Bauerle's Bank Notes

Both/And

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Last week's installment of this column described technology's debasement of labor economic inputs and central banks' unprecedented expansion of the money supply in response to changing labor markets and the 2008 financial crisis. Consequently, commercial banks have struggled to increase earnings consistently. Bondholders have spent five years in short-duration, low-yield purgatory. Equity markets flinch at any report that hints at wage inflation. When and to what extent wage and price inflation will resume occupies everyone's subconscious thinking about financial markets.

Barron's cover story this week features residential real estate website company Zillow, whose shares the newspaper argues are grossly overvalued. The article reflects both the truth and the limitations of the thesis that technology is forever and for always reordering our economy. The Zillow website offers users nationwide access to data on residential real estate. Consumers can research the value of a cliff-side hacienda in Malibu or a horse farm in Kentucky. Prurient types can video tour for-sale properties owned by friends or adversaries, viewing family heirlooms in the parlor, children's toys in their bedrooms, and whether kitchen counters are granite or laminate.

Zillow, the company, recently acquired its leading rival, Trulia. In June, said Barron's, Zillow logged 25 million "unique visitors" browsing from personal computers, plus an additional 28 million via handheld devices. Trulia clocked 23 million visitors total. Seventy six million sets of eyeballs in one month accounts for the company's nearly $8 billion market capitalization, up sevenfold since Zillow's 2011 IPO. What's not to like? According to Barron's,

[Compared to revenue,] earnings have been harder to come by, at least if you count expenses the way GAAP does. After breaking even in 2011 and earning 17 cents a share in 2012, Zillow lost 35 cents in 2013. Last week, Zillow reported that June quarter revenues rose 68% over the prior year period, to reach a record $79 million, but the stock slipped as investors noted a decline in the number of realtors added to Zillow's population of agent advertisers. Growth in ad revenue from mortgage lenders also slowed.

Beyond financial metrics, experience shows consumers use Zillow and similar websites for market intelligence and to preview specific properties, but continue to turn to real estate brokers to help them buy, sell and finance homes. Two reasons suggest themselves. A personal residence is most consumers' largest purchase or sale, a once or twice in a lifetime experience for most. And, as the law says, real estate is *sui generis;* no two properties are exactly alike. So whereas jilted sellers or buyers of goods are typically limited to money damages as a legal remedy, aggrieved parties in real estate transactions can legally compel their counterparty's performance to complete the property transaction.

The special nature of real estate dealings makes knowledgeable brokers indispensible, and most of us know it. Before buying our present home 28 years ago, my wife and I looked at another attractively-priced offering. I asked the broker why it was priced so favorably. "Let me show you," she answered. We drove to the turnaround circle at the street's end, where two four foot pillars stood 20 feet apart, just off the pavement at the circle's terminal point. "See those?" she asked rhetorically. "Next spring there will be a road cut through there, opening up the adjacent acreage to a 100 unit townhouse development that will be built." Suddenly, the bargain price offered by a so-called motivated seller looked more like a price premium.

The lesson for banks in the Zillow story is that customers may shop far and wide via the Internet, but they return to those whom they trust to serve and protect them. Citibank or PayPal may rule the world of consumer financial transactions via smart-phone technology, but life-event and life-altering financial transactions properly belong to institutions that treat customers as neighbors rather than as bits, bytes and code. What regional banks cannot do, however, is take customer loyalty for granted, ignore changes prompted by technology, or dismiss as unworthy those whose deposit balances are small and growing, or whose FICO scores are blemished. Quoted in <u>Barron's</u> about Zillow and other websites, a spokesman for the Coldwell Banker and Century 21 real estate brands says, "We see them as marketing partners."

Given the economic dislocation that has recently affected many Americans, the opportunity is huge to use *both* quantitative tools like FICO scores *and* subjective assessment based on human intelligence to make sensible business decisions about customer needs and abilities. *Both/and* describes the synthesis of technology-enabled financial analysis and proper application of human capital. Those who understand and apply that combination will thrive.