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RLGY - Q3 2013 Realogy Holdings Corp Earnings Conference Call

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PRESENTATION

Operator

Good morning and welcome to the Realogy Holdings Corporation third-quarter 2013 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 tomorrow. A webcast replay will also be made available on the Company's website until November 15. 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 IR*

Thank you, LaShauna. Good morning and welcome to Realogy's third-quarter 2013 earnings conference call. On the call with me today are Realogy's Chairman, CEO and President, Richard Smith, and Chief Financial Officer, Tony Hall.

As a reminder for webcast participants, you need to advance the slides by clicking the forward arrow on the bottom right of the screen beneath the webcast player as we move through today's presentation.

Starting with slide 3, I would like to call your attention to two items. First, you should have access to a copy of our financial results press release and quarterly report on Form 10-Q for the quarter ended September 30, 2013, which we have filed with the Securities and Exchange Commission. The press release and filing are available on the investor information section of our website as well as a copy of today's webcast slides.

Also, certain non-GAAP financial measures will be discussed on this call and these measures are defined and reconciled to the most comparable GAAP measure in our press release.

Second, the Company will be making statements about its future results and other forward-looking statements during this call. Statements about future results made during this call constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. 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. The Company cautions that these statements are not guarantees of future performance. Actual results may differ materially from those expressed or implied in the forward-looking statements.

For those who listen to a rebroadcast of this presentation, we remind you that the remarks that are made herein are as of today, November 4, 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, our 2012 Form 10-K and our third-quarter 2013 Form 10-Q and other SEC filings. Now I will turn the call over to our Chairman, CEO and President, Richard Smith.

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

Thank you, Alicia, and good morning, everyone. We appreciate you joining our call as we report on our third-quarter 2013 financial results and operating performance. Let me begin by saying we had an outstanding third quarter.

Our 29% increase in year-over-year home sale transaction volume, which, as you may recall, is transaction size times price, exceeded our prior guidance for the quarter resulting in a strong 21% year-over-year increase in revenue and a 27% year-over-year increase an adjusted EBITDA, which you can see on slide 4.

While industry observers anticipated that the market rate environment would slow the rate of the housing recovery we now believe the exact opposite occurred, it accelerated. In our view the combination of pent up demand and relatively low inventory substantially contributed to the increase in both home sales and average sale price.

We also believe that the increase in existing home sales were in part attributed to a buyer's ability to lock in mortgage rates for the average 45 to 60 days necessary to close on an existing home loan purchase, which typically is not economically viable to the buyer of a new home for the six to nine months that are typically necessary to build a new home. In a rising rate environment this is a particularly important nuance.

In July we gave guidance that Realogy's combined home sale transaction volume from our NRT Company owned operations and our RFG franchise affiliates was expected to increase 17% to 19% in the third quarter of 2013 compared to last year. This was based on our analysis of our open and close sales volume through the third week of July and at that time our forecast was also in line with NAR's third-quarter forecast of 18% volume growth.

Subsequently, market conditions evolved as we believed buyers reacted to higher mortgage interest rates. And in response NAR edged its full-year forecast up each month from 15% in June to their current forecast of a 21% increase in home sale transaction volume for the full year 2013.

Given our better-than-expected performance in the third quarter we thought it would be helpful to provide more clarity on the full year. On a full year basis, as shown on slide 5, we expect adjusted EBITDA to be between $785 million to $800 million, a 16% to 19% increase year over year and home sale transaction volume to be up 17% to 19% year over year.

Specifically for Q4 sales volume for RFG and NRT combined is expected to increase 6% to 8% compared to the fourth quarter of last year. Breaking it down, we expect 3% to 4% of this growth to come from sides and 3 to 4% site to come from price. Our price increase for the fourth quarter is forecast to be lower than NAR's because of the difficult year-over-year comparison based on our mix of business.

You will recall in the fourth quarter of last year we recorded a significant increase in the sale of high-priced homes which we believe can be attributed to the January increase in the capital gains tax rate. As a result our average sale price for Q4 last year was up 17% versus NAR's reported 9% to 10%. Obviously that will not repeat itself in the fourth quarter of this year.

Also, as we said on the last call, we expected higher rates to impact refinancing. Just to put this in perspective, there is a limited impact on our overall business from refinancing transactions. TRG provides refinancing title services to third-party lenders and PHH Home Loans, our joint venture for mortgage services, helps homeowners refinance existing mortgages.

Rising rates slowed mortgage refinancings which resulted in downward pressure on margins for mortgage lenders. PHH Home Loans is expected to see downward pressure on its earnings in the fourth quarter.

In the fourth quarter of 2012 our share of the joint venture's earnings was $15 million attributed to high margins and exceptionally high levels of refinancing, neither of which are expected to repeat in the fourth quarter of this year. As a result we expect our share of the fourth quarter PHH Home Loan's earnings to be lower. The net impact on the financial results for the fourth quarter is that expected incremental home sale transaction volume will be for the most part offset by lower PHH Home Loans earnings.

Now turning to slide 6, this shows Realogy's quarterly revenue trends over the past three years. Typically the second and third quarters are our strongest while the first and fourth quarters are comparatively slower. There are a number of consumer behaviors that contribute to the seasonality, the principal being a family's need to move in advance of the new school year.

Weather also has historically contributed as warmer weather months are more conducive to the home buying experience for much of the country. Given the seasonality of the business and the difficult comparisons to last year's fourth-quarter tax influenced volume, the increase in transaction volume in the high single-digits in the fourth quarter compared to what we have experienced to date in 2013 should not come as a surprise.

Taking a closer look at the third quarter, the strong performance of both RFG and NRT as in the second quarter was most influenced by the strong influence of and performance of the top 250 largest franchisees in RFG and the first quartile sales associates at NRT. As we've said in the past, in general our franchisees were eligible for volume incentives subject to the terms of their franchise agreements.

As they achieve higher gross commission income, which results in higher revenues to us, they are eligible for volume incentives at year end. Incentives to outperform the market, achieve higher revenues and grow their companies have the corresponding favorable impact on our net royalty revenues and earnings. It is a time-tested system. Our franchisees do well and we do well, it is the nature of our relationship.

That was certainly the case in the third quarter, our 250 largest franchisees performed exceptionally well and our system-wide royalties increased 25% in Q3 which resulted in an increase in volume incentives and the 4% decrease in the net effective rate. To put that in perspective, third quarter of last year saw volume increases that were half of this year's at 14% and royalty rates of 4.65%, so you can see there is an inverse relationship between these metrics which, with few exceptions, are reset on an annual basis.

As we have previously indicated on higher revenues we expect that the full year 2013 net effective rate will be about 4.5%. For Q3 RFG's EBITDA increased 24% and its margin increased from 66% to 69%. As our franchisees continue to grow their businesses and the housing recovery continues we expect RFG EBITDA margin to continue to expand.

We believe that as the housing recovery gross to the second -- the expected second four-year RFG's small to midsize franchisees who do not qualify for incentives given their revenues or are low on the incentive schedules should perform better resulting in higher net royalty fees to Realogy. Given the expected growth of these franchises and other factors we manage and monitor we currently expect that the full-year 2014 net effective rate should be about flat year over year. Also note that we expect the net effective rate will vary quarter to quarter.

As previously mentioned, NRT's approximately 42,100 sales associates, all independent contractors, are located in 35 major metropolitan markets. Performance is measured by their individual transaction volume and, as is the case in many organizations, the top performers are major contributors to the revenue of the Company. Top performers also command the highest compensation or, said another way, higher commission splits.

As in the case of top-performing franchisees, top-performing sales associates produced the lion's share of the business. The third quarter was no exception to that rule. We believe the third and fourth quartile sales associates should increase their production as the housing market continues its recovery and we certainly saw evidence of that and the third quarter.

The NRT commission split improved slightly to 68.2% in the third quarter versus the second quarter of this year. The net result of the strong volume increases at NRT far outweighed the impact of the year-over-year increases of 75 basis points in the split rate. In third quarter NRT's EBITDA before the PHH joint venture earnings totaled $88 million, an 87% increase over the $47 million earned in the third quarter of last year on the same basis.

As we reported earlier in the year, we expect the commission split to be approximately 68% for full year 2013 and based on our current forecast we expect it to be about flat for full-year 2014. Again we expect there will be variances by quarter and mix of business.

Now moving to slide 7, we highlight other noteworthy third-quarter accomplishments. In terms of domestic franchise sales, RFG generated $54 million in gross commission income, or GCI, which is a 34% year-over-year increase from the third quarter 2012. Year to date through September 30, franchise sales on a combined basis are 10% ahead of last year at $180 million in GCI.

RFG expanded its representation in the global markets through its master franchise strategy, signing new agreements with master franchisors and/or launching existing operations in certain territories in India, Germany, Austria, Dubai and emerging markets in Africa.

On the mergers and acquisitions front, NRT added four accretive tuck-in acquisitions during the quarter and just last week announced the acquisition of the Frank Howard Allen brokerage firm in Northern California. A Company whose $1.85 billion in sales volume ranked among the largest brokerages last year according to REAL Trends. This synergistic transaction is expected to increase NRT's San Francisco Bay area revenues and agent count by 10% and will be highly accretive.

Turning to slide 8, Cartus expanded the scope of relocation-related services it provides for 121 of its existing global clients and also signed 17 new clients during the quarter. Cartus continues to face a challenging environment given the continued caution that its corporate clients are exhibiting.

TRG saw its purchase and underwriting activity drive an EBITDA increase of 42% year over year. TRG's underwriting claims rate through the first nine months of 2013 remained significantly below industry averages.

The National Association of Realtors Affordability Index, an industry standard that tracks the affordability of homes, currently stands at 156%, a very comfortable level. This indicates that families have 156% of the median income necessary to purchase a median priced home with a 20% down payment and the remainder financed with a 30-year fixed mortgage. By the way, 30-year rates are currently at about 4.2%, their lowest levels since June according to Freddie Mac's latest weekly report.

Slide nine shows another way of evaluating affordability. The blue line shows mortgage payments as a percentage of median family income over a 40-year period and the red line shows the average. As you can see, in the current department mortgage payments are only at 16% of median family income, which is well below the long-term average of 21% even with higher on prices and mortgage rates. Those two factors would have to rise significantly just to move from current levels to the average.

For prospective homeowners mortgage rates are not the only consideration. Another key factor is the rent versus buy comparison. A number of industry sources continue to report it is less expensive to own than to rent in most markets in the US. While rents increase every year the vast majority of mortgage products today provide long-term stability in the form of predictable costs.

It is important to note that the housing recovery is occurring with the limited participation of first-time buyers who currently represent 30% of all existing home sales versus an historical average of 40%. For a variety of reasons we believe first-time buyers will represent a higher percentage of home sales in 2014.

More broadly, we believe there remains a great deal of room for home sale volume growth in the years ahead. For example, the Case Shiller home price index is still only at 80% of the 2006 peak. Even with 5.1 million existing home sales forecast for 2013, units are still only at 2000 levels, even though 10 million US households have been added since then.

Looking ahead, the Harvard Joint Center for housing studies projects that household growth should average 1.2 million per year between now and the year 2020. Demographics have been and will continue to be a significant driving factor for housing demand.

With regard to corporate governance, we are pleased to report the appointment of Raul Alvarez to the Realty Board of Directors in August. Formerly the President and Chief Operating Officer of McDonald's Corporation and with more than 30 years in the retail industry, Raul brings extensive executive leadership experience in managing leading global brands and company-owned franchise operations.

In addition, his in-depth knowledge of international operations, emerging markets, consumer marketing, strategic planning and Board room experience will add tremendous value to our Board. With Mr. Alvarez's appointment Realogy's Board is now comprised of eight directors, six of whom are independent directors for purposes of the listing standards of the New York Stock Exchange.

We are pleased with the direction of our business and exceptional performance of the management team. We are only 12 months post IPO and have made great strides on all fronts during that time. We believe Realogy is well positioned to capitalize on the anticipated multi-year growth of home sale transactions and average home sale price.

We also believe that we are the best pure play investment in the housing recovery, which, in our view, is still in its early stages. And we are highly confident in our ability to deliver on our value proposition for our franchisees, our clients and our investors. So with that I will turn the call over to Tony for a more detailed review of the third-quarter financial results. Tony?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

Thank you, Richard. In the third quarter we outperformed our prior expectations across the board, with the following highlights starting on slide 10. Revenue was up 21% driven by higher home sale transaction volume at NRT and RFG. Q3 adjusted EBITDA increased by 27% to $286 million resulting in an 18% EBITDA margin. Year to date adjusted EBITDA was also up by 27% to $637 million.

Realogy free cash flow totaled $200 million in the third quarter alone due primarily to the strong gains in operations and lower interest expense. We repurchased $100 million of 9% notes, further reducing interest expense. Our net debt leverage to the trailing 12-month adjusted EBITDA at September 30, 2013 was 4.7 times.

In the one year since our IPO we have exceeded all expectations on the fundamentals of the investment drivers for Realogy. The existing housing market is now poised to finish the two year period of 2012 and 2013 with a combined 44% growth in home sale transaction volume according to NAR. That is 14 percentage points higher than NAR's forecast for the two year period of the time of our IPO in October 2012.

Our operating leverage resulted in a 150 basis point improvement in adjusted EBITDA margins in the last 12 months ended September 30, 2013 compared to the same period in 2012. Finally, our financial leverage, which was 5.9 times at the end of 2012, was, as I mentioned, 4.7 times at the end of the third quarter, better than the five times leverage we anticipated one year out at the time of the IPO. We are delivering more of our enterprise value to our equity investors at a faster rate than anticipated.

Next I will discuss our key revenue drivers on slide 11.

RFG home sale size increased 19% year over year in Q3, and average home sale price gained 10%. RFG's overall home sale volume increase 30% in the quarter and that exceeded NAR's reported increase of 26% by 4 percentage points.

In Q3, our 250 largest franchisees represented 61% of RFG royalty compared to 58% in Q3 2012. RFG's Q3 net effective royalty rate was 4.46% and the year-to-date royalty rate through September is 4.50%. The year-to-date rate is expected to hold for the full year. The RFG royalty rate should not be looked at on a quarter-by-quarter basis but rather on a year-to-date basis due to fluctuations and full-year forecasted volume.

The sequential decline in the royalty rate is due to the increase in estimated volume for the total year since the end of Q2 2013 given the exceptional strength in home sale volume we experienced in Q3. As a result in Q3 we trued up cumulative volume-based incentives from the beginning of 2013 at the higher levels, which had a catch-up effect on the third-quarter net effective rate.

On slide 12, NRT home sales sides increased 17% year over year in Q3 compared to 2012 and its average home sale price gained 8%. The general trend for NRT over the last nine quarters has been that growth in sides has outpaced growth in price due to mix shift -- a greater number of homes are being sold in NRT's comparatively lower priced markets.

During Q3 many NRT markets experienced transaction side increases between 25% and 35% including Connecticut, Westchester, Philadelphia, New Jersey and Chicago. These same NRT markets all experienced price improvements in the low single-digits. New England was up 17% on sides and 5% on price. In Florida sides were up 13% and price was up 17%. Looking at California, average sale price increased 18% but sides were only up 3% because the state continues to have inventory constraints. Finally for Corcoran, which mainly serves New York City, overall transaction volume increased 32% in the quarter.

For the full year we expect to see home sale transaction to increase by 17% to 19%. To reiterate our expectations for transaction volume in the fourth quarter, we expect to see a 3% to 4% increase in transaction sides year over year for RFG and NRT combined. Indications that our average sale price will also be up 3% to 4% on a combined basis which again is lower than year to date because of the unusually high average sales price we experienced in the fourth quarter of 2012 due to tax motivated selling. Total transaction volume for the fourth quarter is expected to increase between 6% and 8% on a combined basis.

Given the anomalous tax impact in the fourth quarter of 2012, another way to look at the fourth-quarter expected volume gains is shown on slide 13. This slide shows our actual home sale transaction volume in Q4 2011 and 2012 and forecasted volume for 2013. We compare to 2011 because it was a more typical fourth quarter based on historical seasonality.

As you can see, our home sale transaction volume in Q4 of 2013 is forecast to be up 42% to 45% compared to the fourth quarter 2011 on a combined NRT and RFG basis, increasing from $67 billion in Q4 2011 to a forecasted $96 billion in Q4 2013. That is about a 19% to 20% per year growth rate from Q4 2011 to Q4 2013, which is a very strong trend over a couple of years.

At Cartus, initiations for Q3 increased 11% and referrals increased 18%. We're seeing growth in the affinity business and international Relocation Services, both of which generate lower revenue per initiation than domestic Relocation Services and that is why initiations are up without commensurate revenue growth.

At TRG Q3 2013 purchase unit volume increased 16%, which was consistent with NRT home sale gains and reflects improved capture rates. TRG's refinance and title closing units decreased 27% in Q3 2013 compared to 2012, which is expected given the lower refinancing trend that will likely continue into Q4. Average fee per transaction improved 15% given the shift in mix to higher priced purchase units.

Now let's look at revenue and EBITDA for the business units for Q3 2013 as shown on slide 14. Our overall revenue growth of 21% was driven by NRT, which contributed about 70% of the Company's total revenue in the third quarter and grew by 24%. RFG revenue, which represents about 12% of the total Company revenue, grew 20%. Cartus revenue was up 2%, TRG revenue increased 18%. Together Cartus and TRG generated 17% of total revenue in the quarter.

Revenue increases do not mirror transaction volume increases due to the heavy influence of NRT in our total revenue and the differing growth rates at TRG and Cartus. EBITDA at RFG improved $26 million and RFG's EBITDA margin increased to 69% from 66% in Q3 of 2012 primarily due to higher revenue.

NRT EBITDA increased $24 million and its margin increased by 100 basis points year over year. The margin improvement occurred even though we experienced a decrease of $17 million in our equity and earnings related to our PHH Home Loans joint venture and overall commission splits increasing 75 basis points to 68.2% for the quarter. We expected that the Q3 commission split will hold for the full year.

The third-quarter joint venture earnings were $3 million in 2013 versus $20 million for the same period in 2012. PHH recently indicated in its SEC filings that, like many large mortgage lenders, it is in the process of reducing staffing levels and overhead to reflect current market conditions. We would expect to see the benefits of such lower costs reflected in our JV earnings next year.

Cartus EBITDA in Q3 2013 was flat to Q3 2012 because the revenue increase was offset by a $2 million charge for the Phantom Value Plan and higher foreign exchange rate losses. TRG EBITDA increased $5 million or 42% in Q3 2013 due to higher purchase transaction volume, higher average fees and a 27% increase in underwriting premiums.

On the next couple of slides we take a more in-depth look at incremental margins for the quarter at RFG and NRT. On slide 15 we make one adjustment. As it relates to RFG revenue we have excluded marketing fund revenue since it has no impact on EBITDA. You can see that for the quarter, after adjusting for marketing revenue, the incremental margin for RFG was 87%. We have often noted that, assuming all else remains constant; we would expect an 85% to 90% incremental margin for RFG. We achieved that objective in the third quarter even with items not remaining constant.

On slide 16 you can see that NRT's incremental margin was 21% factoring out the decrease in PHH Home Loans JV earnings and the year-over-year split rate increase. We were at 21% without adjusting on this schedule for many expense factors that did not remain constant year over year, such as the phantom plan charge, merit increases for NRT's 4,100 full-time employees and higher branch manager incentives due to higher office profits in the quarter compared to last year.

One overall comment to make on the reported EBITDA for the quarter was that it includes two charges that warrant a short discussion. The first is the value of the Phantom Value Plan charge which totaled $19 million in the quarter. This compensation plan related to substantially all of the equity compensation that was awarded to senior management during the six-year period we were private. Funding was triggered by Apollo's final sale of its shares of Realogy in the quarter. There was only about $5 million in aggregate remaining on the plan that will be expensed over the next three quarters which will be immaterial in each of those quarters.

The second is the $22 million loss on the early extinguishment of debt that relates to $18 million of premium payments and a $4 million write off of deferred financing costs to retire $100 million of our 9% notes. The retirement of that portion of the 9% notes saves $9 million a year in interest expense.

Turning to other items on slide 17, we continue to deliver at a rapid pace. Our net corporate debt was down to $3.8 billion at the end of the quarter compared to $4 billion at year-end 2012 and we expect to end the year with approximately $3.7 billion of net debt. We continue to be focused on achieving our target leverage ratio of three times net debt to adjusted EBITDA.

Turning to slide 18, with the improvement to our balance sheet this year our run rate annual cash interest is now approximately $240 million. Declining interest expense and the benefit of $2.3 billion of net operating losses at the end of 2012 that result in minimal cash payments for income taxes going forward will help us reach our target leverage goal more quickly.

If recent positive trends continue, absent any other factors to the contrary, management may be in a position to release a substantial portion of its recorded valuation allowance in the relative near-term. With respect to our income tax expense, subsequent to a reversal of our valuation allowance we expect our GAAP income tax rate will be approximately 40% of pretax income.

Turning to slide 19, to summarize we are extremely pleased with our performance this quarter which bodes well for our full-year results. Current expected full-year EBITDA of between $785 million and $800 million is beyond our initial expectations for full-year 2013. While we are benefiting from the continuing housing market recovery our focus remains on improving our balance sheet, gaining profitable market share and capitalizing on our operating leverage.

In this quarter, as has been the case in every quarter since we went public in October 2012, we exceeded expectations on every important financial and operating metric. With the ongoing and we believe sustainable recovery in the existing housing market, improved operating margins, lower cash interest expense and utilization of our significant NOLs we expect to continue to generate strong free cash flow and create value for our equity investors.

With that, I will turn it over to the operator who will open this call for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Eli Hackel, Goldman Sachs.

Eli Hackel - *Goldman Sachs & Co. - Analyst*

Good morning, and thanks for the additional detail. Just starting off, and I know you didn't specifically give 2014 guidance, but maybe just in the context of what others are saying. I think for example maybe NAR is looking for sort of flattish sides. It sounded like maybe you were a little bit more bullish in that seeing that you expect for several years more of additional growth. Can you give us a little bit of thought as you move into next year from a sides perspective for your Company?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

Yes, I mean NAR is 1 data point and they have been way too low for the last two years when you looked at this year compared to the full year. So just the median forecast for next year is up 9% on sides and price combined. So there are a lot of sources, there is Fannie, Freddie, MBA, we do use the Goldman Sachs but not your side of the house, but the Goldman Sachs forecast on the mortgage side. So the median is a 9% increase for next year.

But just the more important point is if you looked at this point in 2011 and you looked at this point relating to 2012 and if you looked at this point in 2012 looking at 2013 full-year expectations, they were wrong by -- they were too low by 8 to 10 percentage points. So anything anyone is saying right now is -- they don't know any better than anyone else. But we think that if what we've seen over the last two years holds that we're going to be a lot stronger than where they are predicting right now.

Eli Hackel - *Goldman Sachs & Co. - Analyst*

Right, that is really helpful. And then just one more and just an incremental. It sounded like you thought that splits would be flat in NRT in 2014 over 2013. Does that mean that we should expect -- excluding the PHH segment -- NRT in 2014 should see those 20% to 25% incremental margins?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

All less remaining equal, yes.

Eli Hackel - *Goldman Sachs & Co. - Analyst*

Okay, thank you very much. Appreciate it.

Operator

Anthony Paolone, JPMorgan.

Anthony Paolone - *JPMorgan - Analyst*

For 4Q EBITDA, implicitly it is down year over year. Can you just maybe talk through a little bit how much of that relates to PHH and if there is anything else we should be thinking about?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

It is all PHH. The increase in volume is not offsetting the PHH decline.

Anthony Paolone - *JPMorgan - Analyst*

Okay. And you have given the sides and price for 4Q on a combined basis. You make a lot -- there is a big difference in what you make in NRT versus RFG. Any -- can you give us any more color on maybe what NRT looks like or what you expect NRT to look like in the fourth quarter?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

We don't break that down. But you can see the results in the -- we gave you EBITDA, so I think you can factor that in.

Anthony Paolone - *JPMorgan - Analyst*

Okay. And then, Richard, you expressed some optimism on just first-time homebuyers getting a little bit better access to funding or being a bit more robust next year. Can you just give us your updated thoughts on mortgage availability and what you see on that side?

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

Sure. We believe that certain provisions of Dodd Frank will be finalized in January and will be effective in January. Underwriters will then understand what is required of them to properly underwrite a loan. So I continue to believe with that uncertainty being lifted we will see an improvement in the first time buyer mix of business.

As we said, they are running about 30% now; they should be in the 40%s. I don't think it will quite get there that quickly, but I do think it will be incremental to what we have seen this past year. So it's going to all be tied to understood underwriting requirements and the continuation of I think a very good mortgage interest rate environment.

Anthony Paolone - *JPMorgan - Analyst*

Okay and then last question. On the franchise sales up 10% year to date, any way to put that in sort of net context? It just seems like a strong growth rate and just wondering I guess, A, what that might look like on a net business to grow your business and B, just how much runway is left there to go at that kind of clip?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

We -- franchise sales should add a point -- overall net franchise sales add a point or two to our growth over especially at RFG because it tracks the national so over NAR's numbers and we definitely were above them for the quarter. So I think that allows us to outperform -- that allows RFG to outperform the general market. And the other thing is 60% of brokers remain independent and the United States. So there is still a lot of growth in franchise sales and it's something we focus on to continue to expand our brand networks.

Anthony Paolone - *JPMorgan - Analyst*

Okay, thanks.

Operator

Brandon Dobell, William Blair.

Brandon Dobell - *William Blair - Analyst*

Thanks. Maybe want to get some expectation I guess on both segments. NRT and RFG. for a headcount growth going into -- into 14 if you take out the acquisitions, what kind of expectations do you guys have?1

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

This is Richard. RFG, that will be de minimis headcount throughout. There is no need -- I mean as we add franchises it is not necessary to add headcount and service, so. Unless we just substantially grow the franchise system and that will take us a few years to get there.

On the NRT side it is actually the reverse of that. As we acquire companies we generally are not in need of their back office operations. So there is an incremental headcount increase because of the acquired revenue and earnings but these are very accretive and very synergistic. So we find that we reduce headcount at least at the acquired Company. So at the corporate NRT level there is almost no increase in headcount.

Brandon Dobell - *William Blair - Analyst*

Okay and as you think about NRT from an agent or producer perspective, adding in the recent acquisitions, or should we expect agent count to finish out the year? And any expectation for 2014 from that point of view?

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

It's about 300 agents acquired in the Frank Howard Allen acquisition. There will be some breakage their but not much. So we will be about where we are plus or minus 200 or 300. Remember we don't really focus on headcount; we focus on GCI and profitability of the agent. So we will end the year up a couple hundred agents based on today's series of announced acquisitions over the past several months.

Brandon Dobell - *William Blair - Analyst*

Okay, a quick numbers one. Fourth-quarter contribution from PHH, I guess just trying to get a feel for the year-over-year impact of how the mortgage business is impacting the I guess year-over-year contribution to profits.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

We don't disclose that until after the fact. Obviously PHH is a publicly traded Company, so you can look at their research reports for guidance and what their numbers are.

Brandon Dobell - *William Blair - Analyst*

Okay. And then final one for me. Any sense in the RFG segment for upcoming changes in fees or prices on the franchises, things like that that would generate a different revenue per agent or revenue for franchise opportunity?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

No. We said we expect the net effect of royalty rate to remain flat for next year.

Brandon Dobell - *William Blair - Analyst*

Okay. Thanks, appreciate it.

Brandon Dobell - *William Blair - Analyst*

Stephen Kim, Barclays.

Stephen Kim - *Barclays Capital - Analyst*

Yes, I wanted to delve into the splits question a little bit. Could you help me -- remind me of again about the timing of when you set your volume threshold used for your split conversations with your agents? How those conversations and resetting of split thresholds occurs over the course of the year -- we will start with the timing question first. Thanks.

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

The agent splits vary, but a very large percentage of them occur in January and then often they occur on their anniversary date. So anniversary date of their hire date. And they reset every year. So you start at some expectation of what the split is going to be and that is managed through the year and then you restart -- you reset at the beginning of the year either on your anniversary day or January 1, whichever.

Stephen Kim - *Barclays Capital - Analyst*

Great, that is very helpful.

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

That is the split rate for the agent.

Stephen Kim - *Barclays Capital - Analyst*

Right. And with respect to the actual level of those thresholds, in general if we look at your outlook for next year's volume, sides and price, in general should we expect that to mirror the aggregated average of your volume thresholds which are embedded in the agent splits for next year? Or should there be a reason why it would be different from your general outlook for transaction volume growth next year?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

Well, again, we gave you what we think the split rate is going to be next year. So I am not sure -- that is based on what we know today.

Stephen Kim - *Barclays Capital - Analyst*

Well, that's based on an expectation that the actual transactions that you produce will actually be in line with what you expect. But I guess what I am trying to figure out -- that is what I am presuming, right. So that is based upon you hitting your expectations for sides and price. But I just wanted to make sure that that is in fact the case. So if you actually do greater than you expect your splits will necessarily go higher, right?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

No, absolutely not. It depends on who is doing the incremental business. If third and fourth quartile agents are doing the business the split rate could go down. So it is totally dependent on who the business -- it is totally dependent on where the geography is being done. So if more -- the split rate on the East Coast is better than the split rate on the West Coast. So if more of the business like we've seen continues to move to some of our lower price markets that are in the Midwest and East, then that would -- the split rate would go down.

Stephen Kim - *Barclays Capital - Analyst*

And is that embedded in your expectation, Tony? Some of your (multiple speakers)?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

(multiple speakers).

Stephen Kim - *Barclays Capital - Analyst*

Yes, some (multiple speakers).

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

Again, our expectation -- we think it is going to be flat next year. I think that is based on what we are seeing, based on our forecast, based on doing a pretty detailed analysis of each -- a very detailed bottoms up analysis from each market of the 35 markets we are in, that is what we are expecting.

Stephen Kim - *Barclays Capital - Analyst*

Okay. Well, thanks very much, appreciate it.

Operator

David Ridley-Lane, Merrill Lynch.

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

Last quarter, Richard, you talked about the positive impact of recruiting new agents and the positive impacts that would have on commission splits in the NRT segment. So I was just curious what success you are having in recruiting new agents?

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

I don't recall that conversation. I recall the conversation regarding the third and fourth quartile agents. So in an improving market there is a point where your first and second quartile agents can -- have all the business they can handle. And the third and fourth quartile agents are usually those who underperform the broad market, start to participate in a more meaningful way. Thus you have an improvement in your splits, which I think is reflected in our view of where we think splits will be year over year.

So I think it is more a product of the bottom half of the agent market improving their performance. That said, NRT is an aggressive recruiter in the marketplace, that is the nature of their business. They recruit both top producing agents as well as new entrants. New entrants start at the most favorable splits to us. And then our franchisees are very aggressive recruiters for the same reason. So I think it is a combination of those two things that will drive the performance of the Company and also the splits that we talk about so much.

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

Got it. So it is more of the third and fourth quartile coming up than adding new heads, per se?

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

Yes, but --

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

And then (multiple speakers).

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

-- just remember, again, don't discount that entirely. It is that but also NRT's business is recruiting agents. So they -- just like everybody else in the business, they are active and aggressive recruiters of performing agents.

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

Got it. And then maybe one for Tony. Given the unusual tax sales in fourth quarter of last year and your guidance for full-year commission splits, is it possible for commission splits to be down year over year in the fourth quarter of this year?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

It is, they were very high last year because of the tax. That is why we said 68% is our expectation for the full year.

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

Perfect. And then one more if I could. Are you anticipating further open market debt repurchases in 2014? Or are you going to be more in the mindset of stockpiling cash ahead of some call dates on your debt later?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

We will look at opportunities like we looked at this quarter continually to look at improving our balance sheet.

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

Got it. Thank you.

Operator

Michael Kim, CRT Capital Group.

Michael Kim - *CRT Capital Group - Analyst*

Congratulations on and impressive quarter. On the buyer mix, you mentioned you are at 30% today for kind of the first time buyer and headed to a 40% level sometime next year. How should we think about the resulting impact on commission rates I guess on this mix shift? Is there some sort of sensitivity? And presumably it is going to be higher than where we are today, but just wanted to get a sense of how we should think of that.

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

Michael, I think all that is reflected in the guidance we have given on both the agent split year over year as well as the net effective rate. So all of that was taken into consideration.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

Yes, I don't think on the overall commission split it should have -- it's going to have a meaningful -- and by the way that is NAR's -- it's NAR's numbers, the 30%, it is actually -- it was actually 29% were first-time buyers in the last report and the normal should be 40%.

So we just overall think that is going to be a big catalyst for next year because they are facing escalating rents and we think mortgage underwriting is going to ease for them. And we think the inventory situation is going to improve. We think it's going to be a real impetus for growth next year.

Michael Kim - *CRT Capital Group - Analyst*

And my second question, obviously there have been a lot of headlines suggesting PHH is considering a separation of its mortgage and auto fleet leasing segments. In the event this occurs what sort of impact would that have on your JV with PHH? I mean does the underlying agreement permit you to re-evaluate the terms of the JV at all? Or -- just wanted to get an understanding of the options available to you if this happened or (multiple speakers).

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

I am sure you have read that full agreement, Michael. So I don't know why you are asking that question.

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

We are not at all concerned.

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

Yes, our -- as you know, our JV agreement gives us the right to consent to a sale. And obviously our decision would be based on the economics to us, So --.

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

We are in the best possible position so we are not concerned.

Michael Kim - *CRT Capital Group - Analyst*

Okay, great. That is all I had. Thank you.

Operator

Adam Rudiger, Wells Fargo Securities.

Adam Rudiger - *Wells Fargo Securities - Analyst*

I wanted to go back to some of your initial comments about demand and the opposite thing happening that many of us have talked about in terms of when rates rose, do you think that creates some urgency. Can you talk a little bit more granularly about the patterns you saw during the quarter and if they were in days or weeks or weekends when rates really seemed to spike, did that -- was there -- could you clearly see kind of elasticity towards rates? I was just curious more of really what the trends were and how sensitive the buyers are to rates right now?

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

It is reflected in our comments. We just -- we think people acted in advance of what they thought was a rising rate environment. I think the nuance that is interesting and I think very relevant to this discussion is that when you buy an existing home, as we indicated, you can generally lock that rate for 45, 60 days. It is pretty economically very feasible, it is not a burden for the borrower.

If you're buying a new home it becomes a little more difficult to lock that rate for that six- to nine-month period that it takes to build a house, sometimes less, sometimes more. So we think that that sort of shifted some buyers' thinking into existing homes versus new home construction. I think that was probably one of the leading indications that buyer behavior was trying to avoid what they saw as a rising rate environment, which stands to reason, I think.

Adam Rudiger - *Wells Fargo Securities - Analyst*

Okay and then just one -- bringing up PHH again, asking the fourth quarter and a slightly different way. If we were in a stable mortgage rate environment throughout the rest of the fourth quarter, would you expect the year-over-year declines in the PHH joint venture income to be as significant as they were this quarter? I'm just trying to get a sense of how much is volume related versus gain on sale mortgage?

Richard Smith - *Realogy Holdings Corp. - Chairman, CEO & President*

Well, remember most of this pressure is on the refinance side. I mean, the fourth quarter last year was just an incredibly strong refinance quarter, you are just not going to have that this year. So refinance business has shifted down rather dramatically not just at PHH but everywhere, the headlines are pretty robust with that kind of news. So I don't think -- and then you had some margin pressure as a result of that. So I think this is all attributed to the very rapid decline in refinancing, which is the nature of the -- that is the nature of the mortgage business.

Adam Rudiger - *Wells Fargo Securities - Analyst*

Okay, So can you remind us what the full-year last year refinance mix was within the PHH originations, refi versus new?

Tony Hull - *Realogy Holdings Corp. - EVP, CFO & Treasurer*

I mean last year -- yes, last year was like 30%, 35% refi in the fourth quarter. So obviously it is going to be a lot less this year. The other thing is, just as I said during the script, another thing to take into consideration is PHH has publicly stated, so we can say it as well, that -- and you can see it with all the big banks.

They have reduced their staffing, reduced their cost structure pretty dramatically. So I think it is at a more normalized level without the refi input, so I think that is going to -- that is really going to help the profitability of the JV next year.

Adam Rudiger - *Wells Fargo Securities - Analyst*

Great, thanks for taking my questions.

Alicia Swift - *Realogy Holdings Corp. - SVP of IR*

We thank you for taking the time to join us on the call and we look forward to speaking with you over the next quarter. Thank you.

Operator

Ladies and gentlemen, this does conclude today's conference. You may now disconnect.