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RLGY - Q3 2015 Realogy Holdings Corp Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to the Realogy Holdings Corporation third quarter 2015 earnings conference call via webcast. Today's call is being recorded, and a written transcript will be made available in the investor information section of the Company's website later today. A webcast replay will also be made available on the Company's website until November 19. At this time, I'd like to turn the conference over to Realogy's Senior Vice President, Alicia Swift. Please go ahead, Alicia.

Alicia Swift - *Realogy Holdings Corporation - SVP*

Thank you, Stephanie. Good morning, and welcome to Realogy's third quarter 2015 earnings conference call. On the call with me today are Realogy's Chairman, CEO, and President, Richard Smith, and Chief Financial Officer Tony Hull. As shown on slide 3 of the presentation, the Company will be making statements about its future results and other forward-looking statements during this call. These statements are based on the current expectations and the current economic environment.

Forward-looking statements and projections are inherently subject to significant economic, competitive, and other uncertainties and contingencies, many of which are beyond the control of Management. Actual results may differ materially from those expressed or implied in the forward-looking statements. For those who listen to the rebroadcast of this presentation, we remind you that the remarks made herein are as of today, November 5, and have not been updated subsequent to the initial earnings call.

Important assumptions and other important factors that could cause actual results to differ materially from those in the forward-looking statements are specified in our earnings release issued today, as well as our annual and quarterly SEC filings. Also, certain non-GAAP financial measures will be discussed on the call and, per SEC rules, important information regarding these non-GAAP financial measures are included in our earnings press release. Now I will turn the call over to our Chairman, CEO and President, Richard Smith.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

Thank you, Alicia, and good morning everyone, and thank you for joining our call. We delivered solid third-quarter results, from both a financial and operating perspective. Revenue increased 9%, adjusted EBITDA was up 10% on a comparable basis, and adjusted earnings per share increased 15%. We also made significant progress in our de-leveraging initiatives, and our increasing guidance reflects our strong momentum as we head into the fourth quarter. Before we discuss the quarter's results in greater detail, I wanted to begin the call with a brief discussion of our margin performance and our market share data.

Let's start with margin update. Last quarter, we reported that we expected our adjusted EBITDA margins to be between 14.1% and 14.3% for full year 2015. As we reported today, we are now increasing our expected full-year margin range to 14.4% to 14.6%. This represents significant improvement over prior expectations, especially given year-over-year margin headwinds resulting from new operating costs associated with our strategic growth initiatives, and the normalization of management performance incentive accruals. Our margin improvement is attributed to our company-wide focus on maximizing the efficiency of our cost structure.

Moving to the second topic, I'd like to take a few moments to share more context regarding our market position. As we have discussed in the past, you will see some discrepancy, quarter to quarter, between our actual transaction volume results and the market share data released monthly by the National Association of Realtors, which you'll recall is the industry's trade association. At a high level, our rate of change on transaction sides and average sales price can differ from those that NAR publishes, due to the specific geographic and higher price point markets in which we operate, particularly as it relates to NRT's concentrated footprint.

As you might expect, there are always some variances due to NAR's data being based on surveys, extrapolation, and subject to an error factor. So let me spend a few moments here. Our market presence can be best observed on slide 4, which is a map of the footprint of our franchised and owned offices in the United States. As you can see, Realogy affiliates and Company-owned offices do business under one or more of our brands in all 50 states, and essentially in all 800 or so multiple listing services. One metric we use to assess our performance is market penetration. It is relevant to our multi-brand strategy, and measures how often one of Realogy's brands is on either side of the closing table.

On that basis, Realogy was involved, either through our franchised operations or our company-owned brokerages, in approximately 26% to 27% of US existing home sales volumes over the past few years. If you turn to slide 5, you can see that our NRT business was concentrated on the coasts, and in the higher-priced major metropolitan markets across the country. This is the key differentiating factor for us. NRT is geographically concentrated in about 50 of the nation's 100 largest metropolitan statistical areas, and has an average sales price of about $490,000, which is approximately double the national average.

Put another way, NRT operates in about 10% of the total 800 MLS's representing the most attractive housing markets in the country. Even in those limited geographies, NRT's offices are located in the highest priced areas within each MLS, with an average sales price that is about 30% greater than the average sales price in those MLS's. Operating in these areas offers NRT the opportunity to generate the most robust revenues on each and every transaction, particularly when you factor in ancillary revenue opportunities on its buy-side transactions.

As a result of its intentional concentration in the most attractive portions of the markets it serves, NRT's transaction volume trends vary from broad national trends, and also differ from results within the MLS's in which its offices are located. Neither NAR data nor regional reports accurately capture this disparity. So far this year, the lower-priced market geographies of the MLS's in which NRT operates have outperformed the higher-priced areas, largely due to less inventory pressure in that segment, and the strength of the high end in those markets last year. These factors are reflected in NRT's transaction volume, and we expect those comparables will improve over the next several quarters.

Now, let's spend some time on our two largest business units. RFG, our real estate brokerage franchisor, is a highly effective business model that relies on a shared services platform, which maximizes the synergies of our non-customer facing essential services. The result is a very attractive EBITDA margin. Through the first nine months of 2015, RFG -- again, our franchise operations -- achieved a 66% EBITDA margin. During the third quarter, RFG completed new franchise sales and sales production of $79 million in gross commission income, which we often refer to as GCI, and is on schedule to exceed its goal of $300 million in GCI for the year.

This represents approximately $5 million to $8 million of incremental new revenue on a run-rate basis. Our franchise operations are always focused on keeping our brands fresh and relevant. And in that regard, the ZipRealty technology rollout, which further enhances the value proposition of our brands, is going exceedingly well. To date, we have deployed the ZAP technology platform to approximately 280 franchisees, and about 700 more are in queue for the technology installation.

We are on target to have 300 franchisees or more on the platform by year-end, and we are the first franchisor in our industry to make available to its franchisees a turn key integrated technology platform as a feature of the franchise. And the CRM technology alone is expected to make our franchisees and our sales associates more efficient, and ultimately more productive. Just to put that in perspective, if half of our franchise affiliates -- approximately 135,000 US base sales associates -- eventually produce just one more transaction as a result of this proprietary technology platform, the incremental EBITDA to us would be approximately $20 million.

Now, turning to NRT, which you will recall are our company-owned operations, we own and operate approximately 790 of the 6,000 US affiliated offices. As a franchisee, NRT pays a full 6% royalty to the franchise group, and has contributed $218 million to RFG's EBITDA through the first three quarters of this year. We will continue to grow NRT's footprint through accretive acquisitions, just as we did with the addition of the Coldwell Banker United acquisition, and approximately 30 smaller-in-scale tuck-in transactions, which have been completed over the past two years.

The CB United opportunity, in particular, added owned operations to the demographically attractive Sun Belt region of the country, and permits us to capitalize on regional tuck-in acquisitions and ancillary service revenues that were not otherwise available to us when the Company was independently owned by a franchisee. Overall, our market penetration is second to none in the residential real estate services business. These market penetration levels in the presence of our multi-brand offerings across most major markets makes it possible for Realogy to capture a greater share of home seller and buyer transactions.

Our goal, of course, is to be one of their choices. Our presence in most markets, with multiple brand choices for each home buyer or seller, makes it possible to capture more business, be it through a franchisee or one of our company-owned operations. With a US sales force of 180,000 independent sales associates among both our franchised and company-owned operations, and the ongoing industry-leading support and value they receive, we expect to continue to solidify our position as a preeminent industry leader.

More importantly, our model is designed to generate a significant amount of free cash flow. We generated $517 million of free cash flow over the past 12 months, and we expect continued growth in that regard. Turning to slide 6, TRG, our title and settlement services segment, has also grown through attractive acquisitions. The latest being the acquisition of Independence Title, which opened new markets for us in Dallas and San Antonio, and strengthens our existing markets in Austin and Houston. We are very pleased with the operating and financial performance of that acquisition, which strategically complements the recent NRT transactions in the same markets.

Cartus, our employee relocation company, is a leading provider of services to multi-national companies based in the US and abroad. Cartus rounds out an essential value we provide to our franchisees and our company-owned operations. Relocation leads are highly valued by the brokerage industry. If you are moving, as an example, at the request of your employer, from Atlanta to Boston, you are in all likelihood selling a house in Atlanta and buying one in Boston. As an example, there are potentially four transaction sides to a move at the request of an employer, in addition to title and mortgage offerings.

The Cartus model makes it possible to market our products and services in some or all of those transactions. Cartus not only manages moves on behalf of its corporate clients; it also provides similar services to major affinity clients, such as USAA and Navy Federal Credit Union. In the third quarter, Cartus signed 19 new corporate clients, and has a strong pipeline of new client opportunities. Year to date through the third quarter, Cartus is responsible for 7% of our revenue, and 13% of our EBITDA. Now as to the balance of 2015, housing continues to be a bright spot in the US economy.

Demand continues to be stronger than supply, as inventory levels continue to be very low, still well below the historical run rate of six months of supply. The average days on market continues to be brief, averaging 47 days. Again, making the point that demand is strong. And we believe speaks to the underlying strength of the housing recovery. We remain encouraged by the first-time buyer segment, which according to NAR surveys represented about 30% of all existing home sale transactions, on average, for the third quarter of 2015, and we believe has continued room to expand.

As the CFPB's new mortgage disclosure rules under RESPA-TILA went into effect on October 3, and thus far, we have not seen an impact on our business. Mortgage underwriting, although still difficult by historical standards, continues to show improvement. Mortgage rates are still extraordinarily attractive, and all indications are they will remain attractive at least for the near-term. Additionally, mortgage credit availability continues to improve, although slowly. And as we mentioned, inventory continues to be tight, but home builders are increasing their production.

Home prices are trending upwards, and more highly levered homes are beginning to achieve more meaningful equity. Therefore, we believe the building blocks are in place for higher inventory levels over the next 12 to 24 months. Historically low mortgage rates, the slow movement to more rational underwriting standards, job growth, a resurgence in household formation, and the steady rise in apartment and single-family rents will set the stage for solid year-over-year growth in existing home sales for a number of years, achieving the 7% CAGR the industry has enjoyed for decades.

We continue to stay the course on our strategic growth initiatives, specifically acquisitions, and we are enhancing our platforms and opportunities with the ZAP technology rollout, while remaining focused on driving efficiencies throughout our business, and simultaneously de-levering the balance sheet, which Tony will discuss in his comments. And lastly, as our cash flow continues to build, we are making progress toward our goal of being at 3 times net debt to adjusted EBITDA leverage. Tony?

Tony Hull - *Realogy Holdings Corporation - CFO*

Thank you, Richard. Before getting into a more detailed discussion on the quarter, I'd like to highlight several key areas of Realogy's Q3 performance on slide 7. Revenue increased 9%, driven by transaction volume gains of 8%. Adjusted EBITDA was $308 million, which represents an increase of 10% year over year, on an apples-to-apples basis. As a reminder, third quarter of 2014 adjusted EBITDA included an $8 million positive impact due to the reduced 2014 incentive performance accruals.

Adjusted basis earnings per share was $0.76, compared to $0.66 per share in the prior-year quarter. On the same basis, an increase of 15%. We generated $249 million of free cash flow, a $15 million increase from Q3 2014, which equates to $1.70 per share in the third quarter. Year-to-date cash flow increased 59%, to $400 million, compared to the first nine months of 2014. And the result of our strong adjusted EBITDA and cash flow, we achieved a 4 times leverage ratio one quarter earlier than anticipated.

We completed a financing of $1.25 billion in October. That increased our revolver capacity to $815 million, and raised $435 million under a new term loan A facility. In connection with the financing, we called both the $593 million of 7 5/8% debt, and subsequently the $196 million of 9% debt. Along with our plan to retire $500 million of senior notes due May of 2016, this will reduce run rate interest expense in 2016 to approximately $170 million, down from the current annualized rate of $210 million.

For the full year 2015, we have raised our adjusted EBITDA guidance to a range of $830 million to $845 million, an increase of $20 million on the low end and $5 million on the high end. We also raised our adjusted EBITDA margin range to 14.4% to 14.6%, due to our continued focus on -- and continual focus on the efficiency of our cost structure. Now let's discuss key revenue drivers for the third quarter, which you will see on slide 8.

RFG homesale sides increased 4%, year over year, in Q3 2015, and average home sale price increased 5%. NRT homesale sides increased 12% year over year, compared to the third quarter of 2014, and its average homesale price decreased 4%. As we discussed last quarter, the acquisition of Coldwell Banker United was expected to have certain impacts on the comparability of NRT and RFG to the prior year, as shown on slide 9. You will recall that in April 2015, we purchased the seventh largest broker in the United States by transaction sides, a preeminent Coldwell Banker franchisee, which resulted in a shift of sides from RFG to NRT.

This had a 2 percentage point impact on RFG sides, meaning without this adjustment, the increase in RFG sides would have been 6% instead of 4%. The shift in sides also modestly increased RFG's average sales price. Without the impact of the acquisition, RFG's volume gain of 11% would have been comparable to NAR's reported third-quarter metrics. In the middle portion of the slide, you can see that NRT's transaction sides increased 12%, and average sales price decreased 4%, which, when you multiply it out, equates to a 7% volume increase.

Excluding the impact of the Coldwell Banker acquisition, NRT's transaction volume increase was 4%. This was impacted by inventory constraints and difficult comparisons at the high end of the market, particularly in New York City and San Francisco. These markets represented 20% of NRT's volume in the quarter. We believe the NRT same-store comparisons will trend more favorably next year, as we move through the housing cycle. A couple of comments on drivers. Net effective rated RFG was down a couple of basis points in the quarter, but this was timing-related, and we still expect the net effective rate to be flat for the year, at 2014 levels of 4.49%.

Commission splits for the year are also expected to remain flat, at approximately 68%. Moving to TRG drivers on slide 10, you can see that purchase units were up 27%, of which 5 percentage points came from NRT's organic size growth, and the remainder, the acquisition of Independence Title. Refi volume was up 53%, of which 25% was from organic gains and the remainder from the acquisition. Now let's look at revenue and EBITDA, at the business unit level for the third quarter of 2015, compared to the same period in 2014, and that's shown on slide 11.

RFG revenue increased 8%, driven by domestic franchise volume increases, as well as $5 million in higher royalties it received from NRT, mostly from its acquisitions. RFG's EBITDA increase of $16 million was driven by revenue increases, and a $3 million decrease in expenses related to certain -- the timing of certain franchisee conferences. And that was partially offset by a $2 million increase in employee-related costs, which include higher incentive accruals and staffing costs related to ZipRealty. NRT revenue increased $92 million versus Q3 of 2014, due to NRT transaction volume increases of 7% in the period.

NRT's EBITDA increased 3%, or $3 million, due to income from its newly acquired entities. To break that down a bit further, of the total revenue increase, $64 million, or 70%, was from companies acquired during and after the third quarter of 2014, and $28 million was from organic growth. The acquired companies generated $7 million of EBITDA, of which $4 million is reflected at RFG as royalties, and $3 million remained at NRT, which is at the typical 5% industry margin level. Due to strong performance at the high end last year, organic transaction volume growth of NRT was somewhat muted.

Although this growth was more than sufficient to offset commissions, royalties and inflationary cost increases on its operating base of approximately $950 million, it was not enough to offset incremental performance accruals. Cartus EBITDA was flat, due to a decrease in revenues, offset by positive impacts of foreign exchange rates on expenses. Finally, TRG EBITDA increased $5 million, due to higher purchase and refinance volume, as well as the inclusion of the results of its acquisition of Independence Title at the beginning of the quarter. Corporate expense improved $12 million year over year, primarily due to a $12 million decrease in a former parent legacy tax liability in the period.

Excluding that, corporate expense was flat compared with the prior year. Slide 12 shows a pro forma cap table at September 30, reflecting the recently completed de-leveraging transaction. Overall, we are using approximately $860 million to redeem $789 million of debt. Make the January 2016 interest payment on that debt a little bit early, along with premium payments and deal-related fees. The source of funds is approximately $210 million of cash, bringing that balance to $357 million, from $567 million before the transaction, plus $435 million of term loan A borrowing, and $215 million of revolver borrowings.

As a result of these pro-active steps, our cash interest expense will decrease to approximately $170 million in 2016. Our net corporate debt at September 30, 2015, on a pro forma basis for the transaction, was $3.4 billion. From a cash flow perspective, with the early call of our high-cost notes, we are paying approximately $25 million of cash interest accrued on those notes through the redemption date, and $40 million of payments, which consists of interest and call premiums that would have otherwise been made -- paid next January.

Our cash flow items are -- other cash flow items are CapEx, which we continue to forecast at $85 million for the year, and cash taxes at $15 million to $20 million. Looking at our expectations for the fourth quarter of 2015 on slide 13, we forecast that Realogy's combined home sale transaction volume will increase in the range of 7% to 10%, with 4 to 6% coming from homesale sides growth, and 3 to 4% from average sales price growth. On slide 14, for the full year 2015, total home sale volume is expected to increase 8% to 9%.

As we discussed earlier, we raised our guidance range on adjusted EBITDA and adjusted EBITDA margin for the year, which reflects our strong year-to-date performance and effective cost containment efforts. For next year, on slide 15, forecasters we follow are projecting increases in existing home sale transaction volume ranging from 6% at Freddie Mac to 8% at NAR. Unit increases are expected to be 1% to 5%, while median price expectations range from 2% to 4%. On a total volume basis, these forecasts represent a fairly narrow range, so there's alignment as to the outlook for 2016.

With the completion of the refinancing on anticipated transaction volume in 2016, we will apply near-term cash balances, and draw on our revolver, to retire the $500 million of debt due in May. As cash flow builds, we're making progress towards our goal of 3 times net debt to adjusted EBITDA leverage, which will put us in a position to return capital to shareholders. Stepping back and looking at the big picture, the industry experienced some outsized volume gains in 2012 and 2013, recovering from a six-year housing recession.

In 2014, we believe a rapid rise in mortgage rates, among other factors, stalled purchase activity. And thus far, 2015 represents the beginning of a sustainable and steady housing recovery. Given that most of the relevant economic and demographic factors that impact housing are moving in the right direction, we expect we'll benefit from those trends. On top of that, we've made progress on costs throughout the year, as our margin outlook has improved.

Longer term, we are very focused on the efficiency of our cost structure, while continuing to provide the best brands, products and services to our franchisees, sales associates and corporate clients. Finally, our favorable business model and ongoing solid execution will continue to generate growing free cash flow, allowing for further deleveraging, and driving value for our shareholders. With that, I'll turn it over to the operator, who will open the call for Q&A.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Please limit your questions to one question and one follow-up, to allow other participants time for questions. Your first question comes from the line of Jason Deleeuw with Piper Jaffray. Your line is open.

Jason Deleeuw - *Piper Jaffray & Company - Analyst*

Yes. Thanks, and good morning. A question on the margins, with the guidance stepping up, and it sounds like the cost containment efforts are helping there. Is that -- are those cost containment efforts -- are those new? Or is this just what you guys have always been doing, on the cost front?

Tony Hull - *Realogy Holdings Corporation - CFO*

They're basically what we've always been doing on the cost front, which is just making sure our expenses are in line with what's happening on the volume side of the business.

Jason Deleeuw - *Piper Jaffray & Company - Analyst*

Got it. And when we think ahead about the operating leverage in the Realogy model, when we look into next year, can we expect the normal operating leverage framework to take hold next year, if we get some volume and revenue growth? I guess I'm trying to get at, are there going to be any unexpected surprises that we should be aware of? Or can we just think about the normal operating leverage in the business?

Tony Hull - *Realogy Holdings Corporation - CFO*

On the expense side, we don't foresee any unexpected surprises at this point. We're -- so I think you can expect to see, on that basis, the normal operating leverage factor in. And also, we'll be lapping, assuming no other CB United-sized acquisitions, we will be lapping those new expenses coming into the equation this year. And so that will help incremental margins, as well.

Jason Deleeuw - *Piper Jaffray & Company - Analyst*

All right. Thank you very much.

Operator

Your next question comes from the line of John Campbell with Stephens. Your line is open.

John Campbell - *Stephens Inc. - Analyst*

Hey, guys. Good morning. Congrats on a great quarter. Richard, just curious, on your high-level market thoughts over the next years. A few weeks back, the MBA put out its multi-year origination forecast. If we strip out that home price appreciation, I think it implies purchase units or volumes picking up, high single digits in 2016 and 2017. Just directionally, do you agree with this?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

I think directionally, the trend is up. What's interesting about the market now is that we've also grown accustomed to the thought that this is a normal recovery. It's not. The macro economics still are difficult, as we all know. So it's amazing to us that housing is recovering as nicely as it is. We anticipate that will continue, with this stronger economy. So we're -- as you know, we're very bullish on the outward trends.

John Campbell - *Stephens Inc. - Analyst*

Got it. And then just back to Jason's question around the operating leverage. Tony, could you just remind us, or just refresh us, on your thoughts around the ZIP-related expense next year, just relative to this year? And then maybe more specifically, is there a way to think about the average Zap rollout cost per location, or per franchise?

Tony Hull - *Realogy Holdings Corporation - CFO*

The -- we don't expect, currently, that the ZIP-related expenses will change in any significant way between 2015 and 2016. And the cost to rolling out is de minimis, because it's really -- it's software as a service. So it's really just -- the more important thing is getting training, and getting the agents and the broker to use the ZAP platform. So obviously, we're going to commit resources to doing that. But that's really within our existing cost structure. I don't see that improving -- or increasing, excuse me.

John Campbell - *Stephens Inc. - Analyst*

Okay. That's helpful. Thanks, guys.

Tony Hull - *Realogy Holdings Corporation - CFO*

Yes.

Operator

Your next question comes from the line of Tony Paolone with JPMorgan. Your line is open.

Tony Paolone - *JPMorgan - Analyst*

Thanks. Good morning. Just on the margin issue, I think in your press release, you talked about, EBITDA would have been up 10%, if you made some adjustments. And so if I back into the -- if I did that 10% up, and look at that incremental margin, it seems like something to the tune of 21%. Is that a number that seems right, as we look forward, in terms of how the incremental margin should look, on a normalized basis? Or anything to take away from that?

Tony Hull - *Realogy Holdings Corporation - CFO*

Again, I think the acquisition -- the $8 million was really related to the normalization of the compensation incentive accruals. So I think we're absorbing -- we're still absorbing ZIP costs this year, so we have that headwind on top of that. And we're still -- we have some relatively -- it's not huge, but we have some incremental acquisition operating expenses, coming into NRT, that weren't there last year. So I think that would be on the conservative side, for incremental margin.

Tony Paolone - *JPMorgan - Analyst*

The 21% would be on the conservative side, looking into next year?

Tony Hull - *Realogy Holdings Corporation - CFO*

Yes.

Tony Paolone - *JPMorgan - Analyst*

Okay. And then on NRT, I guess a two-part question. You had mentioned in your commentary that the idea that the trends should improve next year. And so I was wondering if you can just give us a little more color as to why you feel that way? It seems like some of your bigger major markets in NRT are further along in their recovery, so I found that interesting. And then also, the competitive landscape in some of those markets, again, given their higher profile, further along. You hear about some big competitors or startups, particularly in New York, that seem to be gaining steam, and just how that landscape looks.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

Tony, this is Richard. We think the -- if you look at the year-over-year comparisons for the high end of the markets in which NRT operates, the comps are tough. But we expect, and we are seeing, indications that is going to change. So we are expecting improving high-end markets in which -- the markets in which NRT operates. We think there was a pause, and we think that becomes a bit more robust next year. As to the competition, it really hasn't materially changed.

We have got rational competitors, irrational competitors. And some that will make it, and some will not. Every market is pressured by some form of competition, which we've always matched or exceeded the expectations in all of the markets in which we operate, in spite of whatever the competitive issues may be. So we don't see anybody who represents any significant threat, in one way or the other. So it's pretty normal.

Tony Hull - *Realogy Holdings Corporation - CFO*

The other thing on -- just on New York City, in particular, is the new development pipeline is very robust. And our participation in that is very robust. So just over the next several years, you're going to see about 10,000 units come in the market in Manhattan, really. And that's going to help -- that's going to be very helpful for the inventory situation, because presumably, there's going to be someone selling an apartment to buy one of the new developments. Maybe someone will be out of town, or foreign buyers, or whatever. But with that many units coming on, you're going to see some inventory open up, for us to hopefully be able to sell.

So -- and again, this is a housing cycle. It's not permanent. So that's why we -- that's really why we feel -- you pointed out, very rightly, in your question, a lot of -- many of NRT's markets are a little advanced on the cycle, versus the overall market, which is why we're seeing a -- the 4% type of organic growth for this quarter. But it is a cycle. So we expect, as we go through that cycle, that part of the market will regain steam, as Richard mentioned.

Tony Paolone - *JPMorgan - Analyst*

Okay. Thank you. Nice quarter.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

Thank you very much.

Operator

Your next question comes from the line of Stephen Kim with Barclays. Your line is open.

Stephen Kim - *Barclays Capital - Analyst*

Yes. Thanks very much, guys. I guess, first of all, I would -- I want to ask a question regarding what we're hearing from the builders about delays. Specifically, I've been talking about construction-related delays, tied mostly to labor availability and things like that. And I was curious if, in the markets where that has emerged most significantly, let's say, in markets like Dallas, for example, and Colorado.

Whether or not you've seen any benefit, either in terms of less availability on the new home side, leading folks who may have been considering both a new or existing purchase to move to existing? Or perhaps an increase in third-party agent commissions, on the part of the builders trying to entice more traffic to their doors, and that kind of thing? Have you seen anything along those lines?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

Sure. The builders I know, most of the public companies, will tell you their delays are attributed to labor shortages, everything from truck drivers to electricians and plumbers. So the demand is still there. So the very strong demand, and you've seen that in their numbers. But it's difficult to find the labor to fulfill those contracts. So that's a strong indication of the rate of recovery in housing, and it varies by market. But across the board, you hear the same theme.

That's -- we view that as a positive. We've seen no material impact on existing home sales. New home sales are typically higher in price. So the existing home market is always a very attractive alternative to waiting 9 months or 12 months for a new construction. So listen, it accrues to our benefit, generally speaking, but it's not having any apparent, immediate impact in any particular market. But again, it's another strong sign of a housing recovery.

Stephen Kim - *Barclays Capital - Analyst*

Okay. Great. And so obviously, I guess that's something we can watch, going forward, to see if it intensifies. I guess my second question, related to capital allocation. You've laid out -- obviously, you've laid out some steps you've been taking, you're going to take next year. Your debt-to-EBITDA continues to come down.

I think in the past, you indicated that when you got to about the level you're at now, that you would begin to talk a little bit more, perhaps, specifically about priorities for capital allocation. I was curious if you were willing to do that? Or if you maybe had another sort of bogey, a threshold, at which point we could expect to hear you talk a little more specifically than what you've said so far in your prepared remarks?

Tony Hull - *Realogy Holdings Corporation - CFO*

We've never said that. We've said when we get to 3 times leverage, we will start discussing that. And that's -- this is something the Board is looking at carefully and thoughtfully now, but we're not ready to go public with it. We are obviously focused on optimizing capital allocation, to enhance value to our shareholders. And as you know, as we said before, our goal is to get to 3 times net debt to adjusted EBITDA.

Stephen Kim - *Barclays Capital - Analyst*

Got it. Okay. Thanks very much, guys.

Tony Hull - *Realogy Holdings Corporation - CFO*

You're welcome, Steve.

Operator

Your next question comes from the line of Ryan McKeveny with Zelman & Associates. Your line is open.

Ryan McKeveny - *Zelman & Associates - Analyst*

Hi. Thank you. And nice quarter.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

Thank you.

Ryan McKeveny - *Zelman & Associates - Analyst*

It's great to see the margin raise. As we look into 2016 and beyond, when we think about just RFG and NRT separately, it seems the majority of the improvement has been on the RFG side. When you think about those segments separately, I guess, just if you could frame how you think about

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the long-term opportunity for leverage within those segments? Can both see growth? Or will the majority be on RFG, just given the cost structures and the differences there?

Tony Hull - *Realogy Holdings Corporation - CFO*

I think on -- clearly, the incremental margin, that RFG is much different, is in the 80% range, and it's in the high teens for NRT. And part of that 80% at RFG is because they're getting a 6% royalty off the top from whatever is growing at NRT. So we would expect it to benefit both.

Ryan McKeveny - *Zelman & Associates - Analyst*

Got it. And if we -- if we focus a little more on the high end -- appreciate the commentary there. But from a demand perspective, just aligning things with some recent feedback we've heard from the market, it seems there's been maybe a bit of a slowdown, in a relative basis, from foreign buyers, some of the higher end markets.

Obviously, some of this could be typical, as the end of the year is a slower time. But maybe if we just focus on the quarter, and what you're currently seeing, are there specific markets where you're seeing more or less acceleration, more or less deceleration? Or just stable growth, across those key markets within NRT?

Tony Hull - *Realogy Holdings Corporation - CFO*

Sure. Just if you break down NRT's regions, the strongest regions in the quarter were the northeast, really New England, I'd say, more specifically, New Jersey. Southern California had a good quarter. The Midwest was strong. So those were kind of our -- I think our strongest regions. And these regions I'm talking about represent like 75% of their revenue, so -- or their transaction volume.

I think Florida and Nor Cal are at par. Florida started their recovery like two or three years before the rest of the country, so they're going through their housing cycle. So we're in a -- I'd say a modest, low-single-digit growth mode. But we only -- there's only one -- in our view, there's only -- it's going through the housing cycle. So there's room for improvement there.

And then really, it's the high end -- it's Corcoran and the Sotheby's operations, which are flattish. But that's really a lot of inventory constraints at the high end. And so it's just going through the cycle. And I think inventory is going to come on in those markets, so that will correct itself over time.

Ryan McKeveny - *Zelman & Associates - Analyst*

Got it. And that flattish, is that transaction volume, or on a [sides] basis --

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Tony Hull - *Realogy Holdings Corporation - CFO*

Yes.

Ryan McKeveny - *Zelman & Associates - Analyst*

What we're thinking about New York City and Corcoran?

Tony Hull - *Realogy Holdings Corporation - CFO*

Volume.

Ryan McKeveny - *Zelman & Associates - Analyst*

Okay. Thank you.

Tony Hull - *Realogy Holdings Corporation - CFO*

You're welcome.

Operator

Your next question comes from the line of Brandon Dobell with William Blair. Your line is open.

Brandon Dobell - *William Blair & Company - Analyst*

Thanks. I'm not sure if this is for Richard or Tony. But hypothetically, if there was a pretty severe consolidation in the MLS organization, so 800 down to 100 or 50 or 30, what do you guys think about the impact? Or just what that would mean for how you guys would run your business, or the strategy you would take to expand share?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

That causes -- that's a call for speculation, Brandon. I think there is virtually no chance of that happening. And I would be cautious not to speculate on something that I think is most unlikely. So listen, the good news is that inventory broadly dispersed. Inventory is -- and the disbursement of inventory, through a variety of different forms of technology, has made for a much better consumer experience.

We think that improves day by day. I expect, in the years to come, it will be far superior to anything we're seeing today. I think the technology is better. The method of distribution is better. The transparency to consumer is better. So I think, long term, technology is having a much bigger and more favorable impact on this industry, and I expect the MLS's to participate in a similar fashion.

So I think we're in a good position, as an industry, to continue delivering value to the customer, through new forms of technology. So I'm not worried about matters that are cause for such severe speculation.

Brandon Dobell - *William Blair & Company - Analyst*

Okay. And then with the ZAP platform, it sounds like, what, you've got 280 of the franchisees that are up and running or installed. A couple of points of color there. How has the uptake been, in terms of those franchisees taking advantage of the resources that you want to deploy against training and usage, and things like that?

Have you seen them take the platform, and then add on a lot of different, or their own, maybe, technology additions? I don't know, small parts that maybe the platform doesn't offer, or things they were using before that they still want to use? I guess I'm just trying to get a feel for how usage looks, relative to your expectations, both from a training perspective, but also from additional technology or productivity perspective?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

Right. So remember, this is an integrative platform that is, by design, intended to displace whatever they're using now that doesn't speak to one another. It's really a disparate, very dysfunctional old form of technology. And we're displacing that with the Zip platform. So we're in beta now. The 280 installations are beta. They're -- we expect more than 300 to be installed by year end. We're fair -- actually, we're exceedingly comfortable with how well that is going.

The training is going well. The use is going well. The beta feedback, from both agents and brokers, is exceeding our expectations. We think it's going to be a tremendous value proposition for our franchisees. It's going to lower the costs, make them more productive. Make it easier for franchisees to recruit and retain agents. It's doing all of the things that we expected it.

And as a platform, it sets the stage for the distribution of new forms of technology that would have been impossible prior to ZipRealty -- just think about this. Every franchisee, prospectively, would be on the same platform. So our ability to deliver new forms of technology through this, what we call the ZAP store, will be a tremendous opportunity for us to make sure that the franchisees are delivering the best possible form of technology for the consumer/ And we can literally do it by pushing a button. So we're intrigued, we're encouraged.

Over time, franchisees, to your point, will be in a position to add on, if they would like. Because this is just the beginning of what we think is a very important change in how this industry deals with the consumer. So we're very encouraged. It's been a great exercise for us, and it's a great investment.

Brandon Dobell - *William Blair & Company - Analyst*

Okay. Thanks.

Operator

Your next question comes from the line of Brad Burke with Goldman Sachs. Your line is open.

Brad Burke - *Goldman Sachs - Analyst*

Hey, good morning, guys. Tony, a question on the balance sheet, since you are taking out high-cost debt, in part with floating rate. Just wanted to know what your forward estimates are for the interest rate savings, in terms of what you're presuming for short-term interest rates? And then once you take care of all of this transaction activity, how you're thinking about the composition of your balance sheet, between fixed and floating rate debt?

Tony Hull - *Realogy Holdings Corporation - CFO*

We -- to get to -- for the $170 million estimate, we had LIBOR going up, I think, to about 1 point by next -- by the end of 2016. So it starts at 50 basis points, and goes up about 1 point by year end. So that was what we used in the savings. Fixed floating, our target is to be 70% fixed and 30% floating. We're below that now. So we'll be looking at that in the future, the near future, to get it back to target.

Brad Burke - *Goldman Sachs - Analyst*

So increasing the floating rate exposure?

Tony Hull - *Realogy Holdings Corporation - CFO*

No. Decreasing it.

Brad Burke - *Goldman Sachs - Analyst*

Got it.

Tony Hull - *Realogy Holdings Corporation - CFO*

Going closer to 70%, 30% [fixed] (multiple speakers).

Brad Burke - *Goldman Sachs - Analyst*

Got it. And then, Richard, I appreciate the opening comments on market share, looking at the 8% transaction volume in the third quarter. If -- can you give us some sense, if we were to normalize for the acquisition CB United, your tuck-ins, any change in the number of franchisees? How that would look, versus the 8%? I imagine it's lower, but just trying to get a sense of the magnitude.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

The magnitude of the acquisition?

Brad Burke - *Goldman Sachs - Analyst*

If we were do a, call it a same-store. So not just CB United, but CB United tuck-ins, changes and new franchisees, and some franchisees may be leaving. What that would look like, versus the 8% that you reported in the quarter?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

I'm not sure how. I'd have to go back and do the math in the quarter. But as you know, we grow our market share every year, through the franchise side of our business, through incremental franchise sales. That's been running about $300 million in GCI, on an annual basis. We've done about 30 tuck-in acquisitions over the past two years. The vast majority of those were independent.

That will be continue to be the case. Listen, through franchise sales and NRT growth, we can add a couple points or more, on an annual basis, in terms of volume. And that generally will flow through to market share. Currently, in that 26% to 27% of volume penetration, that should be very stable to growing. We don't see any downward pressure on that. So through the two vehicles I just mentioned, we should grow a couple points, on an annual basis.

Tony Hull - *Realogy Holdings Corporation - CFO*

Brad, just -- CB United was a wash. We just moved it from RFG to NRT. So that had no impact.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

None.

Brad Burke - *Goldman Sachs - Analyst*

Okay.

Tony Hull - *Realogy Holdings Corporation - CFO*

And as you saw, RFG, with adjusting that, if we hadn't moved it, was right in line with NAR. So I --

Brad Burke - *Goldman Sachs - Analyst*

Okay. No, that's a good point. I appreciate it.

Operator

Your next question comes from the line of Rob Rutschow with CLSA. Your line is open.

Rob Rutschow - *CLSA - Analyst*

Hi, good mornings. Thanks for taking my questions. Just looking for a little more color on how you get to that 70% fixed rate. Would you anticipate, perhaps, floating some fixed rate? Or is that largely a function of debt pay-downs? And then in terms of getting to that 3 times leverage, how much of that target is going to be achieved by growth? And how much by debt pay-downs?

Tony Hull - *Realogy Holdings Corporation - CFO*

We'll get to the 70/30 by putting swaps into the capital structure. We already have $1 billion in swaps. We'll probably do another $300 million or $400 million of swaps, to do that. That will get us to that ratio. And then I think getting 3 times is going to be a combination of assuming the market is cooperative, getting EBITDA growth and paying down, continuing to de-lever.

Rob Rutschow - *CLSA - Analyst*

Okay. And one last question, on the commission splits. I think you talked about needing to see $6 million in volume, to see some downward pressure on that. Is that still the expectation? And what are you seeing, in terms of new brokers entering the market?

Tony Hull - *Realogy Holdings Corporation - CFO*

On commission rates or on splits?

Rob Rutschow - *CLSA - Analyst*

On splits, yes.

Tony Hull - *Realogy Holdings Corporation - CFO*

On commission rates -- on splits, the pressure is daily. A daily event that NRT does a phenomenal job managing, with over 40,000 agents across the country. So there -- that, plus their new initiatives on lead gen[eration] transactions, is keeping them flat at 68%.

Rob Rutschow - *CLSA - Analyst*

Okay. Thanks.

Operator

Your next question comes from the line of Mike Dahl with Credit Suisse. Your line is open.

Mike Dahl - *Credit Suisse - Analyst*

Hi. Thanks for taking my questions. Richard, I know you mentioned that [TRG] hasn't had an impact on the transaction side yet. But it seems like there's some heightened rhetoric, or at least fears in the industry, that CFBB is going to crack down on some of the mortgage -- or, sorry, marketing services and things like captive title businesses. Just wondering if you're hearing anything new on that? Or if you have any updated thoughts on how that might impact TRG, or your PHH joint venture?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

Sure, so we've heard the same rumors. They don't impact us. Everything we do is -- conforms to the regulations, so we have a high degree of confidence that what we are doing in that regard, which is very little -- in fact, I don't think we have an MSA agreement anywhere. And if we do, it complies with the regulations. So I think that's more of a target to those folks who are not in compliance, and that does not include us.

Mike Dahl - *Credit Suisse - Analyst*

Okay. Great. And then, Tony, just so we're all on the same page, in terms of the guidance and the adjusted EBITDA, could you just detail, what is the dollar amount of adjustments that's assumed in your new guidance? And how that compares to the prior guidance?

Tony Hull - *Realogy Holdings Corporation - CFO*

I don't think it changed. I don't think it changed at all. Maybe a couple million dollars here and there. But it didn't really change.

Mike Dahl - *Credit Suisse - Analyst*

And what is the overall level?

Tony Hull - *Realogy Holdings Corporation - CFO*

The only -- so Mike, the one thing that did change is, there was a $12 million legacy benefit in the third quarter. So that made corporate look $12 million better than it was. But that's really reducing a reserve on the balance sheet, so we actually -- we took that out.

We didn't -- we don't have any credit for that, in the adjusted EBITDA number. So it negated. But besides that -- and then with the financing, there will be some other ins and outs, between corporate and adjusted EBITDA, but they'll be net zero numbers. So really, other than those net zero changes, there's no change.

Mike Dahl - *Credit Suisse - Analyst*

Right. Right. But I guess, do you have the dollar amount, just so we know? Because I think there -- or, I guess, said another way, just what the fourth quarter adjustment assumption would be?

Tony Hull - *Realogy Holdings Corporation - CFO*

The fourth quarter is -- I think it's [$19 million], with the legacy.

Mike Dahl - *Credit Suisse - Analyst*

Okay. Great. Thank you.

Tony Hull - *Realogy Holdings Corporation - CFO*

You're welcome.

Operator

Your next question comes from the line of Will Randow with Citigroup. Your line is open.

Will Randow - *Citigroup - Analyst*

Hey, good morning, guys, and nice quarter.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

Thank you very much.

Tony Hull - *Realogy Holdings Corporation - CFO*

Thank you, Will.

Will Randow - *Citigroup - Analyst*

Just a question on the compensation accrual, which has been mentioned. Has that moved at all? I believe it was $20 million to $30 million, as well as some costs or investment, in regards to technology, of about $10 million. And have we lapped most of, I'll call it the heavier chunks of those costs in the first half?

Tony Hull - *Realogy Holdings Corporation - CFO*

In the three quarters, we've now lapped most of the Zip cost, but there still is a little incremental in the fourth quarter. And most of the performance issues are lapped, as well. So it's -- it will be much less of a factor in Q4.

Will Randow - *Citigroup - Analyst*

And I guess on free cash flow deployment, I understand that you don't want to provide specific guidance. But in terms of your goal posts, from doing small bolt-on acquisitions to returning cash flow to shareholders, sub 3 times net debt-to-EBITDA, have any of those directional goal posts changed?

Tony Hull - *Realogy Holdings Corporation - CFO*

No.

Will Randow - *Citigroup - Analyst*

Okay. Thanks for that, and congrats again.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

You're welcome.

Operator

We have time for one more question. Your last question comes from the line of David Ridley-Lane with Bank of America. Your line is open.

David Ridley-Lane - *BofA Merrill Lynch - Analyst*

Good morning. So most industry forecasts are for a decline in refinancing volumes next year. Tony, could you give some idea of the sensitivity around Realogy's EBITDA to refi volumes and TRG and PHH?

Tony Hull - *Realogy Holdings Corporation - CFO*

It's pretty -- it's about 300,000 per point change for the year. So it's not -- it's not that significant.

David Ridley-Lane - *BofA Merrill Lynch - Analyst*

Got it. And then, Richard, could you give your view on the impact of a modest, say, 50 basis points increase in mortgage rates next year, on your business? And maybe contrast that with the impact that you saw from the 100 basis points spike in mid 2013?

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

As you know, the 100 basis point increase in 2013, and rolled into 2014, was sudden. So I think the rate of increase is very relevant. And that was a spike. It took the market about a year to adjust to that, and I think that's the industry standard. I don't see that spike in the coming year.

We think it's going to be -- if there's any increase, it will be a slow increase, which I think the marketplace will adjust to that quite well. Listen, when rates go up, it's because the underlying economics are stronger, and the average consumer can afford whatever increase, they can absorb that increase. So if it's a 50 basis point increase, which most people are forecasting, I think we'll see about a pretty mild, tepid reply to that. And again, you have a stronger economy to go with it. So --

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Tony Hull - *Realogy Holdings Corporation - CFO*

I would -- David, I would just point out that the forecasts for the next year that we talked about, from the third party forecasters. If you look across the board, they're forecasting 5% to 8% increase in volume, and they're also forecasting about, I'd say, a 50 to 75 increase in -- 50 to 75 basis point increase in 30 year mortgage rates, as well. So that's built into all of their models.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

I agree, Tony. It seems it's in all of the forecasts that we're currently seeing for 2016.

David Ridley-Lane - *BofA Merrill Lynch - Analyst*

All right. Thank you very much.

Richard Smith - *Realogy Holdings Corporation - Chairman, CEO and President*

All right. So, operator, I want to thank everyone for joining our call. In summary, we're very pleased with our third-quarter results. It was a great quarter. Our strong EBITDA and cash flow allowed for accelerated deleveraging, and resulted in us raising our adjusted EBITDA and margin guidance for the year. We expect to continue to grow our revenues, improve our margins and increase our cash flow, through a steadily improving housing market, continued innovation and strong execution, to drive shareholder value. So thank you for taking time with us on the call. Have a good day.

Operator

This concludes today's conference call. You may now disconnect.