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CORPORATE PARTICIPANTS

Alicia Swift *Realogy Holdings Corp. - SVP of Financial Planning & Analysis and IR*

Anthony E. Hull *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Richard A. Smith *Realogy Holdings Corp. - Chairman & CEO*

Ryan M. Schneider *Realogy Holdings Corp. - President, COO & Director*

CONFERENCE CALL PARTICIPANTS

Bose Thomas George *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Brandon Burke Dobell *William Blair & Company L.L.C., Research Division - Partner & Group Head of Global Services*

David Emerson Ridley-Lane *BofA Merrill Lynch, Research Division - VP*

Jason Scott Deleeuw *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

John Robert Campbell *Stephens Inc., Research Division - VP and Research Analyst*

Kevin Damien McVeigh *Deutsche Bank AG, Research Division - Head of Business and Information Services Company Research*

Michael Glaser Dahl *Barclays PLC, Research Division - Research Analyst*

Ryan McKeveny *Zelman & Associates LLC - VP of Research*

Stephen Kim *Evercore ISI, Research Division - Senior MD, Head of Housing Research Team and Fundamental Research Analyst*

Will Randow *Citigroup Inc, Research Division - Director*

PRESENTATION

Operator

Good morning, and welcome to the Realogy Holdings Corporation Third Quarter 2017 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.

At this time, I would like to turn the conference over to Realogy's Senior Vice President, Alicia Swift. Please go ahead, Alicia.

Alicia Swift - *Realogy Holdings Corp. - SVP of Financial Planning & Analysis and IR*

Thank you, Amy. Good morning, and welcome to Realogy's Third Quarter 2017 Earnings Conference Call. On the call with me today are Realogy's Chairman and CEO, Richard Smith; President and Chief Operating Officer, Ryan Schneider; 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 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 remarks made herein or as of today, November 3 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 in our annual and quarterly SEC filings.

Also, certain non-GAAP financial measures will be discussed on the call per SEC rule. 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 and CEO, Richard Smith.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

Thank you, Alicia, and good morning, everyone, and thank you for joining us this morning. Before I delve into the third quarter results, I'd like to recap the news we announced 2 weeks ago regarding our leadership transition plan. Following a comprehensive search, we are very pleased to announce that Ryan Schneider has joined us as President and Chief Operating Officer. And upon my retirement effective December 31, Ryan will be appointed CEO. Ryan joins Realogy after nearly 15 years of senior leadership experience at Capital One. He most recently served as President of the Card Division, its largest business, and drove its growth and success. He brings a wealth of experience in leveraging big data, rigorous analytics and new technology, all of which will bring a new perspective to our industry and company. The transition to Ryan is well under way with the 4 primary business units now reporting directly to Ryan and the balance of the transition will occur by December 31. So let me turn it over to Ryan. Ryan?

Ryan M. Schneider - *Realogy Holdings Corp. - President, COO & Director*

Thank you, Richard. Let me start by saying that I am both humbled and excited about joining Realogy. I see incredible potential to drive Realogy's growth with exciting new ways to use data, analytics and technology to enhance our primary strategy of serving agents. Realogy's scale and resources are unmatched in the industry. That's a credit to Richard and the senior management team who have built this company to be the industry leader for residential real estate services in the United States. I'm incredibly excited to hit the ground running and work alongside a great team of business leaders and talented employees who are committed to serving Realogy's affiliated real estate agents, franchisees customers and clients. Together, I know we will drive results.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

Thank you, Ryan, and now let's turn to the third quarter. I'd like to provide you with a summary of the items we're going to highlight on today's call. We faced a number of challenges in the quarter. Our revenue growth of 2% was affected by the continuation of persistently low inventory and the hurricanes that constrained the level of transactions, and our operating EBITDA was adversely affected by higher commission cost at NRT and lower employee relocation volume at Cartus.

Having said that, the combined homesale transaction volume was up 4% for the quarter. It's approximately 170 basis points higher than the statistics reported by the National Association of Realtors. This improvement over NAR is a result of our progress on the strategic initiatives we discussed on Investor Day, which we believe will drive higher absolute revenue and profitability over the next several years.

In particular, we have seen solid progress in agent recruiting and agent retention, especially at the top 2 quartiles of our company. In contrary to what we experienced in the third quarter, in October, we saw strong open contract activity at both NRT and RFG, indicating the potential for improved transaction volume trends in the final quarter of this year.

Now let's address some of the puts and takes that we saw in the quarter. Combined volume growth at NRT and RFG came in at the low end of guidance, and NRT volume growth was 1 percentage point below the low end of our guidance. The lower volume is attributed to the effects of the hurricanes, particularly as it relates to our large NRT operations in Houston and Florida and the persistently low inventory which is limiting growth in transaction volume.

Commission splits in the quarter were higher than we anticipated for 3 reasons: relatively high growth in NRT volume in its higher-split West Coast operations, NRT's successful recruiting and retention efforts and the incremental transaction volume from acquisitions. With significant operations in Florida and Houston, TRG also felt the effects of the hurricanes, and Cartus continues to face the challenge of declining employee relocation activity as an increasing number of its largest corporate clients initiate fewer international and domestic employee relocation assignments.

Of the primary contributors, we are pleased demand has returned to pre-storm levels in the affected markets we serve for NRT and TRG. The overall increased commission splits were a result of intentional efforts by NRT to be more competitive for the best talent as we focused on gains and market share. And greater-than-expected volume growth in NRT's West Coast operations was encouraging, although it pushed overall commission splits up slightly more than expected as West Coast agent splits are higher than the East Coast. And the across-the-board slowdown in Cartus' core business will be addressed in 2018 as we expect to take steps to align Cartus' cost structure with a new level of relocation activity.

If you recall from Investor Day, we made it clear that we are focused on strategies that increase company-generated leads, and that work is progressing nicely. We also continue to work on strengthening our technology and marketing tools for agents and building a world-class training program, all of which are designed to increase the long-term productivity of our existing agents and attract new agents by strengthening the sales agent value proposition. Over the last several quarters, we committed to a strategy of improving our share in key markets through targeted agent recruiting, and we are delivering on that commitment.

The success of our recruiting efforts can be measured in 2 key metrics: agent count and agent retention. NRT's agent count grew 4.5% in the last 12 months to more than 50,000 agents. The retention rate of NRT's first and second quartile sales agents slightly exceeded 94% at the end of the third quarter, which is at our historical high watermark.

While we are successfully addressing the market share concerns, which we pointed out late last year, the cost of doing so, especially when compounded by the geographic mix being skewed toward the West Coast, the splits increased slightly more than anticipated. For the year, we estimate that NRT's commission splits will be in the range of 70.25% to 70.5% as NRT field management balances trade-off between market share and split rating.

In 2018, NRT management is tasked with the objective of slowing the rate of increase in commission splits and agent productivity gains, which are compensated at a much more favorable split to the company in the third and fourth quartile of our agent population.

On the franchise side of our business, we continue to use technology to enhance our value proposition. The Zap platform is at the forefront of our efforts to help our franchisees and agents improve their performance. Zap will be deployed to substantially all eligible franchisees by year-end. We continue to see an uplift in productivity from agents who are actively engaged in using the Zap integrated application suite, and thus our shift from deployment to training and engagement.

In franchise sales, our team continues to build our base of brokerage and agents, adding approximately 92 million in gross commission income in the third quarter and $265 million year-to-date from new franchisee sales and related agent recruitment initiatives.

In our relocation and affinity businesses, a key contributor to our lead generation strategy, Cartus, generated referral opportunities that resulted in approximately 24,000 homesale closings in the quarter.

In addition to welcoming Ryan Schneider to our senior leadership team, we continued our focus on adding depth and strength to our executive ranks. In August, we appointed Nick Bailey as President and CEO of CENTURY 21 Real Estate. Nick most recently served as the Vice President of broker relations with the Zillow Group and has extensive real estate experience as a leader in franchising, brokerage, management and technology.

Also in August, Roger Favano was named as NRT's Chief Financial Officer. He brings more than 25 years of financial leadership experience mainly at General Electric Capital. In Cartus, appointed Mark Sonders as the Senior Vice President of Global Sales and Marketing. He joins the company with over 20 years in B2B sales and strategic business development roles.

While operating EBITDA underperformed compared to the same period last year, we continue to invest in the growth of the company. We are making solid progress on our strategic initiatives and agent recruiting efforts, as evidenced by our strong retention and growing agent count. We are steadfast in our focus on our strategic goals, namely to drive sustainable organic growth in each of our business units by strengthening the services we provide to our affiliated agents which, long term, we believe will result in improved agent productivity and higher volume and revenue growth across Realogy.

I'd like to highlight the tremendous cash flow characteristics of our business. Year-to-date, we have generated $406 million of free cash flow, of which we returned $215 million to stockholders in the form of share repurchases and dividends. Since the inception of our share repurchase program in February of 2016, we have repurchased a total of 13.5 million of our outstanding shares for $394 million in the aggregate, bringing our total share count to 134.6 million shares and that's as of November 1.

Before we move on to Tony's report, permit me to comment on the GOP tax plan. That Tax Cuts and Jobs Act, introduced yesterday by the House Ways and Means Committee, is the first of many steps expected in reaching an agreement on tax reform that will create economic growth for our nation. As written, the industry, at large, is opposed to the bill's treatment of the mortgage interest deduction and state local taxes.

That said, we're optimistic that a compromised position can be reached that keeps the value of the home ownership strong, while also contributing to a stronger economy. Although much work remains, we're pleased to see the House Ways and Means Committee hard at work on this important piece of legislation, and we fully expect to be deeply engaged in the work that should result in legislation that both Realogy and the industry will support.

With that commentary on the GOP tax legislation, let me turn it over to Tony.

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Thanks, Richard. Before I discuss the Q3 results, let me address the changes to our guidance for 2017. Our 2017 operating EBITDA is now expected to be in the range of $725 million and $735 million, which reflects higher commission splits due to greater relative volume in NRT's West Coast operations as well as anticipated initiatives designed to attract and retain agents in the impact of lower global relocation volume on Cartus. An estimated $12 million reduction in EBITDA is due to natural disasters in the third and fourth quarters, and estimated $8 million charge related to changes to our senior leadership.

This guidance incorporates the fourth quarter transaction volume on Slide 5, which shows Realogy's Q4 combined homesale transaction volume, is expected to increase in the range of 4% to 6% year-over-year with sides between flat and up 1% and 4% to 5% coming from price growth. Broken down by business, we expect 3% to 5% transaction volume growth at RFG and 7% to 9% growth at NRT.

On Slide 9, for the full year, we currently expect that Realogy's combined homesale transaction volume will increase in the range of 6% to 7% year-over-year. And by business unit, we expect RFG to have 5% to 6% transaction growth and -- transaction volume growth and NRT to grow between 7% and 8% in 2017. At those volume levels, full year revenue is expected to be between $6.1 billion and $6.15 billion, and free cash flow is forecasted to be between $505 million and $520 million.

Turning to Slide 7, I will review our third quarter 2017 results in greater detail. Revenue of $1.7 billion is up 2% compared to the third quarter of 2016. Operating EBITDA was $258 million. The combined effects from hurricanes in Texas and Florida impacted results by approximately $7 million, mostly at NRT and TRG. Net income for the quarter was $95 million compared to $106 million last year due to lower operating EBITDA. Adjusted net income per share was $0.71 compared to 75% -- $0.75 in the third quarter of 2016.

Turning to Slide 8 for a discussion of the drivers of our business. Our overall homesale transaction volume growth was 4% year-over-year in the third quarter. RFG's transaction volume increased by 5% with a 1 point decline in sides being offset by 6 points of growth in average sales price. The hurricanes had about 0.5% impact to sides at RFG. The third quarter also had one less business day than the same period last year, which equates to a 1% reduction in sides. Excluding these 2 factor sides, growth would have been up 1% at RFG during the quarter, which reflects continued inventory constraints across most price points.

On a geographic basis, for RFG, volume gains in the West were the strongest at 8% followed by the Northeast being up 6% due to price. Volume in the South increased 2% and included a gain of 3% in Texas and 2% loss in Florida for the quarter. Volume in the Midwest increased 1%.

NRT finished the quarter up 4% in transaction volume due to an increase in average sales price. The hurricanes had a more noticeable impact at NRT during the quarter, accounting for a 1% impact to sides, mostly in Florida markets, where NRT derives about 8% of its revenue during this time of year. Excluding the hurricanes, we estimate volume would've been up 5% at NRT.

The high end recovered to the first half of the year and has stabilized in the third quarter. NRT's volume in the $2.5 million and above price segment grew 4% year-over-year, which consists of a 12% increase in sides offset by an 8% decrease in average sales price. The strongest geographic market for NRT in terms of volume growth was the West with 11% growth, driven by strong California growth. Volume in the Midwest region increased 2%. The South region was flat on volume, which included a 2% decline in Houston. The Northeast region was down about 1% in volume.

Turning to other drivers. Average broker commission rate, or ABCR, at RFG was down 1 basis point to 2.49%, and ABCR at NRT was down 1 basis point to 2.45%. Net effective royalty rate for RFG was 4.42%, down 8 basis points for the quarter and in line with our previous estimates, which continues to reflect the success of our top 250 franchisees who pay net royalty rates below 6%. For full year 2017, we continue to expect the royalty rate to be approximately 4.40%.

NRT commission splits increased approximately 209 basis points year-over-year to 71.0%. The increase in Q3 split rate was a result of higher transaction volume and geographic mix of business skewed towards markets like California, which command higher splits, and the impact of heightened retention and recruiting efforts.

Turning to Slide 9. Let's talk about business unit operating performance in detail. At RFG, revenue increased 4%. The growth was from higher net domestic affiliate royalties, increased royalties from NRT and greater international revenues. RFG's operating EBITDA increased to $5 million principally due to the higher revenues.

NRT revenue increased 3% to $36 million in Q3 of 2017, about half of which was due to the year-over-year impact of acquisitions. NRT operating EBITDA decreased $16 million to $64 million, primarily due to $53 million of increased commission expense which more than offset the increase in revenue.

Breaking down the $53 million, higher split rates due to targeted recruiting and retention efforts resulted in $25 million of increase. Higher volume drove $16 million of the increase and acquisitions completed since the second quarter of 2016 added $12 million to the total. Looking at commission expense change in another way, regionally the 11% increase in volume in the West was associated with 70% of the $53 million increase in commission expense.

Cartus revenue decreased $5 million in Q3 primarily due to a decrease in international and other revenue. Operating EBITDA decreased $4 million as a result of lower revenue, partially offset by a $1 million decrease in employee-related costs.

TRG's revenue decreased $10 million and operating EBITDA was lower by $3 million year-over-year. The revenue decrease was driven by reduced refinance activity including the impact on its underwriter, partially offset by higher resell revenue. EBITDA includes $2 million of costs associated with the startup of operations of the Guaranteed Rate affinity joint venture. And as a reminder, the Guaranteed Rate venture will be included in TRG's EBITDA, whereas the PHH joint venture numbers are reported at RFG.

Corporate expense before restructuring legacy and early extinguishment of debt in the third quarter was $3 million greater than the third quarter of last year due to higher expenses relating to investments in technology development, professional fees supporting strategic initiatives and higher employee incentive compensation accruals relative to last year.

With regard to our joint venture, the company has completed the first 3 out of 5 phases of the sale of PHH Home Loans assets to Guaranteed Rate affinity. The remaining 2 phases are expected to be completed in the fourth quarter. After giving effect to the establishment of Guaranteed Rate affinity and the liquidation of Realogy's interest in PHH Home Loans in early 2018, the company expects to realize net cash proceeds of approximately $20 million.

Slide 10 provides guidance for specific cash items below operating EBITDA. In particular, corporate cash interest expense for the year is expected to be approximately $165 million. Cash taxes are expected to be between $10 million and $15 million and full year capital expenditures between $95 million and $100 million.

Finally, working capital is expected to be a contributor of cash between $55 million and $60 million, which includes dividends of approximately $30 million and a wind down of the PHH Home Loans joint venture in the third and fourth quarters.

Based on the expected operating EBITDA range for the year, we expect that the company will generate between $505 million and $520 million in 2017. We intend to use a significant portion of our $0.5 billion of expected free cash flow this year to return capital to our shareholders, predominantly through share repurchases, because we believe Realogy remains a great investment and we have great confidence in our plan, opportunities in the market and our ability to execute.

Lastly, as you know, Richard will be retiring at the end of the year and this will be his last appearance on our quarterly calls. I want to take this opportunity to personally acknowledge Richard Smith for his strong and ethical leadership of our company for the last 20-plus years. During the toughest times of the financial downturn, Richard was at his finest, working tirelessly to bring our company through the storm and back on solid footing to position us for our IPO 5 years ago.

It is largely due to his vision execution and resolve that Realogy has grown into the great company that we are today. Richard, you've established a culture of accountability and respect and built a strong foundation upon which we are well positioned for continued growth and success. On behalf of all the Realogy employees, we thank you for your leadership through the years and all the best in the future.

Now we'll move to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of David Ridley-Lane with Bank of America Merrill Lynch.

David Emerson Ridley-Lane - *BofA Merrill Lynch, Research Division - VP*

Appreciate the detail on NRT agent growth. Wondering if it would be fair to think that the productivity of those net adds are close to the overall average of NRT? Or could the revenue contribution be a bit higher if you're targeting more productive agents?

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

David, these are agents that are at the high end of their game. So they are very productive to begin with, but we fully expect that they will be more productive with us. So you're correct in your assessment.

David Emerson Ridley-Lane - *BofA Merrill Lynch, Research Division - VP*

And then I know it's early in your planning, but any thoughts on the trend of commission split in 2018?

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

So the way we look at this, we -- as you know, we played catch up. We were, I think, in that regard underperforming the market because we are working very, very hard to keep the agent splits as favorable to us as possible for about 3 years. So this year, we've been playing catch up. We fully expect that to start stabilizing. And as you've heard me say, in 2018, NRT management has the goal and objective of slowing the rate of growth and stabilizing the agent split. And I think we're to do that principally through increasing the productivity of the agents in the third and fourth quartile. We have good experience in that regard and we have a high degree of confidence in our ability to make them work productive, thus offsetting the increase in split rates.

Operator

Your next question comes from the line of John Campbell.

John Robert Campbell - *Stephens Inc., Research Division - VP and Research Analyst*

First off, Richard, it was great getting to know you over the years, and congrats on a long and storied career. And then Ryan, welcome, and looking forward to working with you. Richard or maybe Tony, it sounds like the Cartus business, it sounds like that's facing a bit of, I guess, a sustained headwind and you guys could be looking at rightsizing that business next year. Am I drawing the right conclusion from that commentary?

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

No. You heard me say almost that exactly. We don't know if the volume is just seasonal, cyclical, but it's there. So we're to do adjusted cost structure. One of the principal advantages we all have, and we're fully engaged in this, is we think technologies could have a big impact on Cartus' service delivery. There's a project underway to determine to what extent that technology can sort of smooth out the experience to reduce cost. So it's a big project for '18. Senior management of both Realogy and Cartus are fully engaged and we will address it just as we said we would.

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

I'd also add to that, that one of the very critical functions of Cartus within our business is delivering leads that are -- have a 70%-plus chance of converting to the agents of our franchisees and NRT's agents. And the goal is to increase that amount. Those don't -- those come out partially from corporate clients, but most of those leads come from our large affinity clients. And we think there's a great opportunity to increase that number substantially that come from our affinity clients, and that really adds to the retention and recruiting of agents because those leads are highly sought after. They're obviously, much more effective and profitable than leads you get through any source on the Internet. So that's really the reason for the integration of that company in our business. It's incredibly effective in that regard to gain franchisees and to attract agents, and we have a great opportunity to increase that in the future.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

Let me just -- Tony is absolutely right. Let me just make one additional point. That is a critical component of our sort of tool of assets that helps us recruit agents, retain agents. It also helps us recruit and renew franchisees. So it's -- we're just going to rightsize the cost structure to be more flexible going forward. And then, I think, that's going to be an accomplished by Tony's right to underscore the importance of Cartus as one of our key assets in our toolkit.

John Robert Campbell - *Stephens Inc., Research Division - VP and Research Analyst*

Okay. And then I know it's probably pretty early in that assessment, but I mean if you ran the first 9 months of Cartus revenue at the same margin of the first 9 months last year, I think that equates to about $7 million or so of additional EBITDA this year -- I guess of EBITDA headwind. That business has ran at close to 25-or-so percent margins in the past, it looks like it's probably closing in at 22%, 23% this year. Do you think that, just off the top of your heads, that you get back to kind of that margin level? Is that a good way to think about it next year?

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

Yes. No, I think you're right in that assessment. It's been pretty predictable over the past 5 years. I mean we've looked at the trends. It's reliable, predictable. It's been a solid contributor to both revenue and EBITDA in spite of the downturn. So we can definitely improve in this. As I said, it's going to be through better technology and that's well under way.

John Robert Campbell - *Stephens Inc., Research Division - VP and Research Analyst*

Okay. And then just quickly on this. Tony, there's a lot of moving pieces to the EBITDA this quarter and then, I guess, was implied in 4Q guidance. I'm sure I can get to this conclusion eventually, but maybe if you could help us just kind of shortcut it in here's an idea about what is kind of truly onetime that doesn't rollover next year. I know you've got the $8 million of the legal settlement last quarter. It sounds like there's $8 million of CEO transition costs. There's the $12 million of hurricane activity. Anything else I'm missing there as we get into next year?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

I think there's some benefit from the wind down of the PHH joint venture in the fourth quarter, but we feel very good about that that's going to be replaced next year from earnings from our guaranteed rate affinity joint venture. So I think -- I guess that's not onetime as a result of that comment, but it may be a little more squished into Q4 this year then we'll see more spread out next year. But again, that's ramping up next year, so probably the best results will be in the third and fourth quarter of 2018 for that joint venture. So I think those 2 things are -- I think you're right, those 2 things are the largest items of note in the fourth quarter in the forecast in the $12 million, yes.

Operator

Your next question comes from the line of Jason Deleeuw with Piper Jaffray.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

And Ryan, I want to offer my congrats and looking forward to working with you. And Richard, it's been nice working with you and I just want to wish you all the best. The first question is on the -- I guess the -- when I look at the NRT, RFG combined results, the operating EBITDA declined 5% year-over-year this quarter. So it had been growing even with the ramp-up in commission split. So I guess what's kind of the thinking on kind of looking at the segments combined? I mean, can we expect to get back to EBITDA growth as we kind of recalibrate the commission splits? Just kind of your thoughts like are those 2 segments combined, is that still how we should kind of be looking at the business in kind of assessing the strategy here for the recruitment?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Yes. It is. I think I know what happened in the third quarter is we -- our success in recruiting happened to benefit the West Coast more than anywhere else. We were up 11% on the West Coast this year, and the rest of the markets -- I mean forgetting the South for a second because there was a hurricane impact, the Midwest was flat, New England was flat. We actually -- in terms of sides at NRT, we actually outperformed the NAR numbers in both of those. But it's -- we're talking about they reported minus 1% to 2%, NRT was up 1% or 2% in those markets. So we definitely -- we outperformed but we did substantially better in the West Coast than we had anticipated. So again, of that $53 million increase in splits, $37 million or 70% was due to the West Coast being up 11% and kind of flattish for the rest of the country. So another way of looking at it is, if the West Coast had been up 6%, which would have been nice, still, and the rest of the country had been up 6%, you would not have seen -- you would have seen a much more attractive kind of combined EBITDA growth on the revenue growth than we saw. It's just that the West Coast really outperformed, which is a great new story. I think, going forward, I'd like it to continue at 11%. But I think in the future, we'd probably see growth in other areas that have a more favorable splits sort of catching up to the West Coast and that would be something that could potentially take pressure off of splits going forward. But for the quarter, it was very -- the West Coast strength really kind of skewed the results which, again, it's -- I don't want to say a high-class problem, but it's great to see that we're really making huge strides on the West Coast and we expect to play catch up elsewhere and that will be great for the combined growth.

Jason Scott Deleeuw - *Piper Jaffray Companies, Research Division - VP and Senior Research Analyst*

Got it. And then just thinking about the split strategy, is there going to be any recalibration in terms of the split levels being offered? Or any change in kind of which geographies or parts of the country you want to target.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

It's a good question. We think we've accomplished what we intended to accomplish, and personally I remarkably served. So that balancing act between market share gains and splits, for the most part, has been accomplished. Now we'll be very selective as to which markets we want to grow. We'd like all the above, but the focus, clearly, will be on the most profitable markets from a split perspective. So you'll have to monitor our performance turn in 2018, but I assure you we are focused on the most profitable components of those markets.

Operator

Your next question comes from the line Trey Marsh with Evercore ISI.

Stephen Kim - *Evercore ISI, Research Division - Senior MD, Head of Housing Research Team and Fundamental Research Analyst*

Steve Kim, over at Evercore ISI. And let me also add my congratulations and also a farewell to you, Richard. My first question relates to the splits, and I wanted to make sure I got this right. We know that there's naturally a bit of seasonality to your splits. For example, your splits have never gone down sequentially into 4Q at least as far as I can tell. I think some of that relates to the timing of the year when your splits -- or sort of when the clock starts, so to speak, on the commissions and so forth. But I was wondering if you could just help me understand, is there anything in the hiring process that you recently underwent with these very productive agents that is going to make the split trajectory, as we'll see it on the P&L, perhaps more stable through the year? Or is it going to continue to be seasonally weighted through the back?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Again, we expect splits to be 70.25% to 70.5% for the year, and that's reflecting our latest forecast. I think some of the back-end increases that you note, or back half increases that you note, are due to the fact that certain agents get split improvements as they do more volume during the year. So you sort of see that we don't try to predict and smooth out that effect. So you see that in -- that's why you see this trend of increases. But again, the full year, based on what we see today, we expect the commission splits to be 70.25% to 70.5% for the year.

Stephen Kim - *Evercore ISI, Research Division - Senior MD, Head of Housing Research Team and Fundamental Research Analyst*

Got it. Okay. So that sounds like this dynamic is going to continue next year, and that's what I was just trying to clarify. Second question relates to some numbers. I apologize if I didn't quite catch all of this quick. But the change in your EBITDA guidance from where it was last quarter I believe is roughly $35 million. I think you -- correct me if I'm wrong here, but I think you indicated $12 million was due to natural disasters, $8 million for the management transition costs, and that would leave about $15 million, I assume from sort of the recruitment efforts and the higher splits and that sort of thing. And then parsing that $15 million, I think you had indicated there was a higher -- just naturally higher volumes, I guess, than you expected last quarter. Your recruitment efforts in the Western markets, I think, you said was 70% of the commission cost. So I just want to make sure that I got those pieces right, $12 million from national disasters, $8 million from management transition, $15 million for higher splits, and then within the $15 million, 70% of that was due to the Western markets. Do I have that right?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Yes. So the $15 million was mainly due to the shift in -- that we saw in the third quarter to more West Coast volume, and so you're exactly right on that. And then the other factor was some of the activity we're seeing -- the reduced activity we're seeing from Cartus' clients, pretty much across the board, especially on the international front, they just seem to be on pause for this year to see how things shake out in Washington and for whatever reasons. But I think -- I believe it's temporary and I think that, that was the other thing that contributed to that decline.

Operator

Your next question comes from the line of Mike Dahl with Barclays.

Michael Glaser Dahl - *Barclays PLC, Research Division - Research Analyst*

Richard, I'll add my congrats as well.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

Thank you.

Michael Glaser Dahl - *Barclays PLC, Research Division - Research Analyst*

Tony, sorry, but I guess I'll keep beating the horse a little bit here on the splits in the West Coast. I think what I'm still struggling to understand is, if you think about the shift to the West, clearly, it's a higher split rate, but the compensation is higher average price. And so I guess my perception had been it's still an EBITDA positive transaction in terms of the dollar value that goes to you even if it's lower margin percentage. So is this truly something where you're now losing money on these West Coast transactions? Or you're saying this is relative to where you thought the volume would come from that this is -- that's the change? Because I think that's what is not really adding up, why it would actually be a negative and not absolute terms.

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

It's the latter. I mean, it's a combination -- it's really the geographic mix at the same shift, at the same time as we put in place retention and recruiting efforts. So it's a combination of those things kind of have the overall effect of sort of not having the desired results. But again, the positive news is that we have completely -- maybe completely is too strong a word, but the issue that we were concerned about last year, which was market share attrition, is largely behind us. And I think we've gotten the plane stabilized and ready to start gaining altitude. And there's going to be some bumps along the road in that effort, but I think we're well on our way to our ultimate goal of increasing overall revenue and profitability of the company. So I don't think -- this will only just sort of have a double -- 2 impacts at once. And the one we didn't expect is that the West Coast would grow 11% and the rest of the country, because of inventory constraints, would be sort of as -- the rest of the country, forget the hurricanes, was soft. Look at the national statistics, it was just -- this inventory constrained thing, finally, really caught up to us in the third quarter. So again, if we've seen a different picture in the Midwest and the East, the Northeast, the results would have been very different for the quarter, but we didn't. And it happened when we've been successfully improving by leaps and bounds our market position and our retention of agents. So to me, it's like a onetime glitch and it's -- but we're heading in the absolute right direction to increase revenue and EBITDA levels.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

Let me add one. Tony is absolutely correct in that his assessment. And one additional comment I would make in this sort of a holistic view we have of the West Coast operations. You got to remember, in absolute dollars, there've been a substantial contribution to the franchise side of our business through royalty payments. And it also happens to be one of our most profitable title in closing this for services markets, and the higher cost agents on the West Coast our material contributors to that as well. So if take all that into account, California is a very profitable market for us, but Tony's right to point out that the mix of business was much stronger to the West Coast than we anticipated.

Michael Glaser Dahl - *Barclays PLC, Research Division - Research Analyst*

Right. Got it. And that's what I thought regarding California being profitable, which is why I didn't understand the change in the guide related to that part, but I think that is helpful. It also leads to my next question. When you talk about kind of stabilizing the plane and setting it to gain altitude here, and to the extent that you've been successful on some of these recruiting initiatives, what are you seeing in terms of competitive response? Because clearly, and we've talked about this in the past, there's -- you're responding to what some competitors were doing. Over the past couple of years, you've been successful, now what are you seeing from those same competitors?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

From what I've heard from NRT management, there has been very selective and spotty reaction to us doing this and there's nothing large scale that any of our competitors are doing or honestly can do. We have -- again, this is all about using data to attract, to go after the best agents and it's not just -- and then giving them a very small or relatively small transition payment to get them through the pain of going from their old brokerages to NRT, but it's really hit a nerve and it was incredibly successful. We doubled -- we more than doubled our recruiting in this past 12 months versus a year earlier, so we've gone from like our normal recruiting of about $250 million a year of GCI, we're going to be almost $600 million of GCI and recruiting this year. So with very minimal outlays relative to our overall capital structure and our abilities. And we get the agents -- we have an agreement with the agents to stay with us for 3 years, so it's very sticky and it's been just very successful. It's, again, the numbers are -- it's a 1-year payback on this upfront investment. We, obviously, amortized it over 3 years during the life of their contract. But this recruiting -- this sort of targeted recruiting effort has been just very, very successful and it really has shown that the NRT management can -- we reversed the problem and we'd like to get some credit for it. We took a problem that was very severe a year ago and it's -- we turned it around. NRT management turned it around in 1 year. And I think that, to me, gives me a lot of confidence. And when we need to tweak things and fine-tune things, and as Richard mentioned, focus on things that take some pressure off splits for 2018 and beyond, they are the team to do it. And they've proven themselves able to do it and to turn on a dime, so I think it's been a really impressive effort by management in NRT.

Operator

Your next question comes from the line of Kevin McVeigh with Deutsche Bank.

Kevin Damien McVeigh - *Deutsche Bank AG, Research Division - Head of Business and Information Services Company Research*

Can you give us a sense of what would cause EBITDA to come in at the low versus the high end of the range, what the factors there are?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

What would cause the low end is if NRT transaction volume for the fourth quarter is forecast to be between 7% and 9%. And I think if we came in at the low end of that 7% to 9%, that would probably be the most impactful in terms of hitting the low end. Right now, we don't see that. We see -- we feel pretty confident about the mid to upper end of that. And the opens we saw in October, to me, it was almost lights on lights off looking at the opens between a kind of sleepy third quarter. And all of a sudden, in October, in terms of the opens we see, it was a lights on situation, so it's just a big shift. In NRT -- I mean, NRT saw a lot of the same trends in terms of things really just kind of revving up in the third quarter, so -- I mean in October. So I don't know how that's going to play out in November and December and what's going to close and what's not going to close. Our cancellation rates are extremely low. So again, I think it's -- that bounds the range of guidance.

Kevin Damien McVeigh - *Deutsche Bank AG, Research Division - Head of Business and Information Services Company Research*

Would you -- and obviously, the bill only came out yesterday issue, but would you expect a spike in activity given the uncertainty around any changes in tax law to the extent they would take effect in '18? Or is this not factored into this guidance?

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

Listen, we have no idea what's going to happen as a result of the tax laws, except that what's been proposed is not going to get passed into law. The industry is not supportive and I think it's going to be almost impossible to get the vote out of the house, so we'd be supportive of the legislation as it's written. So let's assume for a moment that it becomes far more favorable to the industry and also to the national economy, I don't think the market is going to suddenly spike. I don't think anything is waiting on this. I think some may have hit the pause button, so we need to wait and see. I think the markets completely overreacted to proposed legislation, and we'll see how it plays out. But we spend a lot of time in this issue, we fully appreciate the process and I don't see a spike one way or the other in response to this until something becomes law.

Kevin Damien McVeigh - *Deutsche Bank AG, Research Division - Head of Business and Information Services Company Research*

Super. And then just, Richard or Tony, can you remind us when can you be back in the market from a buyback perspective?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

In a week.

Operator

Your next question comes from the line of Bose George with KBW.

Bose Thomas George - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Can you give us any updated thoughts on how you think the market, overall, is positioned for next year? You noted positive trends in October and you want to have it continued?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Well, the -- we put in the -- on Page 17 of our earnings deck, we put in the 5 forecasters' view as of October of what next year looks like. The average was a 7% growth in volume. So that's pretty much sort of same as we saw -- this year, obviously, we would expect strongly that we are going to outperform because we're continuing to do the targeted recruiting, which was very favorable to NRT this year in terms of their volume increases. And RFG is -- our franchisees, we've launched the program with them to sort of mimic that program, so we'd expect to see some of the benefits of that in terms of agent growth. And obviously, everything we're doing on value proposition in terms of learning and technology is rolling out both to NRT and to our franchisees, so we would expect that, also, to help us exceed whatever happens in the market just like we exceeded in the third quarter by 170 basis points.

Bose Thomas George - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. Great. And if you just -- in terms of the inventory constraints that you noted, it has been limiting the activity in '17 over '16. Do you feel like some of these forecasts might be positive in terms of overcoming that? Because it does seem like '18 over '17 expectations in the forecasts are pretty strong.

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Yes. I would say from our discussions with some of these economists that what they see for next year -- and again, I'm not smart enough, they're economists and I'm not, so I will take -- this is what they're thinking about. They view that there is still a significant amount of pent-up demand. They view that with the wealth in the stock market, the consumer confidence at all-time level -- all-time high levels and we're starting to see some wage growth across the board. I think that makes them positive on a little bit of -- more upside on the unit side of the equation next year than this year and price because the supply demand dynamic is so skewed towards the salary, I guess, in most of the market. There's a lot of demand and not enough supply. That, obviously, will help continue price to go up next year. So I think that's kind of their outlook. Obviously, they understand the inventory constraints, but it's just -- they feel positive about next year.

Bose Thomas George - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. And actually just one company-specific one. In terms of -- to your excess, uses of excess cash, how does the debt side, paying down the debt or playing to that, do you have a target for leverage?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Yes. Our target for leverage is to get down to 3x. We're currently at 3.9x net debt to operating EBITDA or I guess that's adjusted EBITDA or now at -- we don't use that anymore. It's EBITDA as calculated under our credit agreement. So we are 3.9x and we are targeting to go down to 3x. So to the extent, for this year, we're going to generate more than $0.5 billion of free cash flow. About $300 million of that is going to go towards share repurchases and dividends and about 50 for M&A, at this point, and then we're reinvesting in the new joint venture, so that's going to require about a $55 million investment. But everything left over, which is over $100 million, will be used to pay down debt.

Operator

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

Brandon Burke Dobell - *William Blair & Company L.L.C., Research Division - Partner & Group Head of Global Services*

My congratulations and well wishes as well. I guess, first question, relative to the net royalty rate. You talked a lot about factors that you think can change commission splits, but how do we think about the puts and takes on that royalty right now given how the market is progressing and the concentration of market share? Is there any or other tactics or opportunities to reverse that trend in the near term? And if so, how do we think about the magnitude of what you're going to do there?

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

This is Richard, and thanks for your comment. You got to look at the net effective royalty rate in a slightly different fashion. Remember, that's how we incentivize our franchisees to outperform. The stronger their performance, the lower their royalty rate, which we view as a positive not a negative. So that said, what would skew that one way or the other is your top 250 or top 300 franchisees. If they outperform everything in the market and grow much faster than we anticipate, then you're going to see downward pressure on the net effective rate but you've got absolute growth at the top end. So we wouldn't view that as a negative. And now in the other offset, as you add franchisees and smaller franchisees become more productive, then you see the mix change a little bit. But those are the 2 variables we think about when we think about net effective royalty rate.

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Brandon, the point is that we raised kind of the thresholds every year in terms of what qualifies for a rebate. So that's sort of an annual kind of reset, so that helps as well.

Brandon Burke Dobell - *William Blair & Company L.L.C., Research Division - Partner & Group Head of Global Services*

Got it. Okay. And then, I guess, final one. As you think about all these dynamics going on with commission splits and geographic exposures, et cetera, does it change, I guess, your -- not change your M&A strategy, but maybe within that, what kinds of companies you're more apt to take a look at? Maybe it's a particular geographic region or a price point or something like that just to maybe offset some of the trends that are going on or to maybe amplify some of the efforts that you're making to drive the splits in your direction.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

So as you know, we've -- we're well-versed in tuck-in acquisitions, so we'll continue doing that. We announced a couple this week. They're very synergistic. We have a very high threshold for return on invested capital. We can do that in our sleep. We continue to focus on those tuck-ins. I don't think you will see us -- although we look at everything, you don't see us doing anything in a material way that would not be synergistic. So as long as we continue to stay the course on tuck-ins that are very attractive, a lot of leverage, they look great, they operate great, you'll see us continuing that in 2018.

Operator

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

Ryan McKeveny - *Zelman & Associates LLC - VP of Research*

And congratulations, Richard and Ryan. Two questions. On the commission split, I guess, framing it a bit differently. Tony, you mentioned, this year, you're likely to add about $600 million of incremental GCI from the targeted recruitment. And when I weighed that against the commentary on the goal of slowing the rate of increase in split next year, do you anticipate the recruitment efforts continuing at kind of the same pace of saying that $600 million that will be added this year? Can you give any sense of -- if you think that's something that continues into next year or if you slightly pull back on the recruitment efforts to mitigate the split increasing further?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

No. I think we have a program that is highly successful and we're going to continue doing it. There's a very large pool of agents we would love to have join our ranks, and we're going to continue to attempt to attract them.

Ryan McKeveny - *Zelman & Associates LLC - VP of Research*

Got it. And one more on the West, I know it's been asked a lot, but maybe another way to frame it. On California, obviously, the volume gains are encouraging. But at the same time, we know it's a very competitive market with many other competitors expanding there, doing acquisitions and things of that nature. So curious if you can give a sense of how the actual split within California this year compares to last year to try to parse out the mix versus the absolute split actually moving up in that market?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Yes. We don't break it up that way. Obviously, we're very focused on it, but we don't break it up publicly for competitive reasons exactly.

Ryan McKeveny - *Zelman & Associates LLC - VP of Research*

I guess would it be fair to say that it's directionally similar, higher or lower? Is there any sense that way versus the company total split?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Well, it's higher than the company overall split. And in terms of the impact of the recruiting and retention efforts, the increase in commission split on the West Coast was pretty much dead on with the increase in every other market. So it didn't require any more increase to have the 11% growth in the West Coast versus what we are providing in other regions.

Operator

Your final question comes from the line of Will Randow with Citigroup.

Will Randow - *Citigroup Inc, Research Division - Director*

And let me start by saying, Richard, you will be very missed, while we look forward to working with Ryan.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

Thanks. I appreciate that.

Will Randow - *Citigroup Inc, Research Division - Director*

I guess, I'll join everyone else in beating a dead horse. You guys have taken a $15 million hit, apparently, on split. So California, at least nationally speaking, didn't grossly outperform. I guess, the real question is, is that $15 million going to hit you next year, too, when the same thing happens? Because inventory aren't loosening up and if you take the other side of that, what gives you confidence?

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Well, again, we are -- I guess, your question is why do you think the rate of increase will decrease next year versus this year. Is that your question?

Will Randow - *Citigroup Inc, Research Division - Director*

Yes. I mean that $50 million hit that you didn't expect incrementally, either that's driven by your spending more on retaining and gaining, if you will, of agents. Or -- and the question is, if it's a 3-year amortization, why doesn't it hit next year? In addition, I mean, tight inventories are tight inventories. We've been talking about this for years now.

Anthony E. Hull - *Realogy Holdings Corp. - Executive VP, CFO & Treasurer*

Yes. I mean, part of it is, this year, as we've introduced the targeted recruiting effort is that we start amortizing the transition payment that we make to agents before the revenue starts to kick in. So I think it sort of made it a little more impactful this year than you'll see next year when we were just running on -- so we're just sort of building on an existing program. And also, again, to the extent that there's a more balanced growth in the various geographic regions, that would sort of automatically take pressure off of splits. And then the efforts that are -- in terms of strategic initiatives, in terms of getting the third and fourth quartile agents across the country to be more productive, it's kind of the first big program that we're looking at. And also, the overall value proposition refinement and focus and improvement that we're offering to all of our agents should make -- I think, should make the economics less of a factor and really kind of be more productive. If I can do -- if I'm paying a slightly higher split -- or I'm getting a slightly lower split, but I can do 2 or 3 more transactions than I would have working for the guy down the street without any of these tools, any of this coaching and any of that, I think that agents are going to see very quickly that being part of NRT is much more profitable for them than they'd otherwise earn.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

So Will, think about this. NRT management turned around the market share issue that had been building for several years in the context of 1 year -- 12 calendar months so -- which is remarkable by any definition. That same sort of energy has been shifted to now making the third and fourth quartiles far more productive than they are now. That's a fairly significant offset to paying higher splits to the first and second quartiles. So we're very encouraged. We think the model works quite well and they'll execute against our strategy next year and we have a high degree of confidence in our ability to do that.

Will Randow - *Citigroup Inc, Research Division - Director*

And Ryan, if they'll allow me, I'm sure one of the questions Richard asked you when you guys were talking about taking the seat, what your strategic vision was. Now you highlighted on the call very briefly, you have an analytics to drive growth. Can you get any more specific? And how long do you think it will take you to ramp in the new role? And again, congratulations.

Ryan M. Schneider - *Realogy Holdings Corp. - President, COO & Director*

Well, thank you. Look, first off, Richard has just been incredibly instrumental in growing and leading this company, for making Realogy the foremost platform for residential real estate in the U.S., and so I echo all of Tony's comments and all of you and other analyst comments here. Look, I'm on my second week here. I'm incredibly excited to be here. I've hit the ground running, diving in on strategy, technology in all of our businesses. And as I said in my opening, I really think there's opportunities to use data, technology and analytics to build on what's been done here to really drive growth. And so I'm incredibly focused in all those areas as well as, most importantly, meeting and getting to know the great talent at Realogy. And so I look forward to sharing more strategic thoughts with you and others in 2018, and I'm incredibly excited to be here.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

So he doesn't get the last word on my last earnings call. That's going to be left up to me, unless you have another question. But let me say this, this company is uniquely positioned to capitalize on an enormous store of data in a way that other people haven't even contemplated because, in part, they don't have the data, they don't have the sophistication, they don't have the reach, they didn't spend billions of dollars building the largest real estate company in the world. We've been able to use all that to attract someone of the caliber of Ryan. So this is critically important. It's a transformative event for our industry and for our company. So in his hands, we're putting a company with a new approach to data, a new approach to technology and just a different thought process, and we think the upside to us is substantial. So we welcome Ryan and his expertise to the company. Again, I believe it's going to change how this industry thinks of itself and we'll be at the lead of that.

Will Randow - *Citigroup Inc, Research Division - Director*

Well, thanks again guys and particularly to you, Richard, who have spent over 2 decades of building this business.

Richard A. Smith - *Realogy Holdings Corp. - Chairman & CEO*

Thank you very much.

Operator

This concludes our question-and-answer session. I will now turn the call back over to Alicia Swift for closing remarks.

Alicia Swift - *Realogy Holdings Corp. - SVP of Financial Planning & Analysis and IR*

Great. Thank you for joining the call today and we look forward to talking to you over the coming quarter. Thank you.

Operator

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