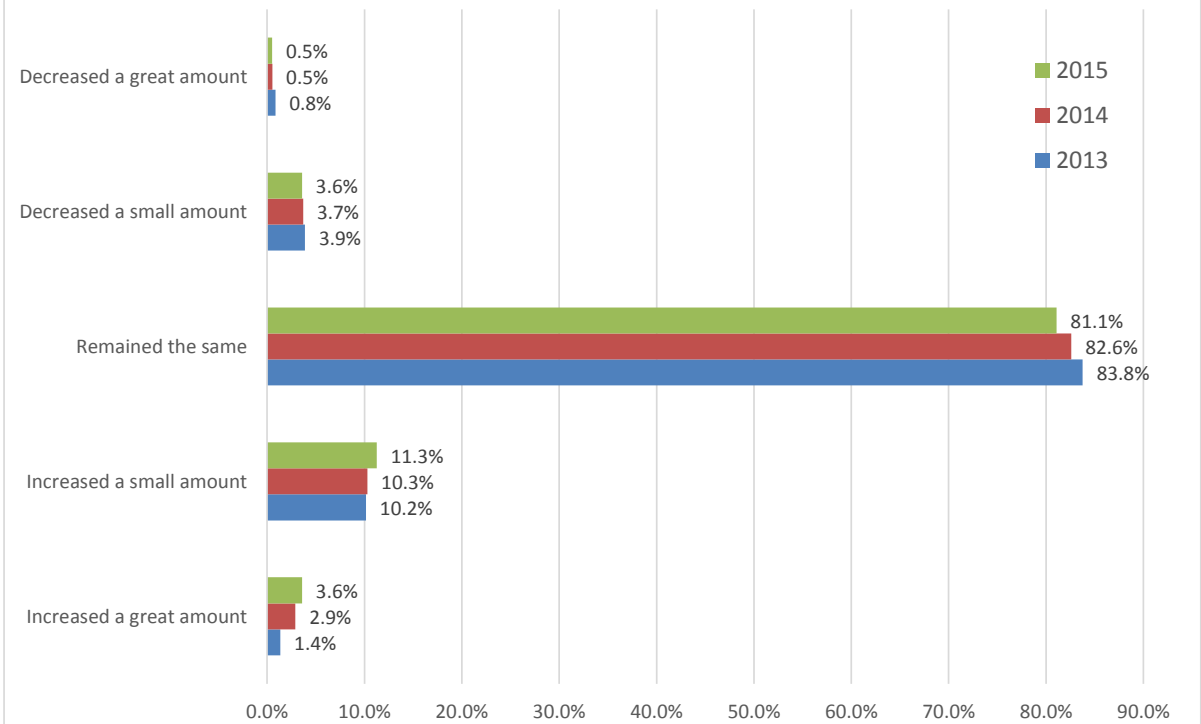


For Brokers the “Bear Case” of Pressure on Commission & Splits with Agents Has Yet to Emerge

How Have Gross Commission Rates Charged to Home Sellers Changed in the Past year?



How Has the Commission Split Changed With Your Brokerage Firm in the Past Year?



Disclaimer: The author of this report has a synthetic short position in Zillow. Positions can change at any time without notice.

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